

This section discusses the evaluation of the current operating results of a trust department and its impact on the bank's profitability. In reviewing the trust department's earnings performance, the examiner must evaluate past earnings trends and assess the effect on profitability of anticipated future business growth. The evaluation of earnings also considers senior bank and trust department management's views about trust department profitability, including the emphasis placed on establishing reasonable goals and objectives for profitability, expressed either in terms of an expected level of profitability or the growth of new business).

This section of the Manual is organized into the following parts:

- A. General
- B. Policies
- C. Accounting for Income, Expenses and Losses
- D. Evaluating Profitability
- E. Budgets
- F. Direct and Indirect Trust Expenses
- G. Regulatory Reporting
- H. FDIC Implementation of 1998 Uniform Interagency Trust Rating System
- I. Alternate Earnings Rating Standards for Smaller Institutions

A. GENERAL

In recent years banks have become increasingly aware of, and focused on, the contribution of non-interest income to profitability. Recurring fee income can enhance profitability, and it is often less volatile than interest income. Trust department income can be an important component of noninterest income. As individuals increasingly accumulate financial assets to store wealth, trust departments have experienced vigorous growth in assets under management. The profitability of these departments has heightened the attention of management. This trend has also resulted in a proliferation of nonbank financial and fiduciary service providers, greatly increasing the competition faced by banks offering trust and other fiduciary services.

The Corporation recognizes that not every trust department will be profitable. Many small trust departments are operated primarily as a community service. Trust services are also offered in order to retain more profitable relationships elsewhere in the bank.

Although various reasons for offering trust services exist, the FDIC expects each bank operating a trust department to be aware of the department's contribution, or cost, to the operating earnings of the bank. Banks operating trust departments should regularly measure and evaluate the impact of both direct and indirect trust income and expenses on their overall profitability. Some form of accounting system should be implemented to provide the basis for an analysis of the department's income and expense data. Management may use those results to determine which services should be continued or discontinued, whether fees should be adjusted, and which types of accounts should be emphasized in new business development efforts.

B. POLICIES

The shareholders of a bank operating a trust department have the right to expect a reasonable return on their investment. This requires profit motivation from the board of directors, and a fee structure which covers the costs of providing trust and fiduciary services and provides a reasonable return. A trust department's fee structure should be reviewed and approved periodically by the trust committee, or some other senior operating committee. Trust management should establish a business plan, with realistic goals, that takes into consideration the department's size and resources. Business plans and budgets that are integrated with those of the entire bank have a greater likelihood of communicating trust profitability goals, objectives, and expectations to bank management and personnel. However, in banks with very small trust departments, policies or plans covering overall bank operating performance may satisfactorily embody the trust department's budget, fee schedule, or business plan. In these situations, examiners should avoid criticizing a bank for not establishing separate trust operating policies, or for not integrating these policies with the institution's operating plan.

Trust policies should also include management's position on fee discounting, fee concessions and waivers, and compensating balances. Policies should clearly describe those to whom discounts will be allowed, the purpose for granting discounts, the types of services for which fees may be discounted, and the method by which the trust department may be compensated by the bank for such discounts. Trust policies should require that all discounts, concessions, or compensatory arrangements be documented and approved by the trust committee, or some other operating committee. The policies should also indicate who is authorized to grant such discounts. Policies which permit trust personnel to unilaterally approve discounts, concessions, or waivers without the informed approval of a senior operating committee pose control weaknesses. Such policies permit individual staff members to alter approved fee schedules without the directorate's knowledge and approval. They also provide individuals with the ability to waive account fees to mask account problems and errors that should be brought to management's attention.

Another aspect of rating trust profitability is the department's prospects for future growth. Examiners should evaluate the control and management of the trust department growth and new business development prospects. An essential element in a successful business plan is marketing, which should identify the segments of the fiduciary services market where the department will concentrate its new business development efforts. In marketing the department's services, management must ensure that the bank has the expertise, staff, and facilities to satisfactorily manage the volume and types of new business sought.

Examiners should evaluate the reasonableness of the marketing plan. While no one approach will suit every bank and market, there are some areas which are common to most departments. The marketing plan should include a definition of the market area for trust services (which may differ from the market identified for commercial and retail banking products). The characteristics of the market area, including demographics, geographic or legal impediments (e.g., there may be difficulties in marketing some products in an adjoining state), and existing trust competition should be considered in estimating the growth potential of various

services. Sources of new business (existing bank customers, new customers based on demographics, professional referrals, etc.) should be evaluated. Finally, the means of generating new business should be addressed. These may take the form of presentations to attorneys or public groups, direct mailings and statement fliers, lobby posters and brochures, and print and broadcast advertising. The bank's strengths and capabilities must be factored into any plan, particularly one which projects large or rapid growth, or contemplates offering new products.

C. ACCOUNTING FOR INCOME, EXPENSES AND LOSSES

Each trust department should have a system for measuring and monitoring its income and expenses. The system does not necessarily need to be elaborate to provide sufficient information for management, but it should be commensurate with the department's size and growth trends. Systems should track direct income and expenses and, to the extent possible, include indirect expenses, as well.

Income

Fee and other direct income of a particular department are usually measured using either a cash or an accrual accounting method. Fees charged to trust accounts are usually the primary component of direct trust revenue. These fees are often based on the size (market value) of the account but may take into consideration the type and complexity of the assets under management, the volume of transactions in the account, the customer's total relationship with the bank, and other factors. Less often, fees may be assessed as a percentage of the income earned by an account. Other direct income may include sweep fees, 12b-1 fees, etc. (Note: Gross income from the trust department is reported as a separate line item of noninterest income on the quarterly Report of Income) Other common contributors to trust income are:

- *Indirect income* - Indirect income may include intracompany income credits, such as credits for deposits, allocated to the trust department in recognition of the income earned in other areas of the bank's operations as a result of the business relationship developed by the trust department. Indirect income is more difficult to measure than direct income. While it is generally recognized that a trust department generates other, often more profitable, business for an institution, many institutions do not attempt to estimate the profits that client relationships developed in the trust department produce in other areas of the institution.
- *Bank calculated credit for deposits* - A credit for deposits is based upon deposit balances maintained in the commercial bank by accounts in the trust department. Both interest bearing and non-interest-bearing deposits should be included in the calculation to obtain a realistic estimate of contribution of the department's deposits to commercial bank profitability. Typically, the calculation considers how the bank is investing the funds deposited by the department, determines (or estimates) the average interest rate the assets acquired when investing trust department deposits are earning, and subtracts the interest paid for each type of deposit (plus deposit insurance premiums and administrative costs) in arriving at the net rate earned. The net rate is then applied to the average balances for each type of deposit account to determine or estimate the dollar value of credit for deposits.

The role played by trust department deposits in bank profitability should not be ignored when evaluating the profitability of the department. Credit for deposits remains a key element in determining a trust department's contribution to bank profitability. Furthermore, specialized trust activities such as corporate trusts and agencies (refer to subsection B. in Section 6), frequently rely on trust deposit balances to achieve trust profitability in the highly competitive market for these services. Consequently, the volume and anticipated float duration of corporate trust deposits play a vital role in the structuring of corporate trust and agency fees and commissions. With respect to the deposits of personal and employee benefit accounts, however, a high level of trust deposits, and a correspondingly higher credit for deposits, may be indicative of a breach of prudent fiduciary practice, since investments in own-bank deposits is both a conflict of interest and self-dealing. Refer to subsection E.3. Use of Own-Bank or Affiliate Bank Deposits, located in Section 8 for specific conflict of interest issues relating to trust deposits.

Since banks may include a credit for deposits in calculating the profitability of trust services, examiners should evaluate the reasonableness of the methodology and assumptions used to calculate the credit for deposits. An analysis that includes a credit for deposits should not be limited to own-bank demand deposits but should include all trust-generated own-bank deposits in determining the credit for deposits, since all deposits, including savings and time deposits, can be invested to provide a positive return to the institution.

With the advent of the automated sweeping of uninvested funds (refer to subsection F.1.b. Sweep Arrangements, located in Section 3) into overnight investments, the volume of idle demand deposits, as well as the associated credits for deposits, has significantly diminished in many trust departments. Nevertheless, departments with a high volume of corporate trust activity may still carry significant uninvested cash balances. The investment of these funds for the department's benefit, in the form of relatively risk-free overnight investments, should not be criticized unless the fiduciary is required to invest the funds for the benefit of the obligor under terms of the governing instrument or corporate trust indenture.

Expenses

Departmental expenses generally fall into two categories, direct and indirect. Direct expenses are identifiable costs directly chargeable to, for and under the control of the fiduciary and related services function. These expenses include: salaries, bonuses, hourly wages, overtime pay and incentive pay associated with officers and employees, expenses associated with employee benefits, such as contributions to employee benefit plans, health and life insurance costs, social security and unemployment taxes, relocation expenses and other fringe benefits, expenses associated with occupancy, such as maintenance, service and repairs, telephones and utilities, insurance coverage, real estate or property taxes, depreciation/amortization, lease/retail payments for premises and equipment, any leasehold improvements charged directly to expense, fees paid directly for external or internal audits of the fiduciary and related services, trust examination fees, employee training, fees directly paid for outside legal counsel and/or consultants, and, expenses paid directly for advertising and business development activities.

Indirect expenses are those expenses charged to the fiduciary and related services activity from other departments of the institution. Indirect expenses are generally reflected in the institution's retail accounting system and include any allocation for the proportionate share of corporate expenses that are not directly charged to a particular department or function. If the institution's internal accounting system is unable to provide the information, the institution may use a reasonable alternative method to estimate indirect expenses. Indirect expenses include: the proportionate share of data processing expenses, building rent or depreciation, utilities, real estate taxes, and insurance, internal and external audits of trust activities, in-house and/or outside legal expenses, non-trust employee incentives, business development activities, charitable contributions, and corporate overhead, such as allocated expenses for corporate planning and/or financial staff, board of director/committee fees, training, temporary personnel and professionals, travel, entertainment, stationary and postage, and automobile expenses. Reporting methods for indirect expenses should remain consistent from period to period.

Settlements, surcharges and other losses should not be included in direct or indirect expenses but should be reported separately. Refer to discussion of losses below.

It is not unusual for a given type of expense to be incurred on both a direct and an allocated basis. Salaries are likely to be the largest direct expense category in most trust departments. Examples of expenses likely to be incurred, other than salaries, are listed in the Direct and Indirect Trust Expenses table located in subsection F.

In larger departments, cost accounting systems may provide a sophisticated means of measuring trust department profitability. Elaborate systems can measure costs by product line, type of account, individual administrator, type of transaction, or other areas or functions within a department. An effective cost accounting system may also help establish a fiduciary services pricing structure based upon the cost of services provided, such as the amount of labor required to provide particular services or to execute transactions, the number of transactions processed, portfolio valuations and investment advisory services, etc.

Even in small departments, the major expense category, salaries, can be estimated by determining the percentage of each staff member's time devoted to trust activities. In the same way, employee benefits may be allocated to the trust department by taking the total amount of benefits for the bank as a whole and dividing it by total salaries. This percentage can then be applied against the previously determined trust salary figure. Data processing and auditing costs can often be identified or easily allocated to the trust department as well.

Losses

An important consideration in any evaluation of trust department profitability is the level of settlements, surcharges and other losses. Persistent or a large volume of losses usually indicates underlying account or asset administration problems, or other operational weaknesses. Management should have reliable systems that identify all settlements, surcharges, and other losses.

Settlements, surcharges and other losses should be reported to the trust committee, or some other senior operating committee. Losses may be attributable to the following:

- **Settlements**
Formal and informal agreements to reimburse trust accounts, customers, or beneficiaries, but which are reached without a court decree.
- **Surcharges**
Amounts that the fiduciary is required by court decree to pay trust accounts, customers, or beneficiaries. Surcharges are normally associated with negligence, failure to perform fiduciary duties, or misconduct.
- **Fee Waivers and Concessions**
The most common form of fee loss. Many departments will waive, or rebate previously charged fees and commissions. While some fee waivers may be based on banking relationships, some fee waivers may also be a way to adjust an account in response to customer complaints for: operating, administrative, or investment errors, the failure to invest funds promptly, the failure to file timely tax returns, losses attributable to the failure to renew an insurance policy or losses attributable to inadequate insurance coverage of property losses, etc.
- **Operational Errors**
Errors from trade processing, lost or stolen securities, miscalculation of fees or taxes, pricing discrepancies or other losses that are realized in the reporting period attributable to the fiduciary and related services.

Other sources of losses from fiduciary activities include defalcations; uncollectible fees; and civil money penalties imposed by regulatory agencies; etc.

In analyzing settlements, surcharges and losses, examiners should recognize that the gross amount of the loss may be offset, in many cases, by insurance coverage. Further, trust accounting systems may account for settlements, surcharges and losses on either a gross or net basis. On a gross basis, the entire amount is reported as loss, and any recovery, such as from insurance proceeds, is reported as an income item. On a net basis, insurance proceeds and other recoveries are netted against the loss, with only the net figure reflected. Either approach is satisfactory if applied on a consistent basis. However, when trust policies permit any form of netting, examiners should determine whether trust management is reporting gross losses to senior management, or "netting" the losses as a method of masking, or hiding, the actual amount of trust losses.

Examiners should be aware that many institutions do not recognize settlements, surcharges, and losses as a component of trust department profitability. Instead, they are shown as losses and recoveries in the bank's general accounting system. Thus, the review of trust profitability should consider the possibility that significant settlements, surcharges and losses may not appear in the trust accounting system at all. It is imperative that the trust department's reporting systems inform senior management and the directorate of the actual dollar amount and nature of trust losses. If not, senior management and the Board may remain unaware of serious operational and administrative deficiencies. Such Internal control weaknesses should be brought to senior management's attention and discussed in the report of examination.

Trust departments with greater than \$100 million in fiduciary assets must report fiduciary settlements, surcharges, losses, and recoveries in Memorandum item 4 of Call Report of Condition Schedule RC-T. Institutions complete Memorandum item 4 only for the December 31st filing, and are required to report settlements surcharges, losses and recoveries on a gross basis, i.e. before insurance payments. Recoveries reported may be for current or prior years' losses, and are reported only when the recovery is actually realized, i.e. payment is received. The filing of an insurance claim does not support the realization of a recovery for RC-T purposes.

D. EVALUATING PROFITABILITY

While earnings can largely be determined through a review of the trust department's accounting system, several other factors should be evaluated concurrently. These are:

- The emphasis placed by senior management on profitability, in terms of establishing profitability objectives and monitoring operating results;
- The bank's size and demographics of geographical market (e.g., a young population is not likely to produce many estates; trust department or commercial bank size may impose natural limitations on absolute levels of profitability; and geographic location may dictate the level of competition for fiduciary services);
- The degree of dependence on nonrecurring fees (e.g., estates or other court appointed accounts);
- Special circumstances, such as major declines in the securities markets, or the loss of a major local employer; and
- Unusual circumstances regarding the composition of business, fee schedules, settlements, charge-offs or other compromise actions, or adverse publicity.

In evaluating earnings, emphasis should be placed not only on the existing levels of profitability, but also on recent earnings trends, the department's new business development efforts, and competitive factors. Such an analysis will permit examiners to determine the likelihood that current earnings performance will continue.

E. BUDGETS

Budgets are encouraged for all trust departments, and should be expected in larger, more complex trust departments. Management should document the reasonableness of the assumptions used in the budget process. Budgets should be established, approved, and periodically reviewed by senior management. Significant deviations between actual and budgeted performance should be brought to the attention of senior management.

Examiners should evaluate policies regarding the operating performance and earnings prospects of the trust department. In situations where management has no clear policy in these matters, or where record keeping is inadequate, the examiner should make appropriate comments in the report of examination.

F. DIRECT AND INDIRECT TRUST EXPENSES

Other than salaries, expenses likely to be incurred by trust departments are listed below:

Category	Direct Trust Expenses	Allocated Expenses: (Trust function's proportionate share):
Employee Benefits	<ul style="list-style-type: none"> • Contributions to employee benefit plans (pension, profit-sharing, 401(k), ESOP, etc.). • Health and life insurance. • Social Security and unemployment taxes. • Employee relocation expenses. • All other "fringe" benefits. 	<ul style="list-style-type: none"> • N/A
Data Processing	<ul style="list-style-type: none"> • Trust department processing performed on trust department equipment or by outside data processing servicers. • Lease or rental of trust EDP equipment. • Depreciation or amortization for trust EDP equipment. • Repairs and maintenance, service or maintenance contracts. • Non-capitalized purchases of software. • Related supplies etc. 	<ul style="list-style-type: none"> • Data processing expense for applications performed by other areas of the bank or its affiliates.

Occupancy	<ul style="list-style-type: none"> • Ordinary repairs and maintenance, service or maintenance contracts. • Telephone and utilities. • Insurance coverage. • Real estate and other property taxes. • Depreciation or amortization, lease and rental payments for premises and equipment (exclusive of EDP). • Leasehold improvements charged directly to expense and not booked as assets. 	<ul style="list-style-type: none"> • Building rent or depreciation, utilities, real estate taxes, and insurance.
Audit	<ul style="list-style-type: none"> • Fees paid for external audits of trust activities. 	<p>Estimated costs for:</p> <ul style="list-style-type: none"> • Internal and external audits of trust activities. • Audits performed by the bank's parent holding company.
Legal	<ul style="list-style-type: none"> • Fees paid for outside legal counsel, whether as a retainer or for specific legal services. 	<ul style="list-style-type: none"> • Institution's in-house and/or outside legal costs.
Marketing	<ul style="list-style-type: none"> • All expenses paid by, or directly chargeable to, the trust function for advertising and other business development activities 	<ul style="list-style-type: none"> • Incentives paid to non-trust employees. • Institution's business development activities, whether performed in-house or by outside contractors.
Corporate Overhead	<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • Non-trust audit and examination fees. • Salaries and benefits of executive management. • Board of directors, trust committee (and related subcommittees) fees. • Public relations and institutional marketing. • Charitable contributions. • Customer parking. • Holding company overhead. • Functions such as personnel, corporate planning, and corporate financial staff.

Other expenses which would likely be found in a trust department operation are:

- Stationery, postage, travel and entertainment, vault and security costs, automobile expenses, etc.
- Applicable state trust examination fees.
- Temporary staffing expenses, including those for attorneys, accountants, consultants, investment advisors or managers, and other professionals who are not salaried officers or employees of the institution.
- Training and testing expenses, as well as dues, fees, and other expenses associated with memberships in clubs and organizations.

G. REGULATORY REPORTING

Trust institutions are required to report certain data concerning the profitability of trust and fiduciary services. Because these reports provide a standardized set of data prepared in a uniform manner, they should be used whenever possible to aid examiner efficiency and eliminate needless requests for earnings data. Nonetheless, examiners should review the reasonableness and accuracy of the trust and fiduciary services profitability data reported. If significant errors in the reported data are found, the institution should be requested to promptly file amended reports correcting the errors.

Call Report - Report of Income

Gross fiduciary income is reported as a separate noninterest income line item (5a) of the Report of Income on both the small-bank report (FFIEC Form 041) and the large-bank report (FFIEC Form 031).

Through year-end 2000, gross fiduciary income was reported as a separate line item of noninterest income only by large banks (i.e. banks with \$100 million or more in total bank assets), which filed FFIEC Form 031. Smaller banks and trust companies aggregated trust income with other fee income.

Call Report - Fiduciary Schedule RC-T

Beginning in December 2001, a new schedule, RC-T, "Fiduciary and Related Services," was added to the Call Report of Condition. Schedule RC-T includes information on Fiduciary and Related Services Income, as well as a memorandum item which covers Fiduciary Settlements, Surcharges, and Losses. Fiduciary and Related Services Income data, as well as the Fiduciary Settlements, Surcharges, and Losses data are confidential and, therefore, not available to the public on an individual-bank basis. Not all institutions, however, are required to report data on fiduciary income, expenses and losses. Only those institutions with greater than \$100 million in fiduciary assets, as of the previous year-end, and those that do not meet the fiduciary income test, i.e. institutions where gross fiduciary and related services income exceeds ten percent of revenue (net interest income plus noninterest income), are required to report income, expense and loss data in Schedule RC-T.

Trust companies, large institutions (i.e. those with more than \$250 million in total fiduciary assets), and institutions that do not meet the fiduciary income test are required to complete certain line items of Schedule RC-T on a quarterly basis. Banks with total fiduciary-related assets between \$100 and \$250 million must complete all applicable line items of Schedule RC-T only as of the December 31st year-end Call Report submission. The trust asset thresholds are based on total fiduciary assets as of the previous year-end.

In reviewing Schedule RC-T for accuracy, examiners must be familiar with the instructions for completing Schedule RC-T. The instructions for completing Schedule RC-T are available on FDIC website, <http://www.fdic.gov/resources/bankers/call-reports/index.html>. Particular note is made of the following:

- Fiduciary and related services income should be reported on the basis of the various lines of trust business reported in the Fiduciary and Related Assets section of Schedule RC-T.
- Direct and indirect fee income is reported in Items 12 through 18 of Schedule RC-T. The total of these items must equal the amount reported in Item 5.a., i.e. Income from Fiduciary Services, of the Call Report of Income.
- Item 18 (Other fiduciary & related services income) is used to report investment advisory fees when the assets are not held by the institution.
- Item 20 (Expenses) includes all direct and indirect expenses attributable to the fiduciary and related services reported in RC-T.
- Item 21 (Net losses from fiduciary and related services) must equal the net totals from Memorandum # 4 (Fiduciary settlements, surcharges, and other losses).
- Item 22 (Intracompany income credits for fiduciary and related services). Three basic types of income credits should be reported at this item: any credit for own-bank deposits calculated by the bank; allocations of income received from elsewhere in the bank; and credits received for other intracompany services and transactions.

Annual Report of Trust Assets - Schedule E (Fiduciary Income Statement)

Prior to the implementation of Call Report Schedule RC-T, institutions reported fiduciary income, expenses and losses in Schedule E of the Annual Report of Trust Assets. Schedule E was implemented in 1996, and, as is the case with the income, expense and loss data reported in Call Report Schedule RC-T, the information reported in Schedule E is confidential and not available on an individual institution basis. Aggregate Schedule E data, however, is available to the public via the FFIEC publication "Trust Assets of Financial Institutions." Schedule E aggregate reports can be accessed via the FDIC's website.

H. FDIC IMPLEMENTATION OF 1998 UNIFORM INTERAGENCY TRUST RATING SYSTEM

The 1998 Uniform Interagency Trust Rating System (UITRS) [refer to subsection B. in Appendix B] was implemented under Division of Supervision Regional Director Memorandum transmittal number 98-102, which was issued on December 31, 1998. Guidelines for the Corporation's implementation of the new rating system, including instructions for the preparation of the Earnings examination schedule, and an alternative rating system for small trust departments, were outlined in this Regional Director memorandum.

The 1998 UITRS permits agencies to adopt their own guidelines governing the assignment of an Earnings rating for institutions total assets of less than \$100 million, as reported on Schedule A, Line 18, Column F of the FFIEC Annual Report of Trust Assets (FFIEC 001). [Note that with the discontinuation of the Annual Report of Trust Assets at the end of the 2000 reporting year, the \$100 million threshold is calculated by adding total fiduciary assets reported on line 9 of Call Report Schedule RC-T to total custody and safekeeping assets reported on line 10 of RC-T.] The Corporation issued the following guidelines in its December 31, 1998 memorandum:

- Required Examination Coverage - Trust earnings must be reviewed, analyzed and evaluated at each trust examination.
- Mandatory Ratings - Trust earnings are to be routinely rated only at:
 - Institutions with \$100 million or more in trust assets (based on the latest FFIEC Annual Report of Trust Assets) and
 - Trust company subsidiaries of nonmember banks.
- Alternative Ratings Assignment for Small Trust Institutions - Trust earnings must be rated in small ("community") trust institutions when one of the following is present:
 - The trust department has \$90 million or more in total fiduciary and custody and safekeeping assets, as reported in Call Report Schedule RC-T, and its recent growth indicates that it is reasonable to believe that it will exceed the \$100 million asset threshold by the end of the current calendar year.
 - The trust department has dropped below \$100 million asset threshold in the past year, but is reasonably expected to exceed \$100 million in the near future.
 - Trust department earnings are significant to the bank's overall earnings (gross trust fees are 50 percent or more of net bank income).

When trust earnings are rated in smaller trust institutions, the revised UITRS provides a different set of standards for evaluating the adequacy of trust earnings. In these cases, the examiner should primarily focus on the following management oversight and approval issues, rather than numerical profitability:

- A reasonable method of measuring trust income and expense, commensurate with the volume and nature of fiduciary services offered,
- Appropriate reporting of trust profitability, not less than annually, to the board of directors or an appropriate committee thereof, and
- Approvals, from the board of directors or an appropriate committee thereof, for the offering of fiduciary services.

I. ALTERNATE EARNINGS RATING STANDARDS FOR SMALLER INSTITUTIONS

The 1998 Uniform Interagency Trust Rating System (UITRS) [refer to subsection B. in Appendix B], provides minimum standards and ratings definitions for rating the earnings component of smaller institutions under an alternate rating system. As discussed above, the Corporation adopted the alternate earnings rating approach for smaller institutions in 1998.

Minimum Standards for Smaller Institutions:

Alternate ratings are assigned based on the level of implementation of four minimum standards by the board of directors and management. These standards are:

- Standard No. 1 - The institution has reasonable methods for measuring income and expense commensurate with the volume and nature of the fiduciary services offered.
- Standard No. 2 - The level of profitability is reported to the board of directors, or a committee thereof, at least annually.
- Standard No. 3 - The board of directors periodically determines that the continued offering of fiduciary services provides an essential service to the institution's customers or to the local community.
- Standard No. 4 - The board of directors, or a committee thereof, reviews the justification for the institution to continue to offer fiduciary services even if the institution does not earn sufficient income to cover the expenses of providing those services.

Alternate Ratings Definitions for Smaller Institutions:

A **rating of 1** may be assigned where an institution has **implemented all four minimum standards**. If fiduciary earnings are lacking, management views this as a cost of doing business as a full service institution and believes that the negative effects of not offering fiduciary services are more significant than the expense of administering those services.

A **rating of 2** may be assigned where an institution has **implemented, at a minimum, at least three of the four standards**. This rating may be assigned if the institution is not generating positive earnings or where formal earnings information may not be available.

A **rating of 3** may be assigned if the institution has **implemented at least two of the four standards**. While management may have attempted to identify and quantify other revenue to be earned by offering fiduciary services, it has decided that these services should be offered as a service to customers, even if they cannot be operated profitably.

A **rating of 4** may be assigned if the institution has **implemented only one of the four standards**. Management has undertaken little or no effort to identify or quantify the collateral advantages, if any, to the institution from offering fiduciary services.

A **rating of 5** may be assigned if the institution has **implemented none of the standards**.