

How to Use This Manual

The regulatory focus on the trust industry has intensified significantly over the past decade. Examiners are scrutinizing the trust function more closely as the areas of responsibility expand due to new product availability, technology, competition, and an aging population. As with other key areas in the bank, regulators expect the trust function to operate within a risk management perspective to minimize the bank's exposure.

Historically, trust profitability was not important to many banks, which viewed the trust business as a service. Therefore, the risks of this business were never analyzed closely. Also clients generally were not very sophisticated regarding investing and relied on the bank for advice. However, today's trust clients, especially senior adults and new retirees, are more technologically and financially savvy; they demand more and different services from their financial advisors. Examiners, in turn, are constantly changing the scope of their reviews while focusing on risk management.

Large trust departments normally have staff dedicated to overall risk management. Many smaller trust departments, however, do not have the staff to balance the demands of regulatory requirements with other responsibilities. The choice often is to outsource some of these responsibilities, but that does not relieve banks of their oversight responsibilities. The regulators still hold you responsible for the activity of third party vendors.

Trust Department Risk Management will assist you in your oversight responsibilities and help you strengthen your risk management function. Because of the nature of the trust industry, the fiduciary environment is in a constant state of flux. The continual changes in tax law with the implementation of the Uniform Acts and the unique issues with state law make it imperative that you establish mechanisms for managing risks in the trust area.

The procedural steps below, which outline the material covered more extensively in the manual, will help you when establishing or reviewing your trust operations from a risk management perspective. In addition, observing the procedures will assist you in preparation for your next examination.

- *Establish clear lines of authority and follow them.* Leave nothing to chance. Address the escalation/approval processes and follow them.
- *Identify your department's strengths and weaknesses.* Based upon this analysis, define what types of business you will or will not accept. Identify the areas that could create substantial risk for your organization and quantify that into high, moderate, and low categories.
- *Develop appropriate policies and procedures.* These need to address specifically your company's fiduciary approach. Once you have appropriate policies and procedures, make sure employees are familiar with them and religiously follow them.
- *Closely monitor outsourced activities.* You may use third party vendors for areas where you don not have the expertise. You are still responsible for the outsourced activities, and is incumbent that you perform the necessary due diligence when considering these outsourcing opportunities.
- *Develop and maintain a disaster recovery plan.* A disaster recovery plan is no longer a luxury, it is a necessity. Along with the plan, you need to have a testing process. Periodically review the plan to keep it viable.
- *Establish (if you don't already have it) a good relationship with internal audit.* Use the auditors as a sounding board and as consultants. The more they know about your business, the more comfortable the examiners will be with their internal audit processes and the smoother your exam will go.
- *Do not underestimate the importance of training.* The fiduciary environment is in a constant state of flux. The continual changes in tax law, the implementation of Uniform Acts, the changing investment environment coupled with unique issues with state law make it essential that you and your employees are up-to-date with this dynamic environment.

CONTENTS OF THIS MANUAL

Chapter 1: Uniform Interagency Trust Rating System

Originally the goal of UITRS was to set certain standards for measuring bank fiduciary activities and provide a necessary management tool for the federal agencies to compare and evaluate fiduciary activities on a uniform basis. Over the years, the UITRS has proven to be an effective internal supervisory tool for uniformly evaluating and identifying institutions that require special attention. In this chapter we review UITRS and its rating system.

Chapter 2: Examinations and Audits

The OCC developed an examination process called the Risk Assessment System (RAS). RAS's objective is to evaluate fiduciary activities using a top-down approach, focusing on the risks that accompany fiduciary activities. This chapter summarizes the two broad classifications of risks — direct and indirect — and what you should expect during the examination process.

Chapter 3: Managing Risk in Trust Relationships

Having a clear idea of what levels of risk your business might encounter will help you manage your risk. You also should understand what areas of compliance are most prominent in the minds of examiners and auditors. This chapter classifies the various types of personal trust relationships in a hierarchy of challenges and opportunities based on overall administration risk; responsibilities to grantor/beneficiaries; tax duties; investment responsibility; fees; and documentation requirements.

Chapter 4: Committee and Board Oversight of Fiduciary Functions

The board of directors is ultimately responsible for the fiduciary function. Board members, however, do delegate oversight among several committees. This chapter

outlines fiduciary responsibilities of committees that the board generally creates. Committees typically include trust, audit, trust administrative, and trust investment.

Chapter 5: Developing and Adopting a Policy and Procedures Manual

The first rule of fiduciary administration is to adhere to the governing document. The second is to follow established policies and procedures. Consistency is key in the administration of trusts; updated policies and procedures protect the institution and its clients. The policies and procedures manuals that we discuss in this chapter are dynamic documents that need to reflect changes in fiduciary laws and regulations, internal business practices of the institution, and the constant change in the wealth management industry.

Chapter 6: Disaster Response and Business Resumption Planning

The process of developing, maintaining, reviewing, and testing a business resumption plan is not simple. You need to consider all contingencies and determine what level of risk you are willing to accept; this chapter will assist you in that endeavor. If your trust organization is part of a bank, you can piggyback with its plan, extending and adapting the plan for your own particular issues. Regardless of what plan you use, remember to frequently review and test it.

Chapter 7: Third Party Due Diligence Worksheets

If you elect to use an outsource solution to present proposals and to enact plans and investment advice, your due diligence process must be thorough. Due diligence is the process of investigating, auditing, and evaluating processes and facts that allow a prudent fiduciary to make an informed decision regarding its business and clients. Senior management and staff will have some responsibility in developing the due diligence analysis, but ultimately it will be the board of directors and its designees who must approve the process and selection of support systems for the department. This chapters reviews the due diligence process.

Chapter 8: Internal Audit Oversight

The board of directors and senior management are responsible for having an effective system of internal control. That responsibility cannot be delegated. This chapter addresses what your system of internal control should prevent or detect.

Chapter 9: Role of Technology in Trust Administration

Information technology is indispensable in our lives and work. In the trust business, access to systems that provide, analyze, and report data is critical in every phase of the many activities and controls that we describe in this book. This chapter highlights technology areas of which you should be aware.

Appendices

Refer to the Appendices to see model trust code and regulation. The model we present is based on North Carolina state law.

VALUE OF THE CD

With the purchase of this manual, you also receive a CD containing the chapter files. Use the files from the accompanying CD to customize documents for your bank.