Trust Company	Enter name and city	Date of Exam	
Charter #		Prepared By	

#11 –TRUST COMPANY LIQUIDITY
(Risk Focused)

ASSIGNMENT OVERVIEW

The importance of liquidity is recognized by its separate rating among the **CAMEL** components; a trust company experiencing severe liquidity problems is in danger of failure. Liquidity is generally defined as the ability of the company to meet its short-term obligations and to convert assets into cash or to obtain cash. Short-term is generally viewed as a time span up to one year. A trust company has liquidity when it can obtain sufficient funds, in a timely manner, at a reasonable cost. Borrowed funds may be justified and warranted if they serve one or more of the following purposes: (a) to meet temporary liquidity needs; (b) to fund short-term payables. Borrowing may be unjustified if it is necessitated by poorly planned funds management practices or is used to fund inadequately controlled loan or investment expansion. To the extent that borrowing may increase the trust company's overall cost of funds, it may contribute to anxiety for income. For guidance, refer to Section 6.1 Liquidity and Funds Management, in the FDIC Risk Management Manual,

INSTRUCTIONS

Examiners must follow the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Trust Examinations.

All examiners performing these procedures must be listed above in the "Prepared By" section. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner's thought process and all significant findings. Items to Consider within the core analysis are not required to be commented on unless there are significant issues. The intent is to assist the examiner in expanding their thought process and analysis of that area.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be indicated on the SCOPE FORM.

EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION'S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.

CORE ANALYSIS

#11 TRUST COMPANY LIQUIDITY

1. Prior Criticisms

1. Determine whether deficiencies noted in the last examination and most recent internal/external audit have been addressed and/or corrected by management. Detail how deficiencies were corrected**.** *Include a copy of audit exceptions and/or prior examination criticisms and management response in work papers or indicate the page number in the prior report of examination where the deficiencies are noted, or summarize exceptions/criticisms below, if applicable.*

Comment:

2. Analysis of Sources & Uses

2a. Review the trust company's balance sheet and identify major sources and uses of liquidity considering the trust company's liquidity needs. Consider unfunded investment purchases, off balance sheet items, and current and long-term liabilities. Refer to **Appendix A** for guidance. *Comment on findings and explain any deficiencies.*

Comment:

2b. Balance and reconcile material Other Liabilities to the GL and verify the accuracy of Call Report schedule RC-D. Comment on any deficiencies noted. Ensure debit balances have been transferred to other assets or vice versa, according to Call Instructions. *Refer to* TAC 17.23(g)(3) for materiality definition. *Include copy of reconciliation in work papers*

Comment:

2c. Determine if the trust company complies with Texas Finance Code §**184.101** which states that a state trust company must invest and maintain an amount equal to at least 50% of their restricted capital in investment securities that are readily marketable and can be converted to cash within four business days. A lesser amount or time extension, for good cause shown, must be approved in writing by the banking commissioner.

Compliance with TFC §184.101 Securities	**Select Response**

Comment:

3. Management Oversight

3. Evaluate the effectiveness and adequacy of Board and management oversight of the liquidity function. Assess the adequacy of policy/procedures, internal controls, and limits for managing and monitoring liquidity considering the complexity of the trust company's balance sheet structure and operating environment. Refer to **Appendix B** for guidance. *Comment on findings and explain any deficiencies.*

Comment:

4. Final Analysis

4. Prepare a Liquidity comment and assign a rating for the trust company. Refer to **Supervisory Memorandum 1002.** Complete the **Summary of Findings**.

SUMMARY OF FINDINGS

#11 - LIQUIDITY

Describe all strengths evident from the evaluation.
Describe all weaknesses evident from the evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/ noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.
Determine why weaknesses exist and comment on management's response and plan of action. Identify bank personnel making the response.
SUMMARY RISK RATING ASSIGNED: Select Rating

Ratings: 1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient; NR-Not Rated

Ratings Definitions.xlsm

Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE FORM.

APPENDIX A

ANALYSIS OF SOURCES & USES

LIQUIDITY SCHEDULE(S) / ANALYSIS

Liquidity needs may be met by managing the trust company's asset structure through either the sale or planned pay-down of assets. Trust companies relying solely on asset management focus on the level of liquid assets held to meet cash demands in response to changes in customer asset and liability preferences. Assets normally assumed to be liquid sometimes are not liquidated easily and/or profitably. For example, investment securities may be pledged against public funds and repurchase agreements or may be depreciated heavily because of interest rate changes. On the other hand, holding liquid assets for liquidity purposes becomes less attractive because of thin profit margins and capital maintenance requirements.

As an alternative to using assets to satisfy liquidity needs, these needs may be met through liability sources. Although core deposits continue to be a key liability funding source, many insured depository institutions have experienced difficulty attracting core deposits and are increasingly looking to wholesale funding sources to satisfy funding and liability management needs. Wholesale funding sources include, but are not limited to:

- Federal funds,
- public funds,
- Federal Home Loan Trust company advances,
- the Federal Reserve's primary credit program,
- foreign deposits,
- brokered deposits, and
- deposits obtained through the Internet or CD listing services.

Completion of the Analysis of Liquidity Schedule

- Confer with the EIC on the completion of the Analysis of Liquidity schedule.

- Verify components of “Liquid Investments” (Statement of Financial Position).
  - “Liquid Investments” are defined as “Readily Marketable Investments”
  - Quantify core components for examination tie-back purposes.

- Notify the EIC of adjustments made on the Analysis of Liquidity schedule to reflect other assets considered liquid/marketable as short-term investments (i.e., other money market instruments), or as other marketable assets due over one year.

- Utilize the Federal Reserve’s reserve requirement letter to determine the amount of cash and due from trust company account balances which must be maintained based upon the current level of trust company deposits.

- Utilize the pledged assets questionnaire to determine the amount of secured liabilities.

- If the trust company has any securities sold under an agreement to repurchase (“repos”), determine whether the activity complies with the FFIEC Supervisory Policy on Repurchase Agreements of Depository Institutions with Securities Dealers and Others.

Definitions

- **Readily Marketable Investments ($000’s)**
  The sum of:
  Cash (includes both demand and interest-bearing trust company balances)
  + Securities (including U. S. Agency and Municipal)
  + Bonds, Notes and Debentures (listed on a recognized stock exchange)
  + Corporate Stock (listed on a recognized stock exchange)
  + Mutual Funds
  + Appreciation in investments
    - Depreciation in investments
    - Pledged securities

- **Short Term Assets ($000’s)**
  The sum of:
  Readily marketable investments (defined above)
  + Fixed rate loans maturing within one year
  + Floating rate loans that mature within one year

- **Short Term Non-Core Funding ($000s)**
  The sum of:
  + Fixed/Floating rate time certificates of deposit and open account time deposits of $100M or more that mature within one year;
  + Brokered deposits less than $100,000 and maturing within one year;
  + Other borrowed money with remaining maturity one year or less;
  + Deposits in foreign offices with remaining maturity under 1 year;
  + Securities sold under agreements to repurchase, and federal funds purchased Demand notes issued to the U.S. Treasury (included in Other Borrowed Money from March 31, 2001 forward)

- **Net ST Non-Core Funding Dependence** –
  = Short term non-core funding less short-term investments divided by long term assets

- **Net Non-Core Funding Dependence** –
  = Non-core liabilities less short-term investments divided by long term assets

- **Other ready sources of asset liquidity -**
  - “temporary investments”
  - marketable securities due over one year
  - excess cash and due from accounts
  - available-for-sale assets
  - and other sources

Return to Core Analysis-Q2a

APPENDIX B

MANAGEMENT OVERSIGHT

LIQUIDITY POLICY GUIDANCE

Regardless of the method or combination of methods chosen to manage a trust company's liquidity position, it is of key importance that management formulates a policy and develops a monitoring system to ensure that liquidity needs are met on an ongoing basis.

A good policy should generally provide for forward planning which takes into account the unique characteristics of the trust company, management goals regarding asset and liability mix, desired earnings, and margins necessary to achieve desired earnings. Forward planning should also consider anticipated funding needs and the means available to meet those needs.

The policy should establish responsibility for liquidity and funds management decisions and provide a mechanism for necessary coordination between the different departments of the trust company. This responsibility may be assigned to a committee. Whether the responsibility for liquidity and funds management rests with a committee or an individual, strategies should be based on sound, well-deliberated projections.

The board of directors and the examiner should be satisfied that the assumptions used in the projections are valid and the strategies employed are consistent with projections.

Consider the following when reviewing the Liquidity Policy:

1. Has the board of directors formally reviewed/revised the written policies regarding liquidity guidelines within the last year to ensure their continued relevance?

2. Does the Policy include the following important points?

    - A reasonable methodology for determining any specific target liquidity parameters?
    - Alternative funding sources (parent company contributions), if appropriate?
    - Guidelines and conditions for borrowing (i.e., authorizations, approvals, limits), if borrowing is employed or contemplated?
    - Are the policy guidelines reasonable based on the trust company's overall condition, size, and location?
    - Does the policy support strategic and/or business plan objectives?

3. Has the board of directors approved written borrowed funds guidelines for long-term liabilities that address the following:

    - Outlines the trust company's objectives;
    - Limits long-term debts by amount outstanding, specific type, or total interest expense;

- Identifies the source and timing of repayments; and
- Provides a system of reporting requirements.

4. Are these policies appropriate relative to the complexity and risk profile of the trust company's overall liquidity program?

5. Is management complying with policy guidelines?

Return to Core Analysis Q3