Trust Dept.		Date of Exam	
Charter #		Prepared By	

#15 SMALL TRUST DEPARTMENT

(Total Fiduciary Assets Less Than $100MM)

ASSIGNMENT OVERVIEW

In evaluating an institution's overall fiduciary risk profile and level of supervision depends on the ability of management to identify, measure, monitor, and control the risks of its fiduciary department. Appropriate management practices vary considerably among financial institutions, depending on the size, complexity, and risk profile. Fiduciary activities of financial institutions are basically evaluated on the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets.

Institutions with assets under management of less than $100 million who engage solely in traditional fiduciary activities, whose management is actively involved with the day-to-day operations and maintain relatively basic management systems and controls are considered Small Trust Departments. Typically, these lower risk profiled institutions with simplified operations and a nominal asset size pose limited risk and warrant a more streamlined examination that includes the use of an abbreviated form of procedures and corresponding report to be completed. The Small Trust Department procedures are intended to promote an efficient and risk focused examination process.

INSTRUCTIONS

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

All examiners performing these procedures must be listed above in the "Prepared By" section. All of the CORE ANALYSIS PHASE should be completed for each fiduciary component. Composite and component ratings are assigned based on UITRS, a 1 to 5 numerical scale. A "1" is the highest rating and indicates the strongest performance and risk management practices and the least degree of supervisory concern. A "5" is the lowest rating and indicates the weakest performance and risk management practices, and therefore, the highest degree of supervisory concern. Comments and findings for each step should be made 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.

The Summary of Findings page contains strengths, weaknesses, and management's response to the weaknesses. The SEIC/EIC should determine which comments on the Summary of Findings will be included in the Report of Examination.

The EIC should review this procedure when completed. Acknowledgement that this procedure has been reviewed by the EIC 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 PHASE

#15 SMALL TRUST DEPARTMENT

1. PLANNING & CONTROL

1a. Review the examination materials listed below and prepare/submit the Scope Form for Chief Trust Examiner's approval. *(Embed the Chief Trust Examiner's approval in the Table of Contents #15 or embed in the following comment section).* Comment on any weaknesses or areas of concern. Scoping material should include:

- Most recent FFIEC Call Report Schedule T;
- Relevant correspondence in Document Manager, including consumer complaints;
- Prior trust examination report, may be included with safety and soundness commercial report;
- Work papers from the previous examination;
- Examination reports of affiliated regulated entities; and
- Most recent status report on any administrative or enforcement actions outstanding**.**

Comment:

1b. Contact the bank's trust department management to coordinate the examination and input information into EDISON. Prepare the Request Packet and send it to the bank at least four weeks prior to examination date. *Note the date management was contacted and the date request packet was sent to the bank in the comment section.*

Comment:

1c. Review the requested material and questionnaires and verify the completeness of data received. Comment on any weaknesses or areas of concern.

- Review the trust department's internal or system reports and compare against the most recent Call Report.
- Prepare the report of examination using the most recent Call Report and the last report of examination. Complete the 5-year Historical Earnings and 3-year Summary of Trust Activity report pages.

Comment:

2. FIDUCIARY MANAGEMENT

2a. 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 #15 of the 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:

2b. Review the department's written policies and procedures and note the date of Board approval. Assess the adequacy of policies and procedures in relation the institution's overall fiduciary practices. Confirm that a

Regulation R policy and program has been implemented and Board approved. Refer to **Appendix A** for guidance.

Comment:

2c. Note the date of approval of the Statement of Principles of Trust Department Management.

Comment:

2d. Assess Board of Directors and committees' structure and oversight of the trust area.

Comment:

2e. Review and evaluate current and long-range strategic and/or business plans. *The strategic plan might be included in the bank's overall plan. Include copy of strategic plan in 15-C of the work papers.*

Comment:

2f. Review the Board (trust activity related) and trust committee minutes making note of attendance and any significant approvals, changes, and issues discussed. *Include a summary in 15-H (board) and 15-J (committee) of the work papers.*

Comment:

2g. Evaluate the Board's level of insurance protection afforded the institution. Note any changes since the last examination. Refer to **Appendix B** for additional guidance. *Include schedule of insurance policies in 15-S of work papers.*

Comment:

2h. Note the type of trust activity and evaluate the overall risk profile of the trust department. Recommend a component rating for Management in accordance with Supervisory Memorandum 1001.

Comment:

Fiduciary Management Rating: Click here to select rating.

3. OPERATIONS, INTERNAL CONTROLS, AND AUDITS

3a. Review the adequacy of the latest fiduciary cash, assets, and suspense account reconcilements to verify that reconcilements are performed by someone other than the person who maintains/posts records on a regular basis. *Include copies of reconcilements in 15-L of the work papers.*

Comment:

3b. Determine if the institution has a written audit program which has been approved by the Board or audit committee. Based on a review of the external and internal audits, determine if the program is adequate for the size and complexity of fiduciary accounts. *Include copy of the Fiduciary Audit, and the Management and Engagement Letters in 15-K of the work papers.*

Comment:

3c. Note the type of trust accounting system utilized and determine if there are material weaknesses or changes with the system.

Comment:

3d. Identify any overdrafts and large cash balances. If any, determine why large or long-standing items exist. *Include in 15-O of the work papers.*

Comment:

3e. Determine if proper dual controls and separation of duties are practiced.

Comment:

3f. Determine if there are procedures in place for the escheating of returned checks, unclaimed checks, or other funds as provided in §74.101 (Property Report) of the Texas Property Code. Determine if all items noted in outstanding checks, returned checks, suspense accounts, or reconcilements are less than three years.

Comment:

3g. Assess the adequacy of the operations area and recommend a component rating in accordance with Supervisory Memorandum 1001.

Comment:

Operations, Internal Controls, & Audit Rating: Click here to select rating.

4. FIDUCIARY EARNINGS

4a. Determine profitability. Review current and prior year earnings to determine if profits are going up or down. Discuss earnings trends.

Comment:

4b. Review the current and prior budget and compare to actual performance. Identify material items with significant deviation from the budget. Determine if the budget process is satisfactory. *Include Budget for current fiscal year in 15-P and Budget Comparison in 15-Q of the work papers.*

Comment:

4c. Analyze overall earnings performance, taking into account Supervisory Memorandum 1001 in accordance with interagency guidelines, which do not require earnings to be rated in institutions with less than $100 million in total trust assets; however, the Department has the option of requiring the earnings of these institutions to be rated using the alternate rating definitions, where applicable. Refer to **Appendix C** for alternate rating definitions.

Comment:

Fiduciary Earnings Rating: **Click here to select rating.**

5. COMPLIANCE

5a. Determine the scope of file review and select account sample. *Include the selection of accounts in 15-U of the work papers.*

Comment:

5b. Review accounts and determine compliance with internal policies and applicable laws and regulations, including CIP and OFAC. Verify account acceptance procedures performed on new accounts sampled if any. Make note of documentation exceptions and any apparent violations. *Provide lists to management.*

Comment:

5c. Determine the adequacy of the administrative review process.

Comment:

5d. Confirm how the institution guards against conflicts of interest and use of potential sources of insider information. Verify that the trust manual includes a conflict of interest policy. Refer to **Appendix D** for guidance.

Comment:

5e. Determine if there are any affiliate relationships amongst insiders for conflict of interest purposes.

Comment:

5f. Assess the overall adequacy of the compliance program and recommend a component rating in accordance with Supervisory Memorandum 1001.

Comment:

Compliance Rating: **Click here to select rating.**

6. ASSET MANAGEMENT

6a. Assess adherence to the investment policy and the Statement of Principles.

Comment:

#15 Small Trust Department

6b. Review and make note of the purchase and sale of investment securities; selection and retention criteria; investment research utilized; and use of advisors, etc. *Include copy of the approved buy/sell list in 15-R of the work papers.*

Comment:

6c. Analyze and comment on the adequacy of the investment review process including initial asset reviews.

Comment:

6d. Assess the overall adequacy of asset management practices and recommend a component rating in accordance with Supervisory Memorandum 1001.

Comment:

Asset Management Rating: **Click here to select rating.**

7. FINAL ANALYSIS

7. Complete the **Summary of Findings**.

SUMMARY OF FINDINGS

#15 SMALL TRUST DEPARTMENT

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.

COMPONENT RATINGS

Fiduciary Management Rating: Click here to select a rating.

Operations, Internal Controls, & Audit Rating: Click here to select a rating.

Fiduciary Earnings Rating: Click here to select a rating.

Compliance Rating: Click here to select a rating.

Asset Management Rating: Click here to select a rating.

OVERALL COMPOSITE RATING: Click here to Select Rating

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

Ratings Definitions.xlsm

APPENDIX-A

Regulation R Policy and Program Guidance

Consider the following program provisions:

1. Board approved SEC/FRB **Regulation R** policies and procedures that address compliance measures implemented by management. Policies and procedures should include, but are not limited to, the retention of records to document the calculation of the chiefly compensated test, compliance with advertisement restrictions, any network or custody arrangements with 3rd party service providers, and any employee compensation programs established. The Board or delegated board committee should regularly monitor for continued compliance with its approved policy and the limits and requirements set by the selected broker exception.

2. The institutions' management training program should include training on SEC/FRB Regulation R and GLBA compliance. Training material utilized should at least include established policies and procedures.

3. The software program utilized by the institution's service providers for trust record keeping and accounting should regularly be verified by external auditors to assess its adequacy in providing accurate and timely records for Regulation R compliance. In addition, the chiefly compensated calculation should be verified along with the figures used to compute the required ratio.

4. Documented analysis provided by the institution on the securities transactions effected by a networking arrangement with broker/dealers, in a fiduciary capacity, or as custodian should satisfy one of the requirements for exemption from the definition of the term "broker" in the Securities Exchange Act of 1934, Section 3(a)(4)(B)(iii). Consider the following:

   A) Networking Exception:

      1. The institution may refer customers to their broker-dealer affiliates or partners in return for a share of the commission earned from the customer's security account without being deemed a broker-dealer.
      2. An unregistered employee may receive for a customer referral a one-time nominal cash referral fees of any amount paid only once for a referral not exceeding the greater of $25 or; twice the average hourly wage for an employee of the same job family or; 1/1000th of the average annual base salary for an employee of the same job family or; twice the employee's actual base hourly wage or; 1/1000th of the employee's actual annual base salary.
      3. Institutions are allowed to pay bonuses based on overall profitability or revenue of the bank/trust company on a stand-alone or consolidated basis, or to any affiliate of the bank provided that the affiliate is not in the business of making broker-dealer referrals, or a broker-dealer.
      4. The institution can pay higher-than-nominal fees for referrals of high net worth and institutional customers. High net worth customers are individuals or couples with a net worth of $5 million or more excluding their primary residence and associated liabilities. Also includes revocable, inter vivos or living trusts, if the settlor thereof, individually or jointly, with his or her spouse, meets the $5 million net worth test. Institutional customers are entities with $10 million in investments or $20 million in revenues.

B) Trust & Fiduciary Exception:

1. Transactions are affected in a department or division of the bank that is regularly examined for compliance with fiduciary standards;
2. The institution is "chiefly compensated" for its trust and fiduciary activities on the basis of an annual/administrative fee, a percentage of assets under management, a flat or capped per order processing fee equal to no more than the cost of incurred, or a combination of these. The chiefly compensated test consists of calculating a moving average ratio over the immediately preceding two years. The bank satisfies the test, if "relationship compensation" to total trust and fiduciary compensation is at least 70%, computed on a bank-wide basis, or if the chiefly compensated percentage for each account is greater than 50%, computed on an account-by-account basis.
3. The institution does not publicly solicit brokerage business. [Note: A bank may, in conjunction with advertising its other trust activities, state that it effects securities transactions as part of its administration of fiduciary accounts.]; and
4. Securities transactions are affected by a registered broker/dealer; in a cross-trade or similar transaction that is not in violation of fiduciary standards, or in any other way permitted by the SEC.

C) Custody & Safekeeping Exemptions:

1. Employee Benefit, IRA, and Similar Accounts

- **a)** The institution does not advertise that 1) it accepts orders, except as part of advertising its other custody and safekeeping activities; 2) custody accounts are brokerage accounts or are a substitute for brokerage accounts. Advertisements and sales literature descriptions of order-taking services should not be more prominent than other aspects of an institution's custody and safekeeping services;
- **b)** No employee of the institution is compensated based on whether a securities transaction is executed, or based on the quantity, price, or type of security involved;
- **c)** The institution is not a trustee or fiduciary, other than a directed trustee;
- **d)** The institution is not acting as a carrying broker; and
- **e)** The institution complies with the Exchange Act Section 3(a)(4)(C) trade execution requirements.

2. Accommodation Trades i.e. order taking for accounts that are not Employee Benefit, IRA, or similar accounts

- **a)** The institution does not advertise that it accepts orders;
- **b)** Sales literature does not state that the bank accepts orders, except as part of describing other aspects of its custodial and safekeeping services. Sales literature should not describe order-taking services more prominently than other aspects of an institution's custody and safekeeping services;
- **c)** No employee of the institution is compensated based on whether a securities transaction is executed, or based on the quantity, price, or type of security involved;
- **d)** Any fee changed or received by the institution does not vary based on whether the bank accepted the order, or the quantity or price of the securities bought or sold;
- **e)** The institution is not a trustee or fiduciary, other than a directed trustee;

   - **f)** The institution does not provide investment advice or research; make recommendations; or solicit transactions;
   - **g)** The institution is not acting as a carrying broker; and
   - **h)** The institution complies with the Exchange Act Section 3(a)(4)(C) trade execution requirements.
3. Non-Custodial Third-Party Administrators
   - **a)** The third-party administrator and the custodial institution that contracted with it both comply with the requirements for Employee Benefit, IRA, and Similar accounts; and
   - **b)** The third-party administrator does not execute cross trades other than crossing or netting open-end mutual funds not traded on an exchange or crossing or netting orders for accounts of the custodial institution.
4. Sub-Custodians
   - **a)** Both the subcustodial and the custodial institution comply with the relevant requirements for Employee Benefit, IRA, and Similar accounts or accommodation trades, as applicable; and
   - **b)** The subcustodian bank does not execute cross trades other than crossing or netting open-end mutual funds not traded on an exchange or crossing or netting orders for accounts of the custodial institution.

D) Other Exceptions and Exemptions:

1. Sweep Account/Money Market Fund
2. Networking/High Net Worth – Institutional Customer Referrals
3. SEC Regulation S Securities
4. Securities Lending Transactions
5. Permissible Securities Transactions
6. Stock Purchase Plans
7. Private Securities Offerings
8. Affiliate Transactions
9. Identified Banking Products
10. Municipal Securities
11. De Minimis

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Regulation R Reference Materials

- DOB Draft Policy Statement on Regulation R
- The joint FRB/SEC final Regulation R published in the Federal Register on October 3, 2007, see Exchange Act Release No. 34-566501: File No. S7-22-06

- FRB Regulation R Compliance Guide
- Securities and Exchange Commission Act of 1934
- Gramm-Leach Bliley Act of 1999
- FDIC Trust Examination Manual, Section 10.F
- *FIL-89-2008 Securities Activities of Banks – Exceptions and Exemptions for Banks from the Definition of "Broker" (09/10/2008)*
- *FIL-92-2007 Final Regulation R: Exceptions and Exemptions for Banks from the Definition of "Broker" (10/25/2007)*
- FRB Regulation R Guidance: *Exceptions for Banks from the Definition of Broker in the Securities Exchange Act of 1934 – A Small Entity Compliance Guide*
- FRB Philadelphia SRC Insights: *Regulation R: Is Your Bank in Compliance?* (Fourth Quarter 2009)

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APPENDIX - B

Insurance Protection

Evaluate the Board's level of insurance protection afforded the institution. Consider the following:

- Blanket bond and related coverage should exceed the minimum required for commercial operations in accordance with vault and custody obligations including the trust function.
- Consideration should be given fiduciary errors and omissions and other related coverage (e.g. blanket real estate coverage and mailing or shipping coverage) based on the character of the institution's trust business.
- Ensure the amount of fiduciary coverage is adequate.

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APPENDIX C

Alternate Rating of Earnings

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

Rating No. 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 administrating those services.

Rating No. 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.

Rating No. 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.

Rating No. 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.

Rating No. 5 — may be assigned if the institution has implemented none of the standards.

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APPENDIX - D

Conflicts and Abuses

Consider the following:

1. Is the institution achieving the best possible securities trading services for its accounts in the context of the needs of its account beneficiaries? Does management consider:
   - Broker's financial condition?
   - Quality of execution and ability to handle specialized transactions?
   - Quality of research received, if applicable?
2. In selecting agents, dealers, brokers, etc., does the institution avoid selection of firms where there is an interest or connection between the institution and such individuals or organizations as might affect the exercise of the best judgment of the institution in effecting the dealings (i.e. selection of firms based upon loan or deposit relationships with an affiliated bank)?
3. Where the volume of activity warrants, is allocation of brokerage business controlled through an approved list which is periodically reviewed and approved by the Board or an appropriate senior committee?
4. Are there procedures to monitor or periodically survey available negotiated commission prices in order to ascertain reasonable costs for the execution requirements?
5. If the institution is paying higher than the "lowest" available negotiated commissions for the executions in order to receive goods and/or services, have/has:
   - Such goods and/or services been determined to reasonably qualify as brokerage and research services as defined in Section 28(e)(3) of the Securities Exchange Act of 1934?
   - An appropriate committee reviewed the arrangement within the last year to determine that the value of goods and services justifies the payment of the higher brokerage commissions?
   - Procedures been adopted to assure the higher commissions are paid only by accounts over which the institution exercises investment discretion; or alternatively, has the institution determined that a program of disclosures and/or consents is sufficient to permit charging the higher commissions to nondiscretionary accounts as well?
6. Are 12b-1 fees and other mutual fund related fees disclosed as required by law?
7. In accounts for which the institution has full investment authority, does it refrain from purchasing securities of an issue if proceeds of the sale are to be used to pay an indebtedness of an obligor of the institution?
8. When multiple investment transactions are conducted, is the allocation of securities and prices equitable among the accounts?

Cash Management and Own-Bank Deposits

Note: Uninvested cash refers to cash in an account that is awaiting permanent investment or distribution. Cash management refers to the effective and efficient management of cash held in fiduciary accounts.

Cash Management Practices – Determine the following:

- Is there an automated cash management program which automatically sweeps uninvested and available cash balances into one or more short-term investment vehicles?
- Does the system minimize the dollar amount and length of time in which cash is left uninvested?
- Does the institution fully utilize currently available cash management systems and techniques for all accounts where it has the normal fiduciary duty to render assets productive?
- Do the short-term vehicles utilized bear a reasonable rate of return for day-to-day investments and permit a high degree of liquidity, together with an assured preservation of principal?
- What types of cash management vehicles are utilized by the institution: money market mutual funds or deposits, repurchase agreements, corporate variable master notes, etc?
- Have any new cash management products been adopted since the last examination? If so, ensure that adequate financial monitoring practices are utilized with respect to obligors and issuers of assets.
- Do the institution's advertising and marketing practices avoid violation of restrictions on the promotion of cash management programs or vehicles as retail investment devices?
- Is there a formal system for monitoring and reviewing uninvested funds?

Own-Bank and Affiliate Deposits - Determine the following:

- Are own-bank or affiliate deposits being purchased as permanent investments? If so, is the deposit a suitable investment for the account, made in compliance with the governing document, and/or directed in writing by the beneficiary?
- Are the own-bank and/or affiliate deposits in compliance with Section 113.057 of the Texas Property Code?
- Have own-bank and/or affiliate deposit totals changed significantly since the last examination? If yes, does the difference make sense in view of changes in the account portfolio (i.e., growth), economic conditions, and/or special needs of specific accounts (i.e. liquidity)?

Holdings of Stock

Assess whether holdings are in compliance with Section 117 of the Texas Property Code. Determine the following:

- Does the institution have policies and procedures relating to the retention and voting of its own securities? Evaluate their effectiveness.
- Are the voting rights of own-bank shares passed on to beneficiaries where possible?

- Are there methods to ensure that, where necessary, the trustee votes the own-bank shares solely in the best interest of the beneficiaries?

Compliance with Rule 10b-5 of the Securities and Exchange Commission

Consider the following:

- Does the list of the largest common stock holdings and/or the "buy list" have stocks in common with those held by outside interests of officers or directors?
- What level of research and other procedures and circumstances relate to any mutual holdings?
- Do procedures sufficiently incorporate the best interests of beneficiaries in determining whether to:
  (1) Sell securities to outsiders in takeover bids?
  (2) Risk accentuating a declining market in securities of such companies by selling them?
  (3) Support such companies in proxy contests?
  (4) Approve securities of such companies for purchase?

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