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Handbook: Trust and Asset Management
Subject: Introduction to Individual Retirements Accounts — **Section: 160**

Individual Retirement Accounts

Summary: This Regulatory Bulletin announces a new Section to the "Specialty Examinations" Chapter in the Trust and Asset Management Handbook. The new Specialty Examinations Section is Section 160, Introduction to Individual Retirement Accounts.

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Regulatory Bulletin 38-03

SUMMARY OF CHANGES

OTS is issuing a new Section to the "Specialty Examination" Chapter of the Trust and Asset Management Handbook. The new Section 160, Introduction to Individual Retirement Accounts, provides examiners with a program to examine an institution's administration of Individual Retirement Accounts.

Background

Individual Retirement Accounts (IRAs) – IRAs are personal retirement plans created or organized in the United States for the exclusive benefit of an individual. They must be in the form of a trust or custodial account and they must satisfy all the requirements outlined in Section 408 of the Internal Revenue Code (IRC) as well as related tax regulations. Many savings associations offer individual retirement account services to their customers. A savings association will provide these services in one of two capacities, "trustee" or "custodian." Savings associations never need fiduciary powers when acting as a custodian to IRA or any other types of accounts. OTS regulations, at 12 C.F.R. § 550.580, permit savings associations to act as trustee of IRA accounts established under Section 408(a) of the IRC without having fiduciary powers, under certain circumstances. If the savings association does not have fiduciary powers it must still observe prin-

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ciples of sound fiduciary administration, including those related to recordkeeping and segregation of assets. If the IRA accounts are invested in securities products, then the institution acting as trustee or custodian must meet all the conditions of the statutory exceptions or regulatory exemptions in section 3(a)(4)(B) of the Securities Exchange Act of 1934 or Regulation R.

— *Thomas A. Barnes*
Deputy Director
Examinations, Supervision, and Consumer Protection

Introduction to Individual Retirement Accounts

This section addresses the administration of Individual Retirement Accounts (IRA). IRAs are personal retirement plans created or organized in the United States for the exclusive benefit of an individual. They must be in the form of a trust or custodial account and they must satisfy all the requirements outlined in Section 408 of the Internal Revenue Code (IRC) as well as related tax regulations. The laws and regulations have been changed numerous times over the years so it is always best to check the most recent version of Section 408 as well as related regulations to see if the IRA accounts meet the conditions specified in the IRC and regulations. The Department of Labor (DOL) does not have jurisdiction over nonemployer sponsored IRAs as they do not fall under Title I of the Employee Retirement Income Security Act (ERISA). However, the DOL has been given authority to issue interpretations of Section 4975 of the IRC involving prohibited transactions of IRAs. There are some prohibited transaction class exemptions issued jointly by the DOL and the IRS involving IRAs and advisory opinions issued by the DOL, discussed later on in this section. Simplified Employee Pension (SEP) IRAs established by an employer under Section 408(k) of the IRC are subject to ERISA Sections 404 and 406 covering fiduciary responsibility and prohibited transactions. Savings associations must have fiduciary powers in order to be either a trustee or custodian for SEP IRA accounts. This section does not apply to SEP IRAs.

LINKS

Program

IRAs have several tax advantages, such as:

- Contributions made to an IRA may be fully or partially deductible, depending on which type of IRA is established and on the circumstances of the individual, and

- Generally, amounts in an IRA account (including earnings and gains) are not taxed until distributed. In some cases, amounts are not taxed at all if distributed according to the rules.

Many savings associations offer individual retirement account services to their customers. A savings association will provide these services in one of two capacities, "trustee" or "custodian." In order to determine if the savings association is serving as trustee or custodian of an IRA account, look at the form used to establish the IRA account. The top line of Form 5305, an IRS Form that is a model trust agreement states – "Traditional Individual Retirement Trust Account." The top line of Form 5305-A, another IRS Form that is a model custodian account states – "Traditional Individual Retirement Custodial Account." The language in the two forms is identical except one uses the term trustee and the other uses the term custodian.

Savings associations never need fiduciary powers when acting as a custodian to IRA or any other types of accounts. OTS regulations, at 12 CFR § 550.580, permit savings associations to act as trustee of IRA accounts established under Section 408(a) of the IRC without having fiduciary powers. If the savings association does not have fiduciary powers, it must limit the investments of the IRA account to its own depository products, its debts or securities, or it may only act in a directed capacity under 12 CFR § 550.600(b). A directed trustee does not make investment decisions or provide any investment advice; it simply follows the investment directions of the IRA accountholder. When a savings association is acting in a directed capacity it generally will allow the IRA accountholder to invest the assets of the IRA account in bank deposits, stocks, bonds, or mutual funds.

If the savings association does not have fiduciary powers it must still observe principles of sound fiduciary administration, including those related to recordkeeping and segregation of assets (12 CFR § 550.590). Savings associations without fiduciary powers must also abide by the rules of fiduciary conduct established in IRS regulations at 26 CFR § 1.408-2(e)(5) relating to:

- The administration of accounts – The owners or directors of the savings association will be responsible for the proper administration of accounts. A written record will be made of the acceptance and of the relinquishment or closing out of all IRA accounts and of the assets held for each account. All employees taking part in the performance of IRA duties will be adequately bonded. Legal counsel shall be employed or retained to be readily available.

- Audits – At least once during each 12-month period, there will be a detailed audit by a qualified public accountant of the savings association's books and records relating to IRA accounts.

- Funds awaiting investment or distribution – Funds held in an IRA account by the savings association awaiting investment or distribution will not be held uninvested or undistributed any longer than is reasonably necessary for the proper management of the account.

- Custody of investments – The investments of each account will not be commingled with any other property except for investments in a collective investment fund. Assets of accounts requiring safekeeping will be deposited in an adequate vault. A record will be kept of assets deposited in or withdrawn from the vault.

- Collective investment funds – The assets of an account may be pooled in a collective investment fund.

- Books and records – Records of the IRA accounts must be kept separate and distinct from other records. An adequate record must be kept of all pending litigation relating to IRA accounts to which the savings association is a party.

Savings associations with fiduciary powers often provide investment advice or investment management to IRA accountholders, particularly for rollover IRA accounts. A rollover IRA account is established when a customer withdraws cash or other assets from a retirement plan and contributes those assets within 60 days to another eligible retirement plan (such as an IRA account). This often happens when an individual retires with a 401(k), 403(b) or 457 retirement plan and chooses or is required to transfer the assets of that plan into an IRA account. Many financial experts encourage retirees to rollover in order to gain maximum control over their retirement funds, particularly when the company retirement plan has limited investment choices or high fees.

TYPES OF IRAS

There are two primary types of nonemployer sponsored IRAs, traditional IRAs and Roth IRAs. Traditional IRAs are generally funded by individual contributions which may or may not be tax deductible. Distributions are taxable income to the recipient. Contributions to Roth IRAs are on an after tax basis and distributions are generally tax free. Traditional IRAs are subject to various minimum distribution rules when the owner attains age 70½ or dies. There are no minimum distribution rules with Roth IRAs while the owner is alive. With both types of IRAs there are various eligibility and contribution limits.

CONTRIBUTION LIMITS

Annual contributions to traditional IRAs are generally tax deductible for the owner. This is not tax avoidance; it is only a deferral as distributions are taxable income to the owner or beneficiary. If the owner is not covered by another qualified retirement plan, contributions are always deductible. If the owner is covered by a qualified plan, there are certain income limits which are adjusted based on inflation. For Roth IRAs, contributions are never deductible. There are limits on the amount of annual income the owner may have and if he or she exceeds this amount, they may be limited or precluded from making a contribution. Additionally, there are annual contribution limits based on the owner's age for all forms of IRAs. Because these various limits are adjusted based on inflation, please refer to current IRS guidance for the specific limits in any given year. The contribution limitations apply to all IRA accounts an individual may possess regardless of the type. An individual may apportion the total annual limit among two or more accounts, but the overall limit may not be exceeded.

Generally, contributions to an IRA must be in cash. The only exception is for rollovers from a qualified plan or another IRA. Any other contribution of property would constitute a prohibited transaction.

ROLLOVERS

A rollover is a tax free distribution to the accountholder of cash or other assets from one retirement plan that is subsequently contributed to another retirement plan. Both traditional and Roth IRAs may accept rollovers from qualified employee benefit retirement plans, such as a 401(k) plan, a 403(b) or 457 plan. With traditional IRAs, this is generally a tax free event; however, the owner will be subject to taxation in the year of the rollover for rollovers to a Roth IRA.

Rollovers can be made by direct transfer from the trustee of the qualified plan to the IRA or by the plan issuing the funds to the participant who then has 60 days to place them in the rollover IRA. If the later option is used, the qualified plan must withhold 20% of the distribution for income taxes. The account holder would then have to obtain these funds from a different source in order to avoid some of the distribution being taxable.

Distributions

Distributions from traditional IRAs are taxable events to the recipient. Additionally, if the owner takes distributions prior to attaining the age of 59½, these distributions are generally subject to a 10% penalty tax. There are several exceptions to the penalty tax that may be applicable. Again, these rules have historically been subject to adjustments and modifications, so refer to current IRS guidance for the latest rules.

For traditional IRAs, the owner must begin taking required minimum distributions on an annual basis by April 1 of the year following the year he or she turns 70½. This is known as the required beginning date. If there are no distributions or the distributions are not large enough, a 50% excise tax on the amount not distributed may be imposed. The required minimum distributions are based on the individual's life expectancy as determined by IRS tables and the value of the account as of December 31 of the preceding year.

In the event the owner dies before his or her required beginning date, the rules vary based on whether the beneficiary is the IRA owner's spouse and on whether a beneficiary was named in the IRA agreement.

If the beneficiary is the IRA owner's spouse, the spouse has the option of leaving the funds in the deceased spouse's IRA and taking distributions based on the decedent's required beginning date or rolling the funds into his or her own IRA and taking distributions based on his or her own required beginning date.

If the decedent is named in the IRA agreement, distributions are based on the beneficiaries' life expectancy in the year of the owner's death reduced by one for each year after the year of death. Distributions generally begin in the year following the decedent's death.

When no beneficiary is named or an estate or trust is named, the entire account must be distributed by December 31 of the fifth year following the owner's death.

If death occurs after the owner's required beginning date, distributions are based on the longer of the beneficiary's life expectancy or the life expectancy of the decedent at the time of death, again reduced by one for each year after the year of death.

For Roth IRAs, the owner is never required to take a distribution, but beneficiaries (other than the owners' spouse) are subject to the distribution rules.

Investments

The trustee or custodian of any IRA may act in a directed capacity or may have investment responsibilities. In order for a trustee or custodian that is subject to OTS supervision to have investment authority, it must have been granted fiduciary powers by OTS. In the event the account is managed, the IRA agreement or a second ancillary agreement should clearly define the duties and responsibilities of both the savings association and the account holder. For those accounts where the institution has investment responsibility, the OTS fiduciary regulations at 12 CFR Part 550 apply.

Generally, an IRA can hold assets similar to those held by traditional trusts, but there are exceptions. Most notably, IRAs are strictly prohibited from holding life insurance and most collectables under Section 408(a)(3) of the IRC. There is an exception in Section 408(m)(3) for bullion coins issued by the United States or any state therein.

It is critical that all IRA investments be registered or titled in the name of the IRA or a nominee name for the IRA trustee. In addition, the IRA trustee must take possession of the evidence of ownership of that property. At the closing of a purchase of property for example, the representative of the IRA trustee should be present, sign the necessary documents, and present a check drawn from the IRA. If the IRA account holder were to purchase the property and have the property titled in his or her own name and then want to place the investment into the IRA account, a prohibited transaction would occur because the IRA account holder would be seen as selling the investment to his or her IRA.

The trustee or custodian is free to impose more restrictive investment rules under its policies and can substantially limit the types of assets the account can hold as investments. Savings associations, whether they are trustee or custodian of the IRA account, have a responsibility to provide a fair market value of the IRA assets at the end of each year. Consequently, they should make sure they are appropriately compensated or the IRA account has adequate liquid assets to pay for an appraisal of investments such as real estate, private placement limited partnerships, and closely held stocks. These assets are generally not actively traded and present a challenge in determining a fair market value.

Examiners should note that although IRA account assets are permitted under Section 408(a)(5) of the IRC and the OCC's rules at 12 CFR § 9.18 to be invested in bank collective investment funds, such investments would trigger problems for the collective fund under the securities laws. The Securities and Exchange Commission (SEC) has stated that if IRA account assets are invested in a collective fund, the fund will be considered in violation of the Securities Exchange Act of 1933 ('33 Act) and the Investment Company Act of 1940 ('40 Act) unless the collective fund is registered with the SEC as an investment company (mutual fund) under the '40 Act and the shares registered as securities under the '33 Act.

Certain investments could generate unrelated business taxable income (UBTI) resulting in the IRA paying income taxes at trust rates. IRA trustees and custodians are responsible for filing Form 990-T and paying unrelated business taxable income from the IRA. An IRA can generate UBTI in one of two ways:

- Operation of a business – An example would be where the IRA account holder wants to direct his or her IRA to purchase and operate a franchise. If that franchise generates more than $1,000 per year in income, the IRA trustee/custodian would be required to file Form 990-T and pay taxes on that income.

- Debt financed income – If an IRA uses debt to enhance its investment returns, earnings attributable to that debt are subject to the UBTI tax. An example would be where the IRA account holder directs the IRA trustee to purchase unimproved real estate in his or her IRA and then borrow against that real estate to make improvements to the property. In such a case, the earnings attributable to that debt would be subject to the UBTI tax.

PROHIBITED TRANSACTIONS

Section 408(e)(2) of the IRC states that IRAs are exempt from taxation unless there is a violation of the prohibited transaction rules in Section 4975. These prohibited transaction rules are similar to the prohibited transaction rules of qualified retirement plans under ERISA. Section 4975 prohibits an IRA from engaging in prohibited transactions with "disqualified persons," which are defined similarly to "parties in interest" under ERISA. These rules generally preclude the owner of an IRA and certain relatives of both the owner and his or her spouse from having any involvement with the IRA holdings other than directing investments.

Because the prohibited transaction rules of Section 4975 apply to all IRA accounts, certain investments such as real estate, although permissible, should be avoided as they create a greater likelihood that a prohibited transaction could take place. For example, an IRA can own individual parcels of real estate, but the IRA account holder and certain family members cannot have any involvement with the real estate. The account holder cannot live on it or act as the property manager. Even certain seemingly inconsequential acts by the account holder such as clearing debris off of the land may result in a prohibited transaction and the property could be deemed distributed to the owner.

An IRA can both borrow in its individual capacity and make loans to other individuals or entities, but there are specific limitations on each. If the IRA borrows funds, the loan cannot be secured by any assets held outside of the IRA and may not be guaranteed by the account holder or certain family members. Additionally, the IRA account holder may not pledge the account as security for a personal loan. Failure to follow these rules will result in a prohibited transaction.

An IRA may act as a lender, but again subject to strict rules. Loans may not be made to the account holder or certain members of the account holder's family. The account holder may not benefit in any way from the loan. Any such activity by an IRA should be well documented.

There are two prohibited transaction class exemptions relating to financial institutions and IRA accounts. These class exemptions are described below:

Prohibited Transaction Exemption (PTE) 93-1 (sometimes referred to as the free toaster exemption) – permits individuals to receive cash, premiums, or other consideration paid by a financial institution in connection with the establishment of or the additional contributions to an IRA or a Keogh Plan (retirement plan for a self-employed individual), provided that certain conditions are met. The conditions must be met in order for individuals not to have their IRAs lose their tax exempt status due to a violation of the prohibited transaction provisions of Section 4975. The conditions are:

- The IRA or Keogh Plan in connection with which cash, property, or other consideration is given, is established solely to benefit the participant, his or her spouse and their beneficiaries;

- The cash, property, or other consideration is given only in connection with the establishment of the IRA or Keogh Plan or the making of an additional contribution, including the transfer of assets from another plan, to an existing IRA or Keogh Plan;

- During any taxable year, the total of the fair market value of the property or other consideration to the sponsor of the IRA or Keogh Plan, and the cash received is not more than: (1) $10 for deposits to the IRA or Keogh Plan of less than $5,000; and (2) $20 for deposits to the IRA or Keogh Plan of $5,000 or more.

- In any case where the consideration provided by a financial institution to an individual for whose benefit an IRA or Keogh Plan is established or maintained, is group term life insurance, the limitations above shall not apply to the provision of such insurance if, during any taxable year, no more than $5,000 of the face value of the insurance is attributable on a dollar for dollar basis to the assets of the IRA or Keogh Plan.

Prohibited Transaction Exemption (PTE) 93-33 – permits individuals to receive services at reduced or no cost from a financial institution when the deposit balances of the individual's IRA, Keogh or Simplified Employee Pension (SEP) (pension plan subject to Title I of ERISA) account are taken into consideration for purposes of determining eligibility to receive banking services at reduced or no cost (relationship banking). There are several conditions that must be met in order for individuals not to have their IRAs lose their tax exempt status due to a violation of the prohibited transaction provisions of Section 4975 and Section 406 of ERISA. The conditions are:

- The IRA, Keogh, or SEP, the deposit balance of which is taken into account for purposes of determining eligibility to receive services at reduced or no cost, is established and maintained for the exclusive purpose of the participant covered under the IRA, Keogh, or SEP Plan, his or her spouse or their beneficiaries;

- The services must be of the type that the bank itself could offer consistent with applicable federal and state banking law;

- The services are provide by the bank (or an affiliate of the bank) in the ordinary course of the bank's business to customers who qualify for reduced or no cost banking services but do not maintain an IRA, Keogh or SEP plan with the bank.

- For purpose of determining eligibility to receive services at reduced or no cost, the deposit balance required by the bank for the IRA or Keogh Plan is equal to the lowest balance required for any other type of account which the bank includes to determine eligibility to receive reduced or no cost services;

- The rate of return on the IRA, Keogh, or SEP Plan investment is no less favorable than the rate of return on an identical investment that could have been made at the same time at the same branch of the bank by a customer of the bank who is not eligible for (or who does not receive) reduced or no cost services.

The Department of Labor has issued several advisory opinions regarding IRA accounts. Some of the more recent advisory opinions that may be of relevance to financial institutions are listed below:

- Advisory Opinion 2005-10A issued May 11, 2005 – When fees received by a bank or an affiliate, in connection with investments in certain mutual funds by IRAs or other qualified retirement plans, are offset against management fees charged by the bank to the plans, would the receipt and offset avoid prohibited transactions under Code section 4975(c)(1)(E) or (F)?

- Advisory Opinion 2000-10A issued July 27, 2000 – Whether allowing the owner of an IRA to direct the IRA to invest in a limited partnership, in which relatives and the IRA owner in his individual capacity are partners, will violate section 4975 of the Code?

Reporting and Disclosure Requirements

Form 5498 – Section 408(i) of the IRC and 26 CFR § 1.408-5 requires the trustee of an IRA to make certain annual reports regarding the account to the Secretary of the Treasury and to the individual for whom such account is maintained. The report must contain information with respect to contributions and distributions aggregating $10 or more in any calendar year. The report must be furnished to individuals no later than January 31 of each year and to the IRS by June 1. Internal Revenue Service Form 5498 is the prescribed form for satisfying the annual reporting requirements of 408(i) of the IRC. Form 5498 requires the trustee to provide a fair market value of the IRA account assets as of December 31. This is a relatively easy task for traditional investments such as bank accounts and marketable securities. It becomes much more difficult when unique assets are involved such as real estate, notes receivable, limited partnerships, and securities issued by closely held corporations. According to an IRS interpretive letter issued to Partnership Valuations, Inc. dated February 24, 1993 the trustee or custodian is responsible for determining the fair market value of the IRA account assets and can't evade valuation responsibility by having the participant sign a release, indemnification or other waiver.

Form W-2P or Form 1099-R – Under 26 CFR § 1.408-7, the trustee of an IRA who makes a distribution during any calendar year to an individual from such account shall make a report on Form W-2P (in the case of distributions that are not total distributions) or Form 1099-R (in the case of total distributions). The report must show the name and address of the person to whom the distribution was made, the aggregate amount of such distribution, and such other information as is required on the form. A copy of the form must be given to the individual receiving the distribution by January 31 and a copy to the IRS by the end of February.

Statement of Required Minimum Distribution – Under 26 CFR § 1.408-8 Q-10, trustees and custodians of an IRA are required to report information to the IRA account holder with respect to the minimum amount required to be distributed from the IRA each calendar year. More information regarding the minimum distribution reporting requirement was furnished by the IRS in Notice 2002-27. In accordance with this notice, if a minimum distribution is required with respect to an IRA for a calendar year and the IRA owner is alive at the beginning of the year, the trustee/custodian that held the IRA as of December 31 of the prior year must provide a statement to the IRA owner by January 31 of the calendar year regarding the required minimum distribution in accordance with one of two alternatives.

Alternative One – An IRA trustee/custodian furnishes the IRA owner with a statement of the amount of the required minimum distribution with respect to the IRA for the calendar year and the date by which such amount must be distributed.

Alternative Two – An IRA trustee/custodian provides a statement to the IRA owner that: (1) Informs the IRA owner that a minimum distribution with respect to the IRA is required for the calendar year and the date by which such amount must be distributed and (2) includes an offer to furnish the IRA owner, upon request, with a calculation of the amount of the required minimum distribution with respect to the IRA for that calendar year.

Under both alternatives, the statement must also inform the IRA owner that the trustee/custodian will be reporting to the IRS (on Form 5498) that the IRA owner is required to receive a minimum distribution for the calendar year.

Disclosure Statement – Under 26 CFR 1.408-6(d)(4)(ii)(A)(1), the trustee or custodian of an IRA account shall furnish a disclosure statement and a copy of the trust agreement to the IRA account holder at least 7 days prior to the earlier of the date of establishment or purchase of the IRA account. However, the trustee/custodian does not have to give the IRA account holder the disclosure statement until the date the IRA account is established or purchased, provided the IRA account holder is given at least 7 days from that date to revoke the IRA. The trustee/custodian may choose to provide the IRA account holder with an IRS publication that contains the required disclosure information in lieu of providing a disclosure statement. If the disclosure statement and the copy of the trust agreement are mailed, then the regulations will deem the individual to have received the information 7 days after the date of mailing. The disclosure statement must explain certain items in plain language. For example, the statement should explain when and how the IRA may be revoked, including the name, address, and telephone number of the person to receive the notice of cancellation. This explanation must appear at the beginning of the disclosure statement.

Regulation R

Historically, banks enjoyed a blanket exemption from being required to register as a broker-dealer even though they engaged in securities activities. This was changed by the Gramm-Leach-Bliley Act (GLBA) and the Financial Services Regulatory Relief Act of 2006 (FSRRA) and now banks and federal savings associations must fit their securities activities under at least one of the various statutory exceptions or regulatory exemptions in order not to be required to register as a broker-dealer. In 2007, the Federal Reserve Board and the Securities and Exchange Commission issued rules that provided definitions to various terms in the statutory exceptions and also provided additional exemptions. These rules are known as Regulation R (Reg. R). Savings associations that continue to engage in securities activities that do not meet the conditions contained in the various exceptions and exemptions or are outside of the exceptions or exemptions must register with the SEC as a broker-dealer. What constitutes securities activities is quite broad.

Examiners need to have a basic understanding of Reg. R in order to recognize when it is applicable and to determine if the savings association meets the conditions contained in the various exceptions and exemptions.

Federal savings associations that offer services to individual retirement accounts that are invested in securities such as stocks, bonds, or mutual funds are subject to Reg. R and will be required to register as a broker-dealer unless the IRA activities comply with the terms of one of the statutory exceptions or regulatory exemptions. Which statutory exception or regulatory exemption may be utilized by the savings association will depend on whether the savings association is designated as the trustee or custodian of the IRA. In order to determine if the savings association is serving as trustee or custodian of its IRAs, look to the top line of the model trust form that the savings association is utilizing.

If the savings association is a custodian that takes trading or investment orders from the IRA owner then it should utilize the safekeeping and custody exemption found in Regulation R.

If the savings association is a trustee, and takes direction from the IRA owner as to investment orders then it has a choice of utilizing the statutory trust activities exception (with terms defined by Regulation R) or the safekeeping and custody exemption found in Regulation R. The statutory trust activities exception may be utilized by savings associations even if they do not have fiduciary powers issued by OTS.

More details regarding Reg. R are located in other sections of the Trust and Asset Management.

EXAMINATION OBJECTIVES

To determine the adequacy and/or effectiveness of the administration of individual retirement accounts. Consider whether:

- Effective policies, procedures and internal controls have been established.
- Management and staff are knowledgeable.
- Actions and decisions are documented and supported.
- Deficiencies are identified and promptly corrected.

EXAMINATION PROCEDURES — WKP. REF.

LEVEL I

Level I procedures first focus on a review of the examination scoping materials. The next step consists of interviews with IRA account personnel to confirm their qualifications and levels of expertise; determine if the department's practices conform to written guidelines; establish whether any significant changes in personnel, operations or business practices have occurred; and determine whether new products or services have been introduced. If items of concern are uncovered during Level I procedures, or if problems are identified during the preexamination monitoring and scoping, the examiner may need to perform certain Level II procedures.

1. Review examination scoping materials related to the provision of products and services to individual retirement accounts. Scoping material should include:

   - Savings association's risk profile.
   - Relevant PERK documents.
   - Previous examination report.
   - Work papers from the previous examination.
   - Copies of any prototype agreements or forms used by the savings association.
   - Board of Directors and other applicable committee minutes.

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- Complaint and litigation files.

2. Review Board and committee minutes to determine if decisions and actions are appropriately documented.

3. Review policies, procedures and practices related to the provision of products and/or services to individual retirement accounts and note any changes since the previous examination. Determine their adequacy relating to:

- Preacceptance process regarding disclosures and review of account assets, particularly of accounts invested in unique assets.
- Administration of accounts (including acceptance of contributions, payment of account expenses, tax withholding where appropriate, investment allocation instructions, calculation of minimum required distributions, and providing disclosures).
- Periodic account reviews, both administrative and, when applicable, investment.
- Savings association's investment policy.
- Identification of disqualified persons, preventing, correcting, and reporting prohibited transactions.
- The filing of Form 5498, 1099-R, or other required forms.
- Valuation of holdings.
- Termination of accounts.
- Use of proprietary products in discretionary accounts.
- Compliance with IRS and OTS law and regulations including OTS fiduciary regulations (where applicable) or IRS fiduciary conduct regulations.

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4. Determine the nature and extent of compliance and audit department review or oversight related to the provision of products and/or services to individual retirement accounts. Determine if compliance and audit reviews are effective. Review applicable compliance and audit reports. Note any material deficiencies and corrective actions.

5. Determine the type, investments, and volumes of individual retirement accounts. Identify any significant changes as well as any changes in product or service offerings since the previous examination.

6. Assess whether management and staff have the expertise to effectively support the provision of products and services to individual retirement accounts. Note any significant changes in personnel since the previous examination.

7. If administrative or investment functions have been outsourced to third parties, assess the selection and oversight process. Review the servicing contracts to ensure that all activities are covered including the fee arrangements.

8. Assess the review process for use of prototype documents.

9. If in a community property state, determine that policies and procedures require spousal consent if someone other than the spouse is designated as beneficiary.

10. Consider whether the following risk contributors (if applicable) have been addressed:

- Administrative policies, procedures, and practices are consistently applied.
- Comprehensive risk management, audit, and compliance systems include IRAs

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and are established and utilized effectively.

- Management reports are generated and utilized appropriately.
- Management and administrative personnel are familiar with account details.
- Sufficient documentation is maintained.

11. If IRA account assets are invested in securities, determine if policies and procedures have been adopted that address compliance with broker-dealer exceptions and exemptions. Also determine if there is adequate documentation to demonstrate compliance with broker-dealer exceptions and exemptions.

The completion of the Level I procedures may provide sufficient information to make a determination that no further examination procedures are necessary. If no determination can be made, proceed to Level II.

LEVEL II

Level II procedures focus on an analysis of IRA account documents. The examiner should complete the appropriate Level II procedures when the completion of Level I procedures do not reveal adequate information on which to base a conclusion that the institution meets the examination objectives. Neither the Level I nor the Level II procedures involve significant verification.

12. Select a sample of accounts for review. A suggested sample might include a selection of new, seasoned and closed accounts or coverage from different administrative personnel or business locations. Also consider in the sample accounts holding unique assets, accounts for which complaints have been lodged with the savings association or accounts that exhibit identifiable concerns. Determine if:

    - Preacceptance process regarding disclosures and review of account assets was followed, particularly of accounts invested in unique assets.

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- Administration of accounts follows policies and procedures (including acceptance of contributions, payment of account expenses, tax withholding where appropriate, investment allocation instructions, calculation of minimum required distributions, and providing disclosures).
- Correct filing of Form 5498, 1099-R, or other required forms.

13. If unique assets are held, assess the procedures for performing annual valuations.

14. Review and verify the accuracy of any applicable management exception reports. Evaluate management's expediency in handling exceptions.

15. Evaluate the procedures for notifying account owners and beneficiaries who have reached their required beginning date of their minimum required distribution amount.

16. Ensure that the savings association has a policy for ensuring that all nonsavings association parties who handle funds or other property under the control of the savings association are bonded.

17. Evaluate the process for determining that prohibitied transactions are not taking place and how they are addressed if they occur.

18. Review the process for certifying the information required by the trustee or custodian to file a Form 5498, including account valuations.

19. If accounts make personal loans to individuals or entities, evaluate the process for administering the loan and repayment. Consider if:

- Proper direction was obtained in writing.

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- A written loan agreement is in place.
- The proceeds were not advanced to the account owner or other disqualified person, either directly or indirectly.
- Adequate books and records are maintained.
- Interest is in compliance with applicable usary laws.
- Delinquencies are monitored and the possibility of a prohibited transaction is considered.

20. If any accounts hold individual parcels of real estate, evaluate the overall administration process. Determine if:

- Proper directions are on file to acquire the property.
- Title has been obtained and recorded in the name of the instition as trustee or custodian of the account.
- Appropriate annual valuations are obtained.
- Adequate books and records are maintained.
- The owner/beneficiary or other disqualifed person is not engaging in activities that would constitute a prohibited transaction.

21. Evaluate the procedures for paying expenses of IRA accounts.

22. Determine if adequate information is obtained and maintained on the owner and beneficiaries, including obtaining proper identification and performance of Office of Foreign Assets Control (OFAC) checks.

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23. Review the complaint and litigation logs regarding IRA accounts to determine if there are systemic problems in the administration of IRA accounts.

If the examiner cannot rely on the Level I and Level II procedures or data contained in department records or internal or external audit reports to form a conclusion, proceed to Level III.

LEVEL III

Level III procedures include verification procedures that auditors usually perform. Although certain situations may require that Level III procedures be completed, it is not the standard practice of the Office of Thrift Supervision (OTS) examination staff to duplicate or substitute for the testing performed by auditors.

24. Determine that only cash is accepted as a contribution unless it is a rollover from a qualified plan or another individual retirement account.

25. Determine whether the savings association has exclusive authority and discretion to control and manage the assets of accounts. If it does not, ensure that the account expressly states who will be responsible for directing investments.

26. Review new accounts to determine whether adequate account acceptance procedures are utilized, committee approvals are obtained, necessary documents are acquired, and synoptic information sheets are prepared.

27. For self directed accounts, determine that appropriate direction was obtained for investment activity, that it was properly documented, and is consistent with institution policy and applicable law.

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28. Review accounts that utilize third-party administrators or are directed by other named fiduciaries or investment managers. Determine whether necessary authorizations or directions are obtained and on file, that they are proper according to the terms of the account, and in compliance with applicable law.

29. Review file documents to ensure that initial, annual, and closing account reviews are complete, adequately documented, and performed in a timely manner.

30. Review asset holdings and account activities for prohibited transactions. If prohibited transactions are identified, determine if an exemption exists, and procedures are in effect to assure compliance with the exemptions. If no exemption exists, assess management's efforts to remedy the situation.

31. Review closed accounts or plans to determine whether accounts were closed in accordance with established procedures and supported by documentation. Ensure that assets have been transferred in a timely manner.

32. For managed accounts, determine that investments are in compliance with investment policy and that asset allocations are within appropriate parameters.

33. Review for impermissible asset investments. Determine that no prohibited investments are held, including collectibles and life insurance.

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34. Select accounts reviewed by the audit and/or compliance functions and determine if the findings of the audit/compliance review are consistent with examination findings.

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EXAMINER'S UITRS RATING, SUMMARY, CONCLUSIONS AND RECOMMENDATIONS:

REFERENCES - 160P

Law

Internal Revenue Code	Section 408
	Section 4975

Employee Retirement Income Security Act of 1974 (ERISA)

Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)

Economic Growth and Tax Relief Reconciliation Act of 2001

Pension Protection Act of 2006

Worker, Retiree, and Employer Recovery Act of 2008

Code of Federal Regulations

12 CFR 218	Regulation R
12 CFR 550	Trust Powers (General)
26 CFR 408	Administration of IRA Accounts

Office of Thrift Supervision Publications

FHLBB Resolution 86-277	Exercise of Trust Powers

Other

IRS Publication 1048

IRS Publication 590

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WORK PAPER ATTACHMENTS - 160P

Optional Topic Questions

The following list of questions is offered merely as a tool and reference for the examiner and is not a required part of the examination process.

Preacceptance Review

• Do policies and procedures require that specific documents be obtained in order for an account to be opened and that specific disclosures are to be given to the customer?
• Is the nature and complexity of the account considered, including the ability of personnel to properly administer it and the type of asset investment?
• Are real or potential conflicts of interest considered?
• Is the potential profitability of the account considered?
• Is an account opening checklist used?
• When real estate is an investment, are potential environmental issues considered?

Account Acceptance

• Have guidelines for account acceptance been established?
• Are the assets of all new accounts reviewed within 60 days of acceptance?
• Does the board of directors or its designated committee approve all new accounts?
• Is the approval documented in the appropriate minutes?
• Are original or certified copies of governing instruments obtained?
• Are other supporting documents obtained as necessary?

Successor Appointments

• Is proof obtained of the prior institution's removal or resignation?
• Are the prior institution's activities reviewed?
• Are procedures in place to ensure that all assets have been received?
• Does the department obtain indemnification from the prior institution and/or the account owner or beneficiaries for prior activities?

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• Is an account statement obtained from the prior institution indicating a zero balance in the account?

Account Administration

• Do procedures employ documentation checklists for opening and closing accounts?
• Do procedures ensure that proxies are voted solely in the best interests of account beneficiaries?
• Are tickler files maintained relating to the preparation and timely execution of future duties?
• Are adequate controls in place to ensure the timely recording of assets and liabilities received?
• Is a written agreement in place for each plan?
• Are proper and timely written authorizations from those whose approval or direction may be required for various actions, maintained?
• Is appropriate evidence of ownership timely obtained for all assets held?
• Are required notifications timely filed or distributed?
• Are appropriate approvals by the board of directors or its designated committee obtained and documented?
• Do procedures require obtaining appropriately executed account documents?
• Are procedures and controls in place to identify and review tax filing requirements for accounts and is the tax information entered into the institution's recordkeeping system on a timely basis?
• Are closed accounts removed from the accounting system on a timely basis?
• Is there evidence in the board or committee minutes indicating that each account was formally accepted?
• Is there evidence that timely annual administrative reviews are performed?
• Is there evidence that timely investment reviews are performed annually when required?
• Are there specific procedures for annually valuing the holdings of each account?

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Account Reviews

• When applicable, are procedures in place to ensure that annual account reviews are timely performed?
• Are closed accounts timely reviewed and ratified by the board of directors or a designated committee?
• Are account reviews sufficiently documented and approved?

Terminations

• Is proper documentation obtained at the time an account is closed?
• Do procedures require that assets be timely distributed?
• Are receipts obtained and maintained when assets are transferred?
• Are account closings reviewed and termination approvals recorded in appropriate committee minutes?
• Are closed accounts promptly removed from the institution's accounting system?

Prohibited Transactions

• Does the institution have procedures to identify persons or entities that are disqualified persons as defined by the Internal Revenue Code?
• Are only permitted investments held in accounts?
• Did transactions with a disqualified person involved the: — Sale, exchange or lease of property? — Lending of money or other extension of credit? — Furnishing of goods, services or facilities? — Transfer to, or use of assets by or for the benefit of such party?
• Did the institution: — Deal with account assets for its own account or in its own interest? — Act in any capacity involving an account on behalf of a party whose interests are adverse to those of the account owner or beneficiaries? — Identify and monitor disqualified persons?
• Do any accounts hold life insurance contracts?

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• Is the account owner using the account property for personal benefit or gain from activities outside of the account?
• Are only permitted investments held by the accounts?
• If the savings association offers premiums, "finder's fees," or related incentives to third parties in connection with establishing IRA accounts, does it conform to conditions specified by the OTS, DOL and IRS for such payments?

Investment Management

• Does the trust department act as investment manager for account assets?
• Are policies and procedures adequate for services rendered?
• Does the policy outline the overall investment philosophy and standards of practice?
• Does the policy outline standard safeguards against conflicts of interest and self-dealing?
• Does the policy discuss the process for the use of proprietary or affiliated products in discretionary accounts?
• Does the policy discuss overall portfolio guidelines regarding percentage distribution among types of investments relative to account objectives?
• Does the policy outline standards and procedures to evaluate and monitor asset quality?
• Does the policy outline the process and criteria for selecting and evaluating potential investments?
• Does the policy outline the process for monitoring existing investments?
• Does the policy outline the documentation requirements to support investment decisions?
• Does the policy discuss diversification guidelines and requirements?
• Does the policy establish standards for the acceptance and disposition of substandard assets?
• Does the policy outline the standards for developing and amending approved lists of investments?
• Does the policy address the requirements for authorization and clearance of account overdrafts?

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• Does the policy establish standards for the selection and use of broker-dealers?
• Does the policy outline the process for voting proxies for investments held in managed accounts?
• Does the policy outline the process for approving deviations from established policy guidelines, as well as a process for monitoring policy deviations?
• Are timely initial and annual reviews performed?

Investment Objectives

• Does the investment selection process consider income and liquidity requirements, tax status, beneficiary ages, account termination date, customer preference and other items?
• Does the process provide for an investment action plan to achieve investment goals, including the restructuring and disposition of assets?
• Are changes to strategies or account objectives tracked to ensure implementation?
• Is the development and implementation of specific investment strategies to meet stated investment objectives timely?
• Is the review and monitoring of investment strategies according to policy?
• Do deviations from approved investment strategies require authorization and approval?

Unique Investments

• Do any accounts hold nontraditional or unique investments such as collectibles, real estate, limited partnerships, personal loans, closely held interests, etc.?
• Is there proper direction on file for these investments?
• Are these investments properly valued annually?
• If real estate is involved, does the account owner have any involvement with the property?
• Does the fee generated justify the services provided?
• Are any collectible holdings limited to authorized bullion coins?
• If personal loans are held, is the loan performing as agreed?
• Is there any unrelated business income derived from carrying on a business or engaging in debt financing?

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Regulation R

• Have policies and procedures been adopted addressing Reg. R?
• If the institution serves as trustee of the individual accounts, are annual calculations timely performed to determine that it is chiefly compensated as a result of relationship compensation unless the alternate test (also applicable when serving as custodian) is used?
• Are chiefly compensated calculations performed within 60 days of calendar yearend?
• If chiefly compensated calculation is performed on an individual account basis, is the relationship compensation at least 50% of total compensation?
• If chiefly compensated calculation is performed on all accounts collectively, is the relationship compensation at least 70% of total compensation?
• If serving as custodian (or as trustee and elect to use this test in lieu of the chiefly compensated test), has the institution determined that it acts solely in a directed capacity, all trades are placed through a registered broker-dealer, and no employee receives compensation that is correlated to the account, its holdings, or its performance?
• Are the results of these tests properly documented?

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