

This document and any attachments are superseded by Comptroller's Handbook - Personal Fiduciary Services.

Introduction to Personal & Court Accounts

This section addresses a trust department's compliance with applicable laws and regulations, standards of fiduciary conduct and internally established policies and procedures relating to the administration of personal and court accounts. Policies and procedures should be evaluated in light of the size and character of the institution's trust and asset management business.

Risks associated with account administration are potentially unlimited because each account is a separate contractual relationship that contains specific duties, responsibilities and obligations. Risks associated with account administration may stem from failure to comply with applicable law and standards of fiduciary conduct, inadequate account administration practices, inexperienced management or inadequately trained staff.

Personal Trust Accounts

A trust is a fiduciary relationship by which legal title and the responsibility of ownership of assets is held by a person or corporation (the trustee) for the benefit of those holding an equitable interest in the assets (the beneficiaries).

Personal trust accounts can be broadly classified as **living** or **testamentary** and as either **revocable** or **irrevocable**. A living trust (also called an *inter vivos* trust or a trust under agreement) is created by voluntary agreement between a living person (grantor/settlor) and a trustee and becomes operative during the lifetime of the grantor. A testamentary trust (also called a trust under will) is created under the provisions of a person's (testator's) will and becomes operative only upon the death of the testator. A revocable trust is one in which the grantor reserves the right to terminate the trust at any time and have the trust property transferred back to his or her possession. In an irrevocable trust, the grantor cannot change any of the terms of the trust or revoke the trust. The benefit to the grantor of an irrevocable trust is that property placed within the trust moves out of the grantor's estate. It is the trust most commonly used for estate planning purposes.

Acceptance

A trust department is under neither a moral nor a legal obligation to accept all business that it is offered. 12 CFR §550.200 requires that prior to accepting a prospective fiduciary account, a trust department must determine whether it can properly administer the account. Trust departments should have written acceptance policies that are reviewed and approved by the board of directors or their designee. Among the specific factors to be considered when deciding whether to accept a trust are:

- whether the service can be provided at a profit to the department;
- the types of assets in the account;
- the legal sufficiency and administrative complexity of the account;
- whether any nonstandard duties are or will be imposed upon the trustee;
- whether any real or potential conflicts of interest exist; and

- whether the trust department has sufficient expertise to administer the account and appropriately invest the account's assets.

Criticism of acceptance policies should normally be limited to the absence of formalized policies or lack of emphasis placed on the preceding acceptable factors. Examiners should recognize that intangible factors might be involved in accepting an account. For example, an account may be accepted because of the customer's deposit relationship with a savings association. The extent to which these intangible factors should be criticized depends on the institution's ability to handle the accounts accepted under such circumstances and their overall effect on the department. These "special" accounts should be reviewed with an eye to: the number of such accounts; the profitability of the accounts; whether trust management has any voice in the acceptance process; available resources to administer the accounts; and the extent of the variation from stated acceptance policies.

Successor Trustee

A trust department may be asked or appointed to act as successor trustee in the event the original trustee is removed or is unable or unwilling to continue to act. Serving in this capacity may subject the institution to an additional source of liability stemming from the acts of the prior trustee. Therefore, a primary consideration prior to acceptance of such an account should be to ensure that appropriate steps are taken to avoid liability for actions of the prior trustee. Although a successor trustee is generally not liable for a breach of trust committed by a prior trustee, the successor may be liable if it knew or should have known of the breach and permitted it to continue, or if it neglects to take prompt action to compel the prior trustee to remedy breach. It is therefore essential that the trust department perform a due diligence review of all account activities prior to the time of its successor appointment. If the review discloses improper administration, the savings association should either: (1) refuse to accept the appointment, or (2) take immediate steps to protect the account beneficiaries by asserting liability against the prior trustee. The savings association may also request appropriate releases from liability from the court or from all beneficiaries to further protect itself from liability caused by the prior trustee. A written record should be maintained documenting the performance of a due diligence review and that appropriate measures were taken to protect both the account and the savings association against liability from actions of prior trustees.

Promptly upon acceptance, the board or its committee should determine the needs and objectives of the account and begin to structure the investments accordingly. In addition, under OTS regulation §550.210, if the savings association has investment discretion, it should conduct a prompt review of the assets held by the account and evaluate whether they are appropriate, both individually and collectively.

Conformity With Legal Requirements

The administration of personal trust accounts is primarily controlled by the terms of the governing instrument, generally a will, trust agreement or court order. State statutes and some federal laws control when the governing instrument is silent. There also exists a common law of trusts that has developed over time to help determine trustee responsibilities when neither statute nor the governing instrument address a particular issue.

Federal and state statutes and regulations govern the overall conduct of trustees (e.g., investment duties under the prudent investor or prudent man rule, the respective state version of the Uniform Principal and Income Act, the provisions of the HOLA and 12 CFR §550). They also govern the activities and the assets held that are incidental to trust and asset management activities (e.g., the federal securities laws govern securities activities, the Internal Revenue Code addresses taxation, consumer protection laws regulate lending

activities). Further, some of these laws and regulations are applicable to all trustees, while others, such as state financial codes, are applicable only to financial institutions acting as a trustee within that respective state. Applicable laws and regulations are discussed in further detail in Section 120 of this handbook.

The governing instrument will generally spell out the powers and duties of the trustee. In the absence of clearly defined provisions in the governing instrument, state statutes regarding the trustee's powers and duties would apply. A trustee's powers can be express or implied. Powers are express if they are granted by the instrument, the order or statute. They are implied if their exercise can be inferred as being necessary or appropriate to carry out the purpose of the trust. A trustee's powers can also be discretionary or nondiscretionary. A power is discretionary if the trustee is given authority to act without direction or approval from another party. It is nondiscretionary when another party has the authority to direct the trustee to perform certain acts. Among the most commonly granted trustee's powers are:

- Those pertaining to the retention, purchase and sale of assets;
- Those pertaining to distributions of principal and income cash;
- Those pertaining to the management of property, such as the power to lease real estate; and
- Those pertaining to the trustee's bookkeeping, accounting and safekeeping responsibilities. This may include the power to hold securities in nominee name, the power to vote securities by proxy and the power to deposit assets in an outside depository.

When two or more individuals or corporations participate in the administration of a trust or the settlement of an estate, they are known as cofiduciaries, cotrustees or coexecutors. It is uncommon for the grantor or a family member to be appointed cotrustee with a savings association, which trustee has a responsibility to participate in the administration of an account but ordinarily is liable only for its own actions. A corporate trustee is often held to a higher standard of care than an individual trustee. As a matter of sound policy and to protect itself against possible liability in a cotrustee situation, the savings association should maintain copies of all correspondence with cotrustees and obtain approvals from them for all discretionary actions.

Failure to comply with state and federal laws and regulations, common law or the terms of the governing instrument can result in financial losses to accounts and, in turn, to the savings association since it may be required to cover the losses. In addition, adverse publicity relating to the losses can damage the institution's reputation to the point that it may lead to a loss of business.

A will or trust instrument may include an exculpatory clause that attempts to relieve a trustee from certain liabilities. However, a trustee is not always protected by such a provision and it does not protect trustees from a breach of trust or actions that are illegal. In some states, courts have held that such provisions are void, thereby providing no protection for the savings association. Some states, however, have passed statutes affording limited protection to a trustee, such as protection to a successor trustee from acts of its predecessor(s).

Duties and Responsibilities

A trust department is subject to a number of duties and responsibilities arising as a result of its trustee relationship with its customers. In terms of account administration, one duty deserving of special mention is the responsibility to properly allocate receipts and expenses between principal and income in a personal trust account.

The provisions of the governing instrument for a personal trust often provide for the specific distribution of income and principal to two classes of beneficiaries. The two classes include income beneficiaries, who are to receive the income from the trust property and remainder beneficiaries, who are to receive the principal of the trust. During the account administration period, the trustee credits the receipt of income and debits the payment of expenses to the income or principal accounts of the trust. Receipts and expenses are to be allocated according to the terms of the governing instrument. If the governing instrument is silent, allocation is made in accordance with state statute. If state statute does not address the situation, allocations are made in accordance with case law. Finally, if there is no applicable case law, the trustee must determine what is reasonable and prudent.

In most states, the state's version of the Uniform, or Revised Uniform Principal and Income Act governs the trustee's duties regarding income and expense allocation. Generally, money received for the use of trust property or as a gain from the property is to be treated as trust income (e.g., ordinary receipts such as rents, dividends and interest). Substitutes for the trust property that amount to changes in form are to be considered trust principal (e.g., proceeds from the sale or exchange of assets). Special rules govern the allocation of some types of income, such as corporate distributions in the form of extraordinary dividends.

The most effective and commonly used method of insuring that the respective interests of income and remainder beneficiaries are kept separate is to maintain separate ledger accounts within the trust account for income and principal items. Except for standard accounting purposes, separate ledger accounts are not needed if no distinction is required for income and principal items or where the income and principal beneficiaries are the same person. For example, agencies and states generally do not require segregation of income and principal cash. Likewise, employee benefit accounts do not require a separate accounting for income and principal cash.

Termination

A personal trust closes at a specified time or upon the occurrence of a specified event. Typical closing triggers include: the trust's objectives being met, the death of the beneficiary (ie, the attainment of a specified date, the beneficiary(ies) reaching a specific age, or the exhaustion of trust principal. When these events occur, the trustee is responsible for terminating the account, distributing any remaining assets and preparing and filing required reports. In most states, a trust's duration is governed by the rule against perpetuities (21 years past the last beneficiary's death, plus 9 months). Some states, however, have recently repealed that rule, giving trusts in those states no legal ending date.

The governing instrument controls the form of asset distribution. Some require that all assets be liquidated and others require certain distributions of assets in kind. If the instrument is silent as to the form of distribution, the trustee is governed by state statute or the prudent exercise of discretion. The trustee is responsible for producing a schedule of distribution which includes information such as assets and their current fair market value, the method of distribution and each beneficiary's share of the assets and the trust's tax liability. State statutes may require filings with the court which would generate a release of the trustee from its obligations. Often, and particularly in the case of small, noncomplex trust accounts, the account may be closed with receipt and release agreements.

Court Accounts

There are two primary types of court accounts administered by a trust department, estates and guardianships. Estates consist of executor (named in a will and appointed by the court) and administrator (appointed by the court without a will) appointments for deceased individuals. Guardianships, which include conservator

appointments, are established for living persons. In an estate, the department is responsible for a decedent's assets from the time of death until a court approves the final settlement. In a guardianship, the trust department is responsible for conserving and managing the assets of a minor, a person suffering a legal disability such as incompetence or a person who is absent or unknown. The administration of estates and guardianships is supervised by a court (typically called a probate, surrogate or orphan's court) that reviews and approves all acts of the institution relating to the assets in the account. Court supervision is designed to protect the interests of deceased, minor, incompetent or unknown persons. The considerations involved in accepting court accounts are similar to those regarding personal trust accounts.

Estates

Although administration of an estate differs in many respects from the administration of a personal trust, the basic principle of sound fiduciary conduct applies to both and is demanded by the courts. Thus, the duties and responsibilities of a department acting as executor or administrator are governed by the provisions of the decedent's will, state probate code, court order and sound fiduciary principles.

The trust department's primary duty and responsibility is to identify and protect all assets belonging to the estate. The department is also under a duty to collect obligations owed to the decedent and to pay obligations of the decedent. After proper notices have been published and claims filed, the department pays the claims in the order of their priority to the extent of assets available. The department may have to sell assets for the purpose of paying expenses or making requested cash distributions. An executor or administrator generally has full power to sell assets of the estate without obtaining court permission. The department is also required to render full and accurate accountings of its activities to the court. The format and time of the accounting are generally governed by state statute. Finally, the executor is responsible for filing and paying any federal and state income, estate and inheritance taxes.

The department's discretionary powers in estates are generally more limited than in trust accounts. For example, prior approval of the court is required for many transactions and the detailed accountings referred to above must be submitted to the court periodically. The department's investment responsibility is primarily to preserve the assets in anticipation of prompt distribution, not look to make them productive. However, if due to complexity or legal impediments the administration of an account is expected to last for several years, the department would be expected to make the estate's assets productive.

A final settlement should be filed as soon as the assets of the estate have been fully administered. Once the various tax returns have been filed, the taxes paid and appropriate closing letters received from the taxing authorities, the estate assets can usually be distributed and the account closed. The distribution is made to those persons or organizations designated in the will or under a controlling state statute. The department then files its final settlement and at the same time petitions the court to approve the final distribution of the assets. If acceptable, the court will then enter an order of discharge.

Guardianships

Under a guardianship arrangement, the ward (the person for which the guardianship was originally established) is the beneficial owner of the property and the trust department, acting as guardian, receives all powers and duties from the court. The duties of a guardian are similar to those of a trustee. Specifically, the guardian is obligated to:

- protect and preserve the assets;
- submit an inventory and appraisal to the court;

- retain or invest assets;
- use income and principal for the benefit of the ward; and
- submit an annual accounting to the court.

Investment limitations are often delineated by statute and any exceptions require court approval.

The guardianship terminates on the death of the ward, when a minor reaches legal age or when a court declares the ward competent.

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Personal and Court Accounts Examination Program

Examination Objectives

To determine the adequacy and effectiveness of the trust department's administration of personal and court accounts. Consider whether:

- Effective policies, procedures and internal controls have been established;
- Expertise is available to administer the accounts;
- There is adequate documentation regarding administrative and investment decisions. The documentation should include all communication between the trust department, the beneficiaries and other interested parties;
- Policies and procedures have been established to ensure compliance with governing instruments, applicable law and accepted fiduciary principles; and
- Deficiencies are identified and corrective action promptly initiated.

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 trust department personnel to confirm their qualifications and levels of expertise to: determine if the trust department's practices conform to written guidelines; establish whether any significant changes in personnel, operations or business practices have occurred; or whether new products and/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 administration of personal and court accounts. Scoping material should include:
 - Risk profile
 - Relevant PERK documents
 - Previous trust and asset management examination report

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- Workpapers from the previous examination
- Examination reports of subordinate, functionally regulated entities
- Board of director and other applicable committee minutes
- Complaint and litigation files

2. Review the master list or account ledger(s) to determine account types and volumes being administered. Determine any changes in product offerings since the previous examination. Determine whether required approvals, notifications or registrations have been filed.

3. Review policies, procedures and internal controls related to the administration of personal and court accounts, noting any changes since the last examination. Determine the adequacy of policies and procedures, given the number and size of personal and court accounts, including:

- acceptance of accounts;
- administration of accounts (including cofiduciary and directed accounts); and
- termination of accounts.

4. Is there sufficient expertise to carry out administrative functions in accordance with existing policies and procedures? Identify and note any changes in personnel responsible for the administration of personal and court accounts.

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5. Consider whether the following risk contributors have been appropriately addressed:
- Has the board implemented appropriate policies, procedures and internal controls covering all facets of account administration?
 - Have comprehensive and effective audit, compliance and risk management processes been established?
 - Does management exhibit the appropriate level of expertise to ensure compliance with applicable law and accepted fiduciary principles?
 - Are appropriate management reporting systems in place?
 - Does the trust department exhibit consistency in account administrative practices?
 - Are standards in place governing account documentation?

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 trust department documents such as reports and outsourcing contracts. The examiner should complete the appropriate Level II procedures when the completion of Level I procedures does not reveal adequate information on which to base a conclusion that the trust department meets the examination objectives. Neither the Level I nor the Level II procedures include any significant verification procedures.

1. Review new business production (including both accepted and rejected accounts). Determine whether policies require that the trust department perform a preacceptance review of accounts prior to acceptance. Interview management to ensure the actual practice is consistent with stated policies.

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2. Interview management to determine whether account approval procedures are used, committee approvals are obtained, necessary documents are acquired and synoptic records are prepared consistent with policies and procedures.

3. Review successor appointment policies and procedures to determine whether acts of prior fiduciaries are reviewed, assets are properly received and appropriate documentation is obtained.

4. Review cofiduciary, directed and escrow account policies and procedures to determine whether necessary authorizations or directions are obtained and on file.

5. Review closed account policies and procedures to determine if there are established procedures for closing accounts and if reasons for closing are noted. Determine if the policies ensure that assets are transferred in a timely manner.

6. Review committee minutes to ensure that initial, annual and closing account reviews are adequately performed and documented in a timely manner consistent with internal policies and procedures and OTS regulations.

7. Review policies and procedures for estates to ensure that state probate laws are followed as appropriate. Also ensure that the policies address the timely filing of tax returns.

8. Are procedures in place to gain immediate physical control over the decedent's real and personal property? Are dual control procedures followed with respect to negotiable items, collectibles, safe deposit contents and other valuable property?

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9. Are procedures in place to ensure that all items in the estate inventory are promptly recorded on the books of the account?

10. If necessary to validate an assertion, finding or concern arising from the completion of the Level I and II procedures, judgmentally select a limited number of accounts for review considering the degree of risk to the institution. Not all types of accounts need to be reviewed to arrive at a well-founded conclusion.

If the examiner cannot rely on the trust and asset management Level I or Level II procedures, or data contained in department records or internal or external audit reports, 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.

1. Select a sample of personal and court accounts for review. Ensure that the sample contains all types of accounts, including a selection of new, seasoned and closed accounts and provides coverage of all administrative personnel and all business locations. If necessary, select additional accounts considering:
 - accounts in which litigation is pending or has been threatened, and accounts for which complaints have been lodged with the institution;
 - accounts reviewed internally which exhibit identifiable concerns; and
 - accounts holding large investments in illiquid or unusual assets.
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2. From the sample, review account administration practices to determine compliance with terms of the governing instruments, applicable law, accepted fiduciary principles as well as conformance with policies and procedures.

3. Review accounts to determine that receipts and disbursements are received and processed appropriately.

4. Review accounts to determine conformance with policies and procedures relating to discretionary distributions.

5. Review accounts to determine that appropriate documentation is maintained supporting all account transactions. Determine accuracy of customer account statements.

6. Review accounts for conflicts of interest or preferential treatment to insiders or affiliates.

7. Review estates to determine whether any have remained in the process of settlement for an extended period of time, and if so, determine why.

8. Review discretionary account investments with regard to adherence to approved lists, diversification and the meeting of account objectives. Also review accounts with restricted investment clauses to determine compliance with the terms of the governing instruments.

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9. Review a selection of closed accounts to determine if the accounts were closed in accordance with established procedures and the assets transferred in a timely manner.

10. Review successor trusteeships to ensure that acts of prior fiduciaries are adequately reviewed and indemnification is obtained from the prior trustee or account beneficiaries.

Examiner's UITRS Rating, Summary, Conclusions and Recommendations:

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References - 720P

Laws

HOLA Section 5(n), Trusts

Code of Federal Regulations

12 CFR 550 Trust Powers (General)
12 CFR 550.200-220 Review of Fiduciary Accounts
12 CFR 550.410 Recordkeeping

Office of Thrift Supervision Publications

Other

Prudent Person Rule
Prudent Investor Rule

Workpaper Attachments - 720P

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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

<ul style="list-style-type: none">• Do policies and procedures identify documentation requirements for the preacceptance account review?
<ul style="list-style-type: none">• Does the preacceptance process consider the type and character of account assets relative to administrative complexity and the institution's expertise?
<ul style="list-style-type: none">• Does the preacceptance review consider provisions of the governing instrument, relative to legal sufficiency, administrative complexity and any unusual duties imposed?
<ul style="list-style-type: none">• Does the preacceptance review consider whether the account can be administered to achieve the purpose for which it was established?
<ul style="list-style-type: none">• Does the review identify any real or potential conflicts?
<ul style="list-style-type: none">• Is the potential profitability of the account considered?
<ul style="list-style-type: none">• Are environmental risks and other liabilities for assets such as real property and closely held business interests identified?

Account Approval

<ul style="list-style-type: none">• Does the board of directors approve all new accounts?
<ul style="list-style-type: none">• If the board of directors does not approve all new accounts, has there been proper delegation of acceptance authority to a committee or individual officers, with guidelines established for decision-making?
<ul style="list-style-type: none">• Is there documentation of approvals in appropriate minutes, reports or files?
<ul style="list-style-type: none">• Has the trust department obtained the appropriate executed account documents?

Successor Appointments

<ul style="list-style-type: none">• Is proof obtained of the prior trustee's removal or resignation?
<ul style="list-style-type: none">• Are original or certified copies of governing instruments obtained?
<ul style="list-style-type: none">• Does the trust department verify that all governing documents and essential supporting documentation have been received?
<ul style="list-style-type: none">• Do trust department personnel obtain and review accountings by prior trustee(s)?
<ul style="list-style-type: none">• Is a reconciliation performed to ensure that all assets, as well as any income, have been received?
<ul style="list-style-type: none">• Does the trust department obtain indemnification from the prior trustee or the account beneficiaries for activities of the prior trustee?

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Closed Accounts

<ul style="list-style-type: none">• Are proper account documents, such as death certificates, final accountings, court discharges, directions to terminate and trustee releases on file?
<ul style="list-style-type: none">• Are there procedures requiring the timely distribution of assets?
<ul style="list-style-type: none">• Are receipts obtained and maintained for the delivery of account assets?
<ul style="list-style-type: none">• Are account closing reviews and termination approvals recorded in appropriate committee minutes?
<ul style="list-style-type: none">• Are closed accounts promptly removed from the trust accounting system?

Account Reviews

<ul style="list-style-type: none">• For new accounts, are procedures in place to ensure that an initial review is performed within 60 days of receipt of assets?
<ul style="list-style-type: none">• Are procedures in place to ensure that annual account reviews are performed in a timely and orderly manner?
<ul style="list-style-type: none">• Are annual reviews documented and reviewed by senior management and the board of directors (or their designated committee)?
<ul style="list-style-type: none">• During the annual review, are investment objectives updated?

Account Administration

<ul style="list-style-type: none">• Do procedures employ documentation checklists for opening and closing accounts?
<ul style="list-style-type: none">• Do procedures ensure that proxies are voted solely in the best interests of account beneficiaries?
<ul style="list-style-type: none">• Are tickler files maintained relating to the preparation and timely execution of future duties?
<ul style="list-style-type: none">• Are adequate controls in place to ensure the timely recording of assets and liabilities received?
<ul style="list-style-type: none">• Is evidence of appointment, such as trust or agency agreements, wills, letters of office from the court or similar documentation, maintained?
<ul style="list-style-type: none">• Are proper and timely written authorizations from cofiduciaries or others whose approval or direction may be required for various actions, maintained?
<ul style="list-style-type: none">• Do procedures ensure accuracy of income and principal allocation, as appropriate?
<ul style="list-style-type: none">• Are timely filings of accountings with the court, principals, grantors, trustees or beneficiaries made?
<ul style="list-style-type: none">• Are appropriate approvals by the board of directors or its designated committee obtained and documented?
<ul style="list-style-type: none">• Do procedures require obtaining appropriate executed account documents?
<ul style="list-style-type: none">• Are procedures and controls in place to identify and review tax filing requirements for accounts and is the tax information entered into the trust systems on a timely basis?
<ul style="list-style-type: none">• Are closed accounts removed from the tax accounting system on a timely basis?
<ul style="list-style-type: none">• Has the savings association established the proper amount of quarterly taxes due and are they being filed on a timely basis?

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<ul style="list-style-type: none">• Are federal and state estate taxes paid within the time limits required by the Internal Revenue Code and state law?
<ul style="list-style-type: none">• For estates, are fair market values of the estate assets obtained?
<ul style="list-style-type: none">• Are the effects of the Generation Skipping Tax on distributions to younger generations being taken into consideration?
<ul style="list-style-type: none">• Do policies and procedures address the handling of late taxes and the penalties and interest assessed to them?
<ul style="list-style-type: none">• Does management review tax returns prepared by an outside service provider prior to actual filing?
<ul style="list-style-type: none">• Are potentially escheatable assets properly identified and controlled?

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