OCC 2008-10
OCC BULLETIN

Comptroller of the Currency
Administrator of National Banks

Subject: **Fiduciary Activities of National Banks**

Description: **Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6 (c)**

Date: March 27, 2008

TO: Chief Executive Officers of National Banks, Department and Division Heads, Examining Personnel, and Other Interested Parties

Background and Purpose

The Office of the Comptroller of the Currency (OCC) is providing guidance to national banks on the annual review requirement contained in OCC fiduciary regulation 12 CFR 9.6(c). Under the regulation, at least once during every calendar year, a national bank is required to conduct a review of all assets of each fiduciary account for which the bank has investment discretion to evaluate whether they are appropriate, individually and collectively, for the account. These annual reviews are commonly referred to as "annual investment reviews."

The OCC has developed this guidance to clarify the agency's expectations for the depth and breadth of annual investment reviews. Specifically, the guidance will:

- Identify information that should be considered in a bank's annual investment review process;
- Address the importance of ensuring that all account assets, including unique and hard-to-value assets, are reviewed for appropriateness and consistency with account investment objectives;
- Provide information on the different types of reviews currently used by the industry, including an overview of their strengths and limitations; and
- Emphasize the need for thorough documentation of reviews and a strong "exception" tracking system.

Elements of an Effective Annual Investment Review Process

In addition to being a regulatory requirement, annual investment reviews are among the most useful tools bank fiduciaries have to ensure they meet their fiduciary responsibilities and properly administer their customers' accounts. An annual investment review is a point-in-time evaluation of both account assets and objectives. Regardless of the tools employed by a particular institution, management supervision, information systems, and follow-up are all critical to an effective investment review process. An effective investment review process should be based upon policies and procedures that provide clear standards for scope, documentation, and exception reporting and tracking. The process should:

- Ensure that account investment objectives are current and appropriate, and that investments are consistent with those objectives.
- Ensure that the investment review provides for an annual assessment of the portfolio in its entirety. This is particularly important when unique assets make up a portion of the account.
- Include exception tracking that identifies and provides for follow up and resolution of exceptions such as securities not included on “approved” or “retention” lists, assets posing potential conflicts of interest, or asset concentrations.
- Include performance measurements and a process for handling performance outliers.
- Ensure that each asset is valued using an appropriate valuation process.

Exception tracking systems are essential to a strong investment review process. An effective tracking system should provide notification to management of items such as investment reviews coming due, identification of reviews that are past due, and realistic time frames for implementing corrective action. The bank should have a process for reporting and escalating issues/exceptions to appropriate management or committee levels. Exceptions should be properly addressed and corrective action should be implemented in a timely manner. Any waivers granted by administrators or portfolio managers should be based upon clearly defined parameters.

Unique or hard-to-value assets such as real estate, oil, gas and mineral interests, farms and ranches, timberland, closely held businesses, loans, and personal property should be included as part of the annual investment review. The review of these assets should:

- Be sufficiently detailed to document the bank’s determination that the asset is appropriate for the investment objectives of the account and should be retained.
- Include a careful review of Asset Retention letters because these investment directions can require a bank to hold assets that may be inconsistent with the bank’s investment strategies. A bank should accept Asset Retention letters only from authorized parties.
- Provide updated asset valuations appropriate for the type of asset and nature of account.[1]
- Ensure that proper insurance coverage is maintained on assets that warrant protection.

Various types of assets, including unique assets, held in a single account may be reviewed at different times. However, the investment review process must ensure that an assessment of the account as a whole is made at least annually. This is particularly important when unique assets make up a substantial portion of the account.

Appropriate document retention policies and procedures should be in place to ensure that the bank maintains adequate documentation of each annual investment review. This will provide evidence of the bank’s review process in the event complaints are lodged against the fiduciary, or litigation issues arise.

Automated and Manual Investment Review Processes

The annual investment review process has evolved over time. In an effort to increase efficiencies, many banks are increasing their use of automation to facilitate investment reviews. Some banks have acquired investment review packages from vendors, while others have developed their own in-house systems. Some automated systems have the ability to screen an account's marketable securities on a daily basis. Many banks use hybrid processes that encompass features of both automated and traditional manual investment reviews.
A manual investment review process provides a more hands-on approach to investment reviews. Marketable securities and unique assets are usually reviewed at the same time, which can allow for more dialogue among administrators, portfolio managers, and unique asset managers. However, manual reviews can be more labor intensive, and some banks use a risk-based approach that relies upon a higher level of oversight (e.g., an asset review committee) for higher risk accounts and asset types, and for accounts with exceptions.

Factors to consider in using a manual review process:

- Manual investment reviews can be time consuming, particularly if the department has a large number of discretionary accounts with an array of unique assets.
- As the number of reviews becomes larger, the risk level becomes higher of a bank's review becoming a "rubber stamp," or of reviews not being completed in a timely manner.
- The quality of reviews may vary with the individual(s) performing the review.

Automated investment reviews can also be a useful investment management and compliance tool. Lower risk accounts, such as those invested in model portfolios comprised of mutual funds or collective investment funds, lend themselves well to an automated process. Automated systems allow marketable securities to be screened efficiently and frequently to identify assets not on an approved list, concentrations, own-bank securities, or accounts with allocations inconsistent with account objectives. While automation can provide efficient identification, reporting, escalation, and ongoing monitoring of many types of exceptions, an automated investment review is not a substitute for good portfolio management or committee oversight and accountability.

Factors to consider in using an automated review process:

- A wholly automated screening process may not provide for the independent perspective customarily provided by an effective committee review process.
- Automated systems may not address whether an account's investment objectives have, or need to be, changed over time.
- If account administrators are not included in the automated investment review process, key information such as account objectives, cash needs, grantor intent, and beneficiary requests may not be properly considered.
- Vendor systems may only identify exceptions to a limited number of pre-set parameters.

Supervisory Considerations
The OCC expects annual 12 CFR 9.6(c) investment reviews to be performed in a timely

and comprehensive manner. Banks may use manual, automated, or a combination of tools to facilitate a review process that complies with the requirements of 12 CFR 9.6 (c). During the normal course of the supervisory process, examiners will evaluate the adequacy of annual investment reviews to determine compliance with the requirements of the regulation and this interpretive guidance. Examiners will seek corrective action for significant weaknesses or unwarranted risks.

Additional Information
For additional information, contact Joseph Sifuentes, National Bank Examiner, Asset Management Group, or Joel Miller, Asset Management Group Leader, at (202) 874-4447.

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Kerri R. Corn
Director for Credit and Market Risk

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[1]For example, valuation of assets in charitable trusts may require appraisals that comply with IRS rules such as Internal Revenue Code Section 6695A. Other rules addressing valuation of real estate or closely held companies may also apply.