Office of the
Comptroller of the Currency

FIRMA National Risk Management Training Conference
OCC Update

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Disclosure

The views and opinions expressed in this presentation are my own, and do not necessarily represent those of the Office of the Comptroller of the Currency or the Senior Deputy Comptroller for Bank Supervision Policy.

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OCC Asset Management Supervision

OCC Asset Management Supervision

- OCC regulates 872 national banks and 310 FSAs.
  - They range from large complex banks with global footprints to local community banks.
  - Includes 55 limited purpose national trust banks and 16 trust only FSAs.
- Approximately 44% of all national banks and 27% of Federal savings associations have Asset Management (AM) activities, which include fiduciary, custody and retail nondeposit services.
- Over 150 examiners with specialized Asset Management expertise perform ongoing supervision.

Based on Active Charters as of 12/31/18

Role of AM Policy

- Asset Management related guidance
  - OCC Bulletins
  - *Comptroller's Handbook* – AM Booklets.
- External outreach
  - Industry Outreach
  - Other regulators
- With OCC Legal, interpret relevant banking laws and regulations; assist examiners with securities, ERISA and tax law issues.
- Support OCC Legal on AM regulatory initiatives.
- Support OCC Licensing on AM matters.
- Support Office of Innovation on AM matters.
- Provide internal training for OCC examiners.
- Support examiners addressing specific bank issues.
- Provide on-site examination support.

Office of the Comptroller of the Currency

Asset Management Risks and Areas of Focus

AM Risks and Areas of Regulatory Focus

- Investment Risks
- Conflicts of Interest
- Retail Non-Deposit Investments
- Fiduciary Audit Expectations
- Custody of Fiduciary Assets
- Delegation of Fiduciary Activities
- Third Party Relationships
- AM Operations

Investment Risk

- Market Volatility
- Interest Rate Risk/Reaching for Return
- Use of complex products
- Liquidity
- Increased Litigation and Reputation risks
- Model Risk Management

Conflicts of Interest

- The duty of loyalty is the duty
  - to administer a trust solely in the interest of the beneficiaries.
  - to not engage in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests.
  - to deal fairly and to communicate to the beneficiary all material facts in connection with the account.
- The OCC Conflicts of Interest HB applies these principles to bank fiduciary activities in the context of applicable laws and regulations, especially 12 CFR 9 - national banks (NBs) and 12 CFR 150 - federal savings associations (FSAs).
- Banks need effective processes to identify and appropriately manage all types of conflicts of interest in order to fulfill their fiduciary obligations and to mitigate legal and reputation risks.

Conflicts of Interest

- Placing client funds for which a bank has investment discretion in proprietary products is, by definition, self-dealing.
- Although self-dealing may be authorized, bank fiduciaries must still demonstrate how proprietary products are appropriate for that client and establish how those products meet the bank's fiduciary obligations to its clients.
- Proprietary products should be subject to the same due diligence standards as third party products.

Retail Non-Deposit Investment Products

- Retail Non-Deposit Investment Products
  - Many banks recommend or sell nondeposit investment products either to retail clients directly or more commonly through arrangements with affiliated or unaffiliated third parties.
  - Banks engage in these activities to enhance client relationships through expanded product offerings, increase fee income, and remain competitive with other banks and financial service providers.
  - Banks should operate their RNDIP sales programs safely and soundly to properly protect retail investors from harm and to control their risk exposures.
  - “Retail Nondeposit Investment Products” booklet of the Comptroller’s Handbook (January 2015)

Retail Non-Deposit Investment Products

- Retail Non-Deposit Investment Program risk factors:
  - Aggressive sales practices
  - Improper use of complex products
  - Weaknesses in determining suitability and improper use of higher-risk products
  - Client misunderstanding of the risks associated with specific products
  - Poor customer service
  - Inadequate resources to implement and oversee the program
  - Sales programs that take advantage of seniors and lower income clients
  - Incentive programs that may encourage improper practices

Retail Non-Deposit Investment Products

- A bank's board and bank management should implement effective program management over the RNDIP sales activities.
- Banks are expected to adopt a written program management statement consistent with the Interagency Statement.
- Risk Management expectations include initial and ongoing due diligence of both affiliated and non-affiliated vendors:
  - Banks should continually assess the vendor's performance by requiring the vendor to provide the bank (at least quarterly) with information regarding: the vendor's sales practices; surveillance results; exception tracking; product & service offerings; customer complaints, litigation/settlements; hiring practices; stability of its sales force; regulatory findings; and compliance issues.
  - Assessment of financial strength and reputation (at least annually).

Fiduciary Audit Expectations

- Annual Audit: A suitable audit of all significant fiduciary activities as least once each calendar year – or –
- A Continuous Audit System – discrete audits of each "significant fiduciary activity" – some more/some less frequently than annually.
- Audit plan should be based on inventory and risk assessment of fiduciary activities, and reflect frequency of discrete audits.
- "Significance" should be determined in the context of a bank's fiduciary activities – not the overall bank or enterprise.

Fiduciary Audit Expectations

- Fiduciary audit work should be performed by qualified persons with fiduciary-specific expertise commensurate with the complexity of the bank's fiduciary activities under the direction of a fiduciary audit committee that:
  - Meets the independence requirements of 12 CFR 9.9 for NBs and 12 CFR 150.470 for FSAs.
  - Approves bank's fiduciary audit plan at least annually, and is apprised of any significant changes or deviations from the plan.
  - Reviews the results of the fiduciary audit, including significant actions taken as a result of the audit. (Must be noted in the minutes of the board of directors.)
  - When an independent party is engaged to perform specified or "agreed-upon procedures" and report findings, the recipients of the report (bank auditor or fiduciary audit committee) should form their own conclusions on the subject matter of the report.

Custody of Fiduciary Assets

- *Control of fiduciary assets (12 CFR 9.13)**

A national bank shall place assets of fiduciary accounts in the joint custody or control of not fewer than two of the fiduciary officers or employees designated for that purpose by the board of directors.

A national bank may maintain the investments of a fiduciary account off-premises, if consistent with applicable law and <u>if the bank maintains adequate safeguards and controls</u>.

A bank that is deemed a fiduciary based solely on its capacity as investment advisor (as that capacity is defined in §9.101(a)) and has no other fiduciary capacity as enumerated in §9.2(e) is not required to serve as custodian when offering those fiduciary services.

* *12 CFR 150.230-245 provides similar requirements for FSAs.*

Delegation of Fiduciary Activities

- OCC regulations and guidance permit banks to use third parties (including affiliated third parties) to perform services related to the bank's exercise of fiduciary powers (12 CFR 9.4).

- Fiduciary activities, whether delegated to third parties, or performed by the bank, are the responsibility of a bank's board of directors.

- Fiduciaries are required to exercise reasonable care, skill, and caution when selecting an agent and establishing the scope and terms of the service performed by the third party. This requires the fiduciary to monitor the agent's performance of the fiduciary activity and compliance with the contract.

- The use of third parties for fiduciary activities requires heightened oversight to ensure that the bank is fulfilling its fiduciary obligations and that it is not engaging in impermissible conflicts of interests.

- Specific guidance for delegation of Investment Management, "Investment Management" booklet of Comptroller's HB, Appendix F.

Third Party Relationships

OCC Bulletin 2013-29 – "Third-Party Relationships: Risk Management Guidance"

- Effective Risk Management includes:
  - plans that outline bank's strategy, identify inherent risks of the activity, and detail how the bank selects, assesses, and oversees the third party.
  - proper due diligence in selecting a third party.
  - written contracts that outline the rights and responsibilities of all parties.
  - ongoing monitoring of the third party's activities and performance.

OCC Bulletin 2013-29 – "Third-Party Relationships: Risk Management Guidance" (Continued)

- Effective Risk Management includes:
  - contingency plans for terminating the relationship in an effective manner.
  - clear roles and responsibilities for overseeing and managing the relationship and risk management process.
  - documentation and reporting that facilitates oversight, accountability, monitoring, and risk management.
  - independent reviews that allow bank management to determine that the bank's process aligns with its strategy and effectively manages risks.

Third Party Relationships

- OCC Bulletin 2017-7, (January 24, 2017) – "Third-Party Relationships: Supplemental Examination Procedures"
  - Tailored to risk and complexity of bank's third-party relationships.
  - Procedures to assess a bank's quantity of risk and quality of risk management, especially over critical service providers.
  - Includes consideration of
    - Service providers' use of subcontractors.
    - Banks' due diligence and ongoing monitoring of financial market utilities.
    - Reg W compliance for affiliated service providers.
    - Conflicts of interest.
  - Focus on risk management throughout the lifecycle of third party relationship.

Third Party Relationships

- OCC Bulletin 2017-21 (June 7, 2017) – "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29"
  - Risk management practices should be commensurate with risk and complexity of third-party relationship, adjusted for risk, and should be periodically reviewed and updated as needed.
  - Highlights bank collaboration for oversight, including user groups.
  - Provides guidance for Fintech relationships.
  - Addresses use of third party compliance management systems.
  - Addresses use of SSAE 18 Service Organization Control Report, especially with respect to third party's oversight of subcontractors to assess whether additional audit or review is required.
  - Addresses bank access to Service Provider ROEs.

AM Operations

- Operational Risk
  - Cyber risks
  - Third party service provider oversight
    - Legacy systems
    - Emerging systems
    - Interconnectedness
  - Service provider consolidation/concentration/conversions
  - AM outsourcing – effective oversight – contract provisions
  - External fraud – Distribution requests/authentication
    - Client email account take-over
  - Internal Controls – fundamental risk management
    - Segregation of duties
    - Joint control/custody (“Maker/Checker”)
    - Logical access controls – consider all systems

Regulatory Developments

Questions?

Appendix I

Asset Management Data

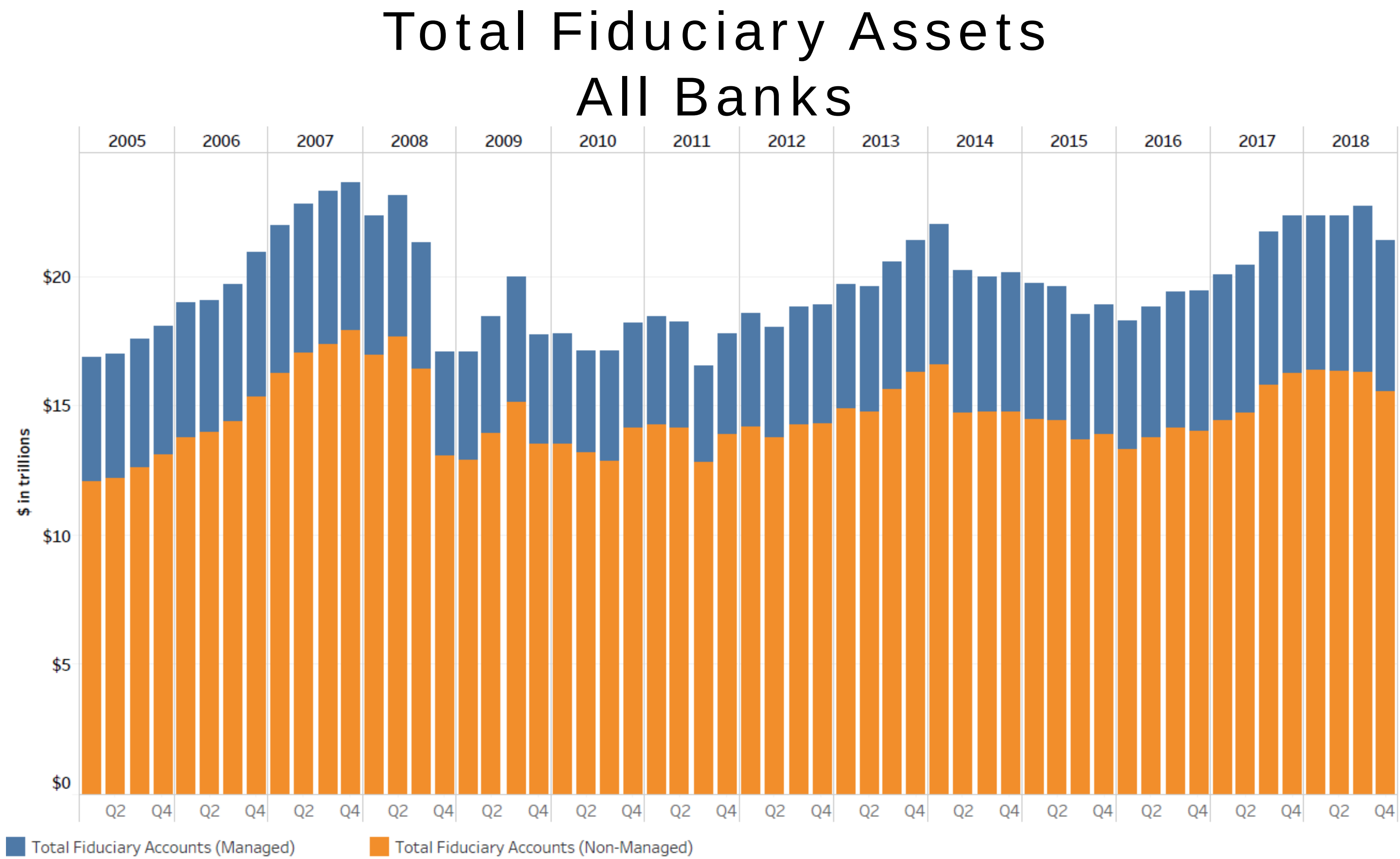
Fiduciary and Custody Assets
All Banks

	Managed	Non-Managed	Total Assets
Personal Trust and Agency Accounts	$694,413,001	$395,779,973	$1,090,192,974
Employee Benefit - Defined Contribution	$1,131,562,161	$2,165,137,242	$3,296,699,403
Employee Benefit - Defined Benefit	$941,478,643	$4,588,918,071	$5,530,396,714
Other Employee Benefit and Retirement Related	$366,474,598	$1,552,972,079	$1,919,446,677
Corporate Trust and Agency Account	$16,343,128	$3,376,273,441	$3,392,616,569
Investment Management and investment Advisory	$2,216,210,129	$209,630,288	$2,425,840,417
Foundation and Endowment	$336,276,881	$258,496,067	$594,772,948
Other Fiduciary Accounts	$107,224,495	$3,022,931,086	$3,130,155,581
Total Fiduciary Accounts	$5,809,983,036	$15,570,138,247	$21,380,121,283
Custody and Safekeeping Accounts		$96,797,681,865	$96,797,681,865
Total Fiduciary & Custody/Safekeeping			$118,177,803,148

$ in thousands

Source: Call Report Schedule RC-T
Data: As of 12/31/2018
Includes all banks except uninsured, state-chartered limited purpose trust companies

Asset Management Data



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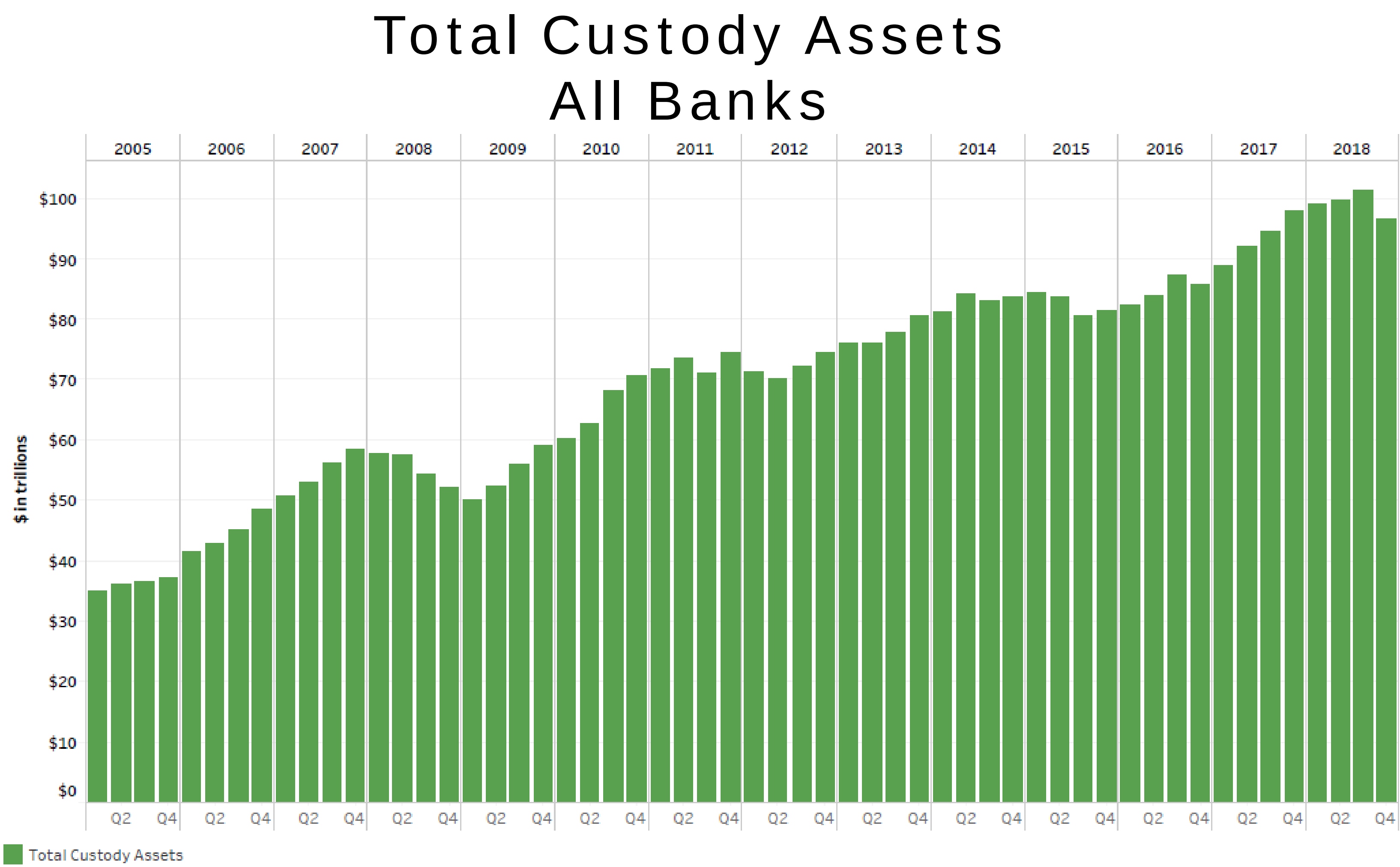


Source: Call Report Schedule RC-T
Data: As of 12/31/2018
Includes all banks except uninsured, state-chartered limited purpose trust companies

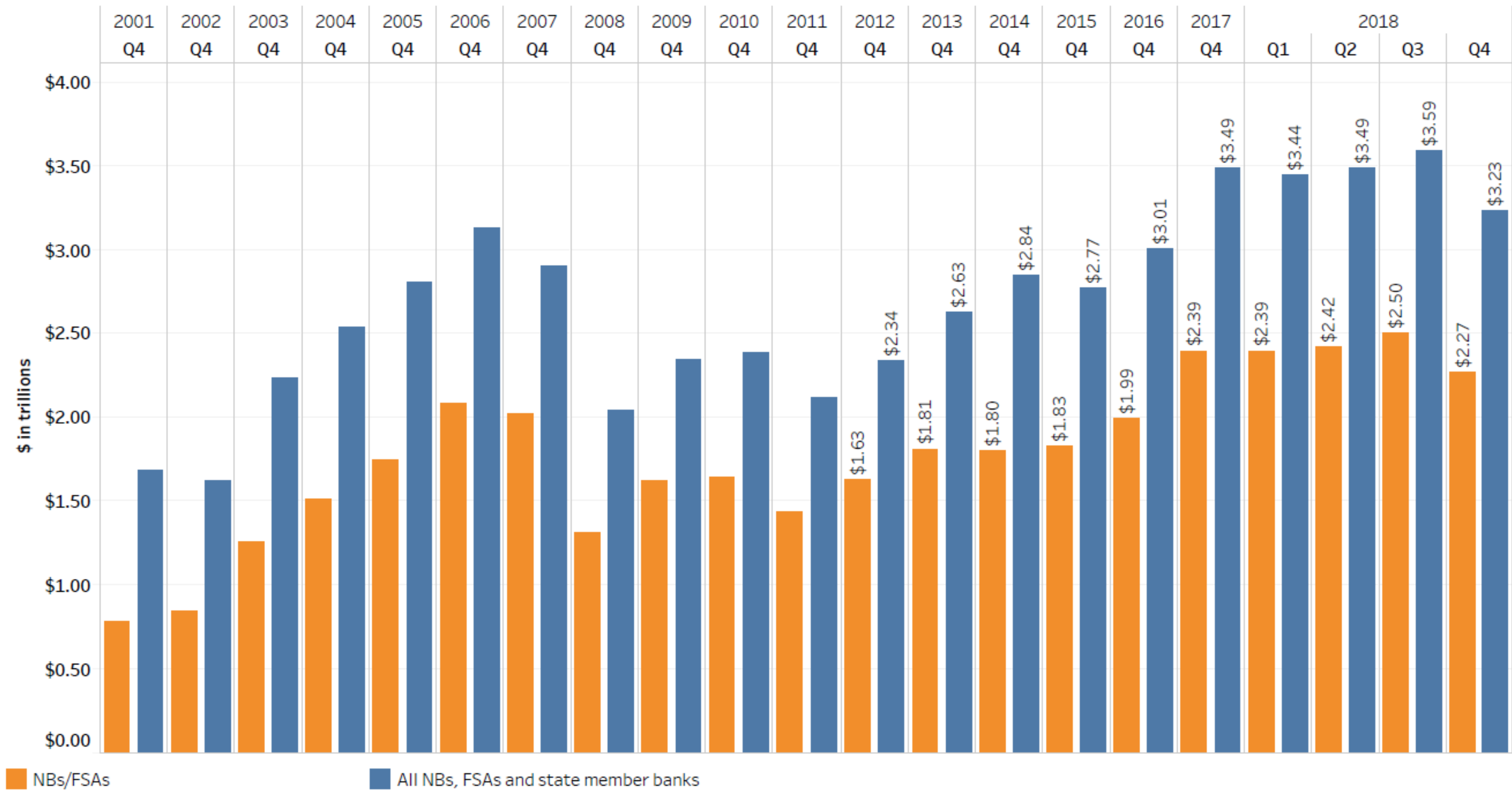
Asset Management Data

Managed Fiduciary Assets by Asset Class
All Banks

Source: Call Report Schedule RC-T
Data: As of 12/31/2018
Includes all banks except uninsured, state-chartered limited purpose trust companies

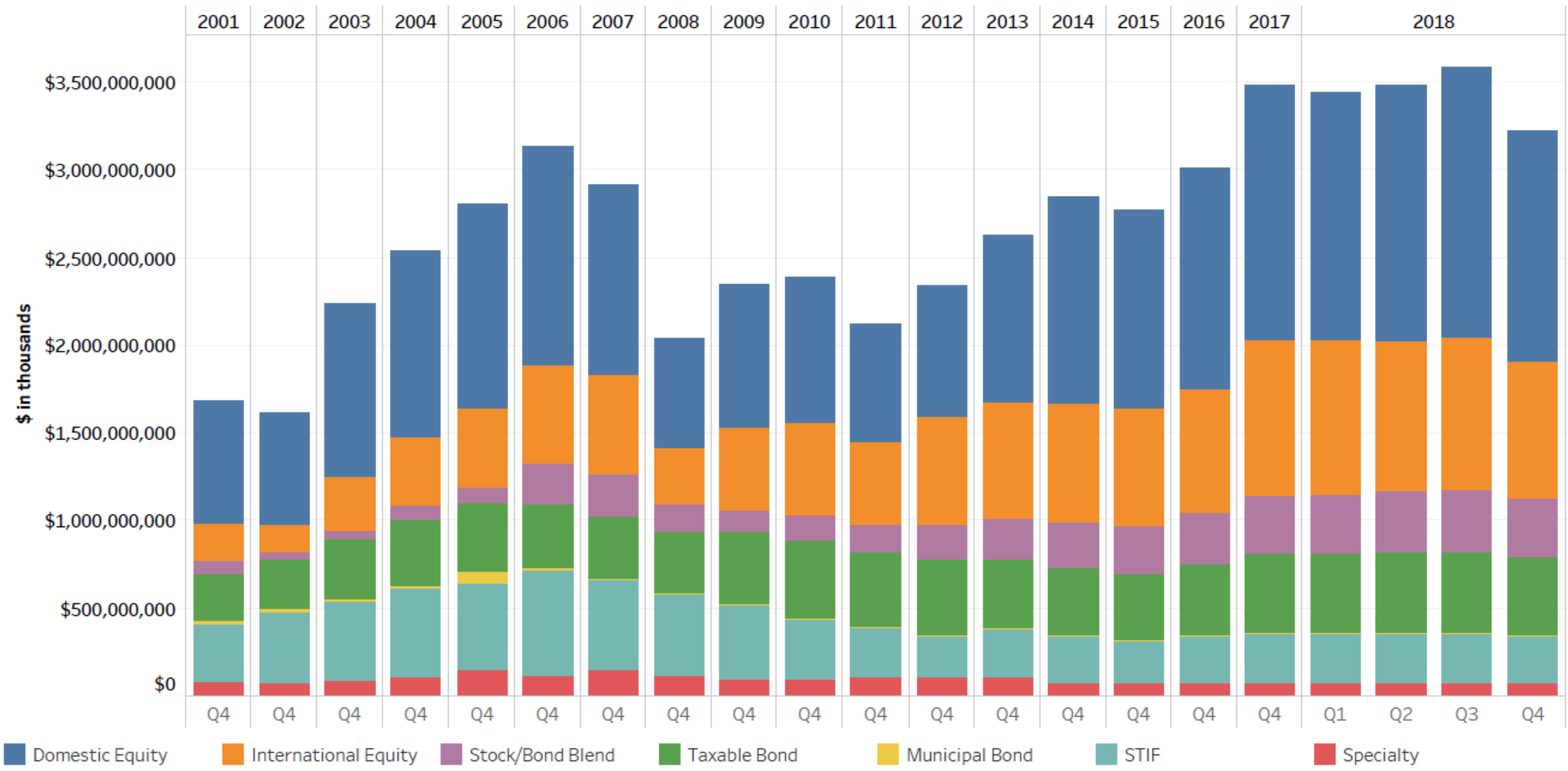
Asset Management Data

Collective Investment Funds
All Banks



Source: Call Report Schedule RC-T
Data: As of 12/31/2018
Includes all banks except uninsured, state-chartered limited purpose trust companies

Common and Collective Investment Funds by Asset Class
All Banks



Source: Call Report Schedule RC-T
Data: As of 12/31/2018
Includes all banks except uninsured, state-chartered limited purpose trust companies

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Appendix II

Selected OCC Asset Management Guidance

OCC Bulletins, Banking Circulars, Interpretive Letters and Booklets of the *Comptroller's Handbook for Asset Management* are available at OCC: Capital Markets: Asset Management

Recent Publications – *Comptroller's Handbook*

- OCC Bulletin 2018-18 (6/28/18) – Updates to Core Examination Process Handbooks and rescinds guidance that was either outdated or incorporated into the updated booklets:
- Of interest for Asset Management:
  - Bank Supervision Process
    - Uniform Interagency Trust Rating System
    - MRAs and Violations
  - Community Bank Supervision
    - AM Core Assessment
    - Quantity of AM Risk/Quality of AM Risk Management
  - Large Bank Supervision
    - Quantity of AM Risk/Quality of AM Risk Management (New)

OCC AM Guidance

Comptrollers Handbook for Asset Management Booklets

- Asset Management (2000)
- Asset Management Operations & Controls (2011)
- Collective Investment Funds (2014)
- Conflicts of Interest (2015)
- Custody Services (2002)
- Investment Management Services (2001)
- Personal Fiduciary Services (2015)
- Retirement Plan Products and Services (2014)
- Unique and Hard to Value Assets (2012)
- Insurance Activities (2002)
- Retail Nondeposit Investment Products (2015)

OCC Guidance

Comptrollers Handbook for Safety and Soundness - (Selected Booklets)

- Community Bank Supervision (2018)
- Large Bank Supervision (2018)
- Bank Supervision Process (2018)
- Corporate Risk and Governance (2016)
- Internal and External Audits (2016)
- Internal Control (2001)
- Insider Activities (2013)

Comptroller's Licensing Manual

- Fiduciary Powers (2017)

Selected OCC Bulletins

- OCC Bulletin 2017-43, New, Modified, or Expanded Bank Products and Services – Risk Management Principles
- OCC Bulletin 2016-17, Compliance with SEC Money Market Fund Rules by Bank Fiduciaries, Deposit Sweep Arrangements, and Bank Investments
- OCC Bulletin 2013-29, Third-Party Relationships: Risk Management Guidance
- OCC Bulletin 2017-7, Third-Party Relationships: Supplemental Examination Procedures
- OCC Bulletin 2017-21, Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29
- OCC 2013-8, Short-term Investment Funds Reporting Requirements

Selected OCC Bulletins

- OCC 2011-11, Risk Management Elements: Collective Investment Funds and Outsourced Arrangements
- OCC 2011-12, Supervisory Guidance on Model Risk Management
- OCC 2010-37, Self-Deposit of Fiduciary Funds
- OCC 2009-19, New Notice Requirements for Sweep Accounts
- OCC 2008-10, Fiduciary Activities of National Banks: Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6(c)
- OCC 2008-5, Conflicts of Interest: Risk Management Guidance Divestiture of Certain Asset Management Businesses
- OCC 2007-42, Bank Securities Activities: SEC's and Federal Reserve's Final Regulation R

Selected OCC Bulletins

- OCC 2007-21, Supervision of National Trust Banks: Revised Guidance: Capital and Liquidity
- OCC 2007-6, Registered Transfer Agents: Transfer Agent Registration, Annual Reporting, and Withdrawal from Registration
- OCC 2006-24, Interagency Agreement on ERISA Referrals
- OCC 2004-2, Banks/Thrifts Providing Financial Support to Funds Advised by the Banking Organization or its Affiliates
- OCC Bulletin 2002-16, Bank Use of Foreign-Based Third-Party Service Providers
- OCC Bulletin 2001-35, Examination Procedures to Evaluate Compliance with the Guidelines to Safeguard Customer Information

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