



# BACKGROUND

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## How Does My Bank Trust Department Protect My Managed Assets?

**Understanding custodial and investment management services offered by commercial banks, savings banks and trust companies.**

Customers may wonder how their managed assets held in bank trust departments are safeguarded. Here is a brief explanation of how extensive regulation, examination, and sound practices protect a bank customer's interests.

### Who supervises my bank?

Bank trust departments and trust companies often act as both custodian and investment manager of client assets. Banking institutions that offer these services are subject to rigorous and frequent examination, as well as extensive regulation, by federal regulators such as the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), or by state banking regulators.

### How are my managed assets protected?

Assets, including certificates of deposit, but not cash, held in *managed accounts* for which the bank trust department also serves as custodian are neither assets nor liabilities of the bank. By law, assets held in these accounts must be segregated from all other bank assets. Likewise, the books and records of these accounts must also be kept separate from the books and records of other bank activities, such as routine deposit and withdrawal transactions.

The ownership of these assets remains vested in the individuals or entities for whose benefit the bank is acting as investment manager and custodian. In addition, many institutions use third-party entities, such as Federal Reserve banks or the Depository Trust & Clearing Corporation, to hold these assets. In all of these instances, the assets are not subject to the claims of a bank's creditors.

All custodial assets held in *deposit accounts* (cash) are entitled to FDIC insurance. Until December 31, 2009, the FDIC will fully insure cash held in non-interest bearing transaction accounts and will insure cash held in other types of deposit accounts up to \$250,000.

### How is my bank's trust department regulated?

Bank trust departments are extensively regulated not only to protect the interests of bank customers, but also to ensure the safety and soundness of the institution for the public good. With respect to custodial and investment management services, state and federal regulations address various aspects of these activities, including the fiduciary obligations of the bank, potential conflicts of interest, and the bank's management of transactional, strategic, compliance, and reputational risks.

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### Segregation of Duties

Bank trust departments segregate and often rotate the duties of their employees who work in the custody and investment management operations. Under such a regime, no one individual is able to authorize, execute, and review the processing of custody assets, including securities, cash, income payments, and corporate actions. These dual control procedures ensure that one person, acting alone, cannot complete all phases of a transaction or transfer client assets.

### Record Keeping Requirements

In addition to records for tax and accounting purposes, bank custodians and investment managers must maintain detailed records to document and confirm securities transactions. Banks must record securities transactions daily in chronological order. The records must include the account name, description of the securities, amount purchased or sold, trade date, and name of the broker/dealer purchaser or seller. A separate order ticket for each securities transaction, whether executed or canceled, must also be maintained. The order ticket includes such details as the time the trade was placed or received by the bank and the type of order used such as market order, limit order or an order subject to special instructions.

### Internal Audits

In addition to imposing rigorous record-keeping obligations, banking regulations require annual or continuous audits of all significant fiduciary activities conducted by an audit committee. The fiduciary audit committee's adoption of a thorough audit program allows the bank's board to identify practices that contravene policies or violate fiduciary laws and regulations. The audit committee may not contain any officer who participates significantly in the administration of the bank's fiduciary activities.

### External Audits

All FDIC-insured institutions must be audited each year by an independent public accountant (IPA) who is licensed to practice and in good standing under state law. To ensure the accountant's reliability and adherence to good accounting and auditing practices, IPAs must be peer-reviewed each year in a manner consistent with the standards of the American Institute of Certified Public Accountants.

IPAs must audit and report on the bank's internal controls on financial reporting directly to the bank's board of directors. Federal bank regulators prohibit banks from limiting an IPA's legal liability for their audits and require that the IPA's audit work papers, policies and procedures be made available to the bank's examiners upon request.

### **How is my bank examined for compliance with banking laws and regulations?**

Federal and state banking regulators routinely examine trust departments for compliance with laws and regulations, as well as the bank's management of various risks. These thorough on-site examinations occur at least every eighteen months. Some institutions have regulators within the bank's premises throughout the year to examine fiduciary activities continuously.

During an examination, examiners do not simply rely on documentation provided by the institution to determine compliance with banking laws. Examiners sample and test various operations to ensure that important transactions may be properly completed and that the record-keeping function is accurate. In addition, examiners review and test the bank's internal controls on custodial and investment management activities, conflicts of interest, record-keeping of securities transactions, and management information systems. The testing of internal controls allows the examiner to determine whether the bank is able to identify transactional mistakes or fraudulent activity.

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### **Where can I find more information about my bank?**

All FDIC-insured institutions must disclose extensive financial information in quarterly reports known as Call Reports. These publicly available reports (<https://cdr.ffiec.gov/public/>) provide timely and accurate data regarding a bank's financial condition and the results of its operations. Bank regulators use the information in the Call Reports to monitor the institutions when not engaged in an on-site examination. The information provided in these reports is extensive and covers everything from the income and expenses of the bank as a whole, to the number of fiduciary accounts and the amount held in those accounts.

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