Office of the Comptroller of the Currency

Fiduciary Investment Risk Management Association
Trust Regulatory Panel
Office of the Comptroller of the Currency

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Disclosure

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

Overview

- Selected Asset Management Risks and Hot Topics
- Selected Regulatory Developments
- Appendix I: Asset Management Industry Data
- Appendix II: OCC Asset Management Guidance

AM Hot Topics and Risks

- LIBOR Transition
- Investment Risk
- Fee Compression/AM Earnings
- Conflicts of interest
- Sweep Arrangements
- Custody of Fiduciary Assets
- Fiduciary and non-fiduciary sub-custody
- Third-Party Relationships

LIBOR Transition

- The Libor transition is a significant event that poses complex challenges for banks and the financial system. Banks may have LIBOR exposure in many on-balance sheet or off-balance sheet activities.

- Per the November 30, 2020 Interagency Statement:
  - The banking agencies encourage banks to cease entering into new contracts that use USD Libor as a reference rate by December 31, 2021.
  - Entering into new Libor contracts after December 31, 2021, or failure to prepare for disruptions to USD Libor would create safety and soundness risks.

- For more information on considerations when assessing the appropriateness of alternative reference rates, expectations for fallback language and additional considerations, see Joint Statement on Managing the LIBOR Transition issued October 20, 2021

- Recent state and federal legislation may assist banks in handling tough legacy contracts.

Investment Risk

- There are a number of factors and areas of focus related to investment risk:
  - Market volatility/geopolitical uncertainty
  - Low interest environment - reaching for return
  - Use of complex products
  - Use of proprietary investment products
  - Need for effective portfolio management processes

Fee Compression /AM Earnings

- Fee compression continues to place pressure on AM earnings, resulting in actions by banks that may increase risks:
  - Entering new lines of business with inadequate expertise or resources.
  - Increased use of investment products that lack transparency with respect to fees, resulting in conflicts of interest.
  - Use of proprietary products resulting in conflicts of interest
  - Reduced earnings due to fee compression, causing some banks to exit some lines of business.
  - Expense reduction by reducing resources devoted to control functions such as audit or compliance, or risk management.
  - Increased reliance on third parties and outsourcing to reduce costs, requiring effective oversight of third-party arrangement.

Conflicts of Interest

- Use of proprietary products in discretionary accounts is, by definition, self-dealing.
- Even if self-dealing is 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.

Sweep Arrangements

- Emergence of deposit placement services that interface with trust accounting systems has resulted in banks considering these services as an option for AM sweep arrangements.
- Key risks to consider include:
  - Are these programs structured and documented to be consistent with FDIC’s requirements to ensure deposits are fully insured via pass-through insurance? Where applicable, do they comply with Regulation DD, “Truth in Savings”?
  - For discretionary fiduciary accounts, has the bank fully identified any conflicts of interest, and are these conflicts authorized and appropriately disclosed? Any prohibited transaction issues under ERISA or the Tax Code? Is the sweep vehicle in the best interest of the fiduciary account?
  - For both fiduciary and non-fiduciary accounts, is the compensation received by the bank or its affiliates reasonable and fully disclosed?

Sweep Arrangements

- Banks should seek the advice of counsel before entering into these or any other sweep arrangements for which the bank may be receiving compensation.
  - If applicable, counsel should specifically address the permissibility of these compensation arrangements for accounts subject to ERISA or the Tax Code.
- For additional guidance refer to the "AM Conflicts of Interest" and "Retirement Plan Products and Services" booklets of the *Comptroller's Handbook*.
- For guidance on self-deposits as sweep vehicles, and on factors to consider when comparing sweep vehicles, refer to OCC Bulletin 2010-37, "Self-Deposit of Fiduciary Funds."
- For guidance on pass-through insurance coverage, refer to FDIC rules and guidance, including FIL-29-2010, "Guidance on Deposit Placement and Collection Activities."

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.

AM Custody

- Risk management considerations for both fiduciary and non-fiduciary sub-custody arrangements
  - Does the bank have adequate control over the client assets – title, authorization of distributions, free deliveries, address changes?
  - If the bank has investment discretion, is sweep vehicle appropriate for a fiduciary account and are any resulting conflicts authorized and disclosed in accordance with applicable law?
  - Arrangements modelled after RIA arrangements may not comply with OCC regulations or be consistent with OCC guidance, as they may be based on SEC regulations that take a different approach than OCC regulations.
  - Does the bank should have access to “system of record” and related exception reporting and management information?

AM Custody

- Other concerns related to sub-custody arrangements
  - Agreements, SLAs, policies and procedures that do not reflect the extent to which a bank is outsourcing its fiduciary activities.
  - Inadequate bank due diligence and oversight of these third-party arrangements.
  - Affiliate sub-custody arrangements that result in conflicts of interest issues.
  - Banks relying on SOC reports that do not address all outsourced fiduciary activities or compliance expectations.
  - Inadequate contingency plans for termination of arrangement.
  - Inaccurate reporting on Call Report
- Key expectation: The bank’s oversight of these arrangement is commensurate with the nature, scope and risks of the outsourced activity.

Third-Party Relationships

- OCC Bulletin 2021-40, "Third-Party Relationships: Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks," was issued 8/27/21
  - Provides information relating to six common areas of due diligence discussed in existing supervisory guidance
  - Focuses on general considerations, potential sources of information, and illustrative examples that may be relevant as community banks conduct due diligence on a financial technology company
  - Reiterates that the scope and depth of due diligence performed by a community bank depends on the risks posed by each third-party relationship and the nature and criticality of the prospective product, service, or activity

Third-Party Relationships

- OCC Bulletin 2020-10, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29," was issued 3/5/20.
  - Clarifies that "business arrangements" covered by the 2013 bulletin should be broadly interpreted, and not limited to "vendors" and "outsourcing providers."
  - Provides expanded guidance for cloud computing providers.
  - Provides guidance for various types of data aggregation arrangements, including risk management expectations when there may not be a business arrangement (screen scraping).
  - Provides guidance where a bank has limited negotiating power.
  - Clarifies expectations for Board approval of contracts for critical activities.

Third-Party Relationships

- OCC Bulletin 2020-10 provides expectations for banks’ oversight of third parties’ use of subcontractors (fourth parties). This includes:
  - Assessing the extent to which third parties use subcontractors (fourth parties).
  - Assessing the ability of the third party to manage, identify and control risks from its use of subcontractors.
  - Including contractual provisions that the third party keep the bank informed of its use of subcontractors, and provide periodic reports on the performance of the subcontractors and relevant audit and compliance reports.

Third-Party Relationships

- OCC Bulletin 2020-10 also provides expectations for banks related to third parties and model risk management.
  - Includes risk management guidance when a bank uses a third party's model or engages a third party for model risk management activities such as model validation and review, compliance functions or other activities in support of internal audit.
  - Supplements the Sound Practices for Model Risk Management provided in OCC Bulletin 2011-12 issued in July 2011.

Regulatory Developments

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Regulatory Developments

- Crypto-Assets – Custody
- SEC Updates
- DOL Updates

Crypto Assets – Custody

- Interpretive Letter #1179 (November 2021): Banks should obtain supervisory non-objection prior to engaging in activities covered by the crypto interpretive letters

- IL 1179# also clarified that Interpretive letter 1176 does not change the current obligations of national banks with existing fiduciary powers under Part 9.

  - For national banks that have been granted fiduciary powers, Part 9 continues to apply

  - For national banks currently conducting non-fiduciary activities, those activities are not and will not become subject to Part 9

Crypto Assets – Custody

- Interpretive Letter #1170 (July 2020): Banks may provide custody of cryptocurrencies in both fiduciary and non-fiduciary capacities
  - Need for more secure storage, as exchanges have been subject to hacking and theft and stolen cryptoassets cannot generally be recovered
  - Custody entails taking possession of cryptographic keys, which are generally held in “wallets”
  - Banks could have different service methods, depending on expertise, risk appetite, and business model
    - Safekeeping copies of private keys
    - Full possession of assets
    - Fiduciaries must comply with custody regulations in 12 CFR 9.13 or 12 CFR 150.230-250

Crypto Assets – Custody

- Banks may offer additional services besides safekeeping
  - Facilitating exchange transactions, transaction settlement, trade execution, record keeping, valuation, tax services, reporting, or “other appropriate services”
- New activities should be developed consistent with sound risk management practices and aligned with overall business plans and strategies
  - OCC Bulletin 2017-43, “New, Modified, or Expanded Bank Products and Services: Risk Management Principles”
- Traditional controls may need to be tailored for crypto
- Must have appropriate technical expertise to oversee sub-custodians
  - OCC Third-party Risk Management Guidance (OCC 2013-29)
  - Guidance on sub-custody

Crypto Assets – Custody

- Join Statement on Crypto-asset policy sprints
  - Summarized sprint work
  - Agencies anticipate providing greater clarity on whether certain crypto-related activities are permissible and the agencies expectations of banks engaging in these activities

SEC Updates

- Securities Lending Data Reporting
  - Proposed rule requiring any person, including any bank, to report the material terms of each securities loan it makes to a registered national securities association (RNSA), such as FINRA

- Money Market Fund Reform
  - In December 2021, the SEC voted to approve proposed amendments to the rules governing MMFs.
  - Comment period closes April 11, 2022
  - Goal is to improve resilience and transparency of these funds

- T + 1 Rule
  - Proposed in February, and if adopted, T+1 would be implemented by March 31, 2024.
  - Comment period closes April 11, 2022

DOL Updates

- PTE 2020-02: Investment Advice Exemption, effective February 16, 2021
  - Available for investment advice fiduciaries who receive compensation that would otherwise be prohibited such as commissions, 12b-1 fees, revenue sharing fees, mark-ups and mark downs
  - Must provide advice that is in the best interest of the participant or IRA customer and comply with the Impartial Conduct Standard
  - Initial transition period was through December 20, 2021, but was extended through FAB 2021-02 to January 31, 2022, for compliance with the Impartial Conduct Standard and through June 30, 2022 for compliance with the disclosure and documentation requirements

DOL Updates

- ESG and Proxy Voting Proposed Rule
  - Eliminates any restrictions on plan fiduciaries' ability to consider ESG factors when selecting investments or exercising shareholder rights
- Crypto-currency Guidance (Compliance Assistance Release No. 2022-01
  - Cautions plan fiduciaries to be extremely careful prior to adding cryptocurrency to a 401(k) plan's investment menu as these products present significant risks and challenges

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Appendix I

Asset Management Industry Data

OCC Asset Management Supervision

- As of 9/30/21, OCC supervises 797 national banks, 269 federal savings associations (FSAs), and 52 federal branches and agencies
  - They range from large complex banks with global footprints to local community banks.
  - $15.1 trillion in assets – 65% of U.S. commercial bank total
  - 61 NBs and FSAs with >$10 billion in assets; 198 with $1 -$10 billion in assets; and 807 with <$1 billion in assets.

- As of 12/31/21, OCC supervises $11.9 trillion in fiduciary assets and $62 trillion in custody assets
  - Approximately 43% of all national banks and 29% of FSAs engage in AM activities, which include fiduciary, custody and retail nondeposit services.
  - Over 150 OCC examiners with specialized AM expertise perform ongoing supervision.

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Limited Purpose Trust Banks

- OCC has long history of chartering special purpose, limited purpose trust banks.
- NTB and FSA charters:
  - 53 limited purpose national trust banks and 17 trust only FSAs
  - FSAs are, by statute, required to be insured; NBs are not
  - Evolving area – uninsured NTB charters; in 2016, OCC adopted a receivership regulation to address uninsured national banks
- Recently, we have considered uninsured de novo NTBs and conversions from uninsured state banks.
- During the chartering process we determine conditions of approval and minimum initial capital.
- See the “Charters” booklet of the OCC Licensing Manual and OCC Bulletin 2007-21.

Asset Management Data

Fiduciary and Custody Assets
All Banks

	Managed	Non-Managed	Total Assets
Personal Trust and Agency Accounts	$920,309,681	$604,031,726	$1,524,341,407
Employee Benefit - Defined Contribution	$1,977,982,197	$2,267,430,231	$4,245,412,428
Employee Benefit - Defined Benefit	$1,241,416,737	$3,100,751,504	$4,342,168,241
Other Employee Benefit and Retirement Related	$533,657,391	$788,042,366	$1,321,699,757
Corporate Trust and Agency Account	$33,614,734	$4,607,237,905	$4,640,852,639
Investment Management and Investment Advisory	$3,240,910,626	$411,348,825	$3,652,259,451
Foundation and Endowment	$538,685,055	$92,095,825	$630,780,880
Other Fiduciary Accounts	$202,360,713	$3,127,446,758	$3,329,807,471
Total Fiduciary Accounts	$8,688,937,134	$14,998,393,173	$23,687,330,307
Custody and Safekeeping Accounts		$144,572,249,573	$144,572,249,573
Total Fiduciary & Custody/Safekeeping			$168,259,579,880

in $ thousands

Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

Asset Management Data

Fiduciary and Custody Assets
OCC-Supervised Banks

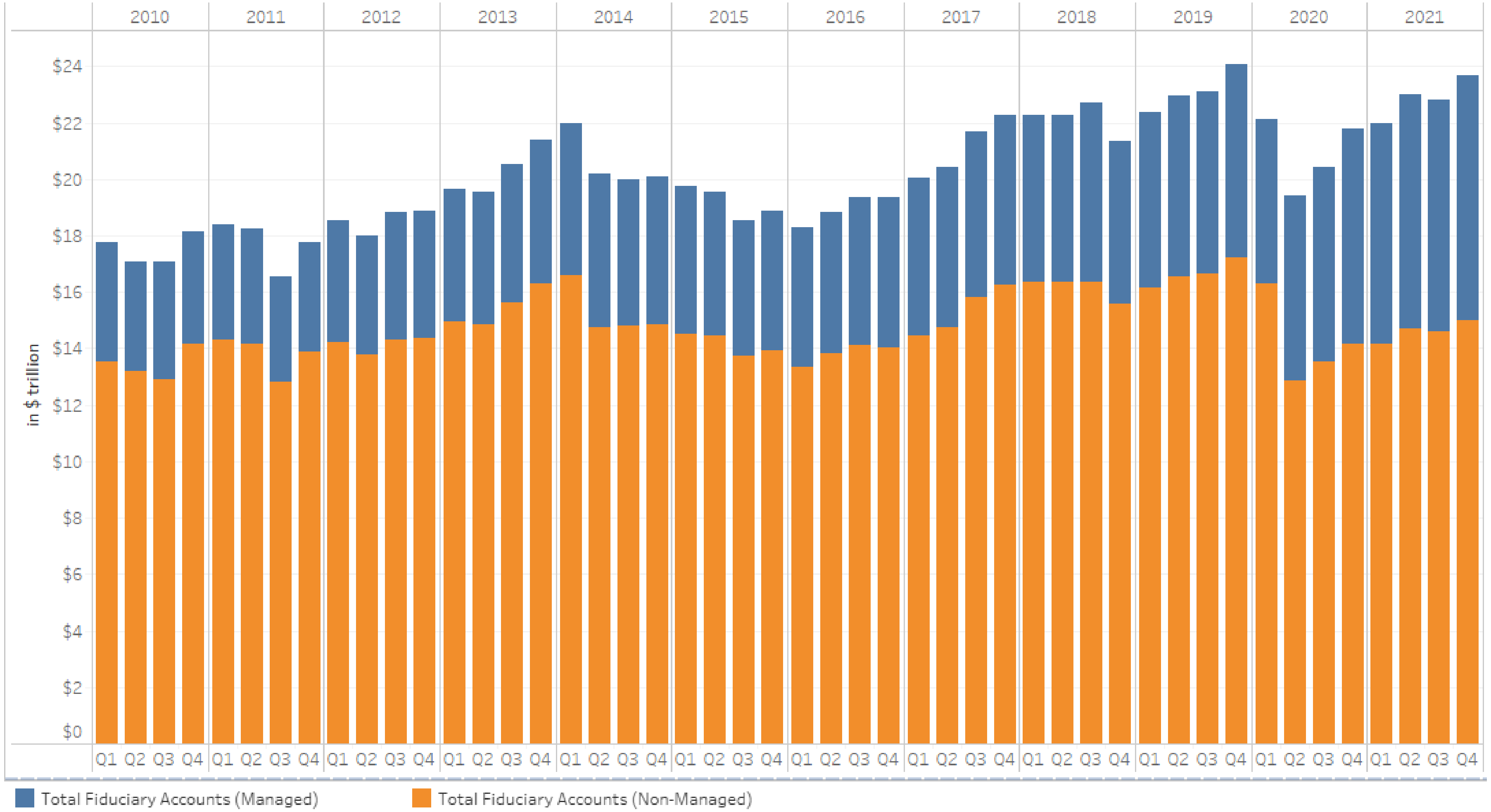
	Managed	Non-Managed	Total Assets
Personal Trust and Agency Accounts	$600,635,282	$435,608,069	$1,036,243,351
Employee Benefit - Defined Contribution	$1,356,210,374	$783,939,986	$2,140,150,360
Employee Benefit - Defined Benefit	$619,721,252	$795,239,984	$1,414,961,236
Other Employee Benefit and Retirement Related	$307,386,388	$193,824,564	$501,210,952
Corporate Trust and Agency Account	$29,107,889	$2,758,369,255	$2,787,477,144
Investment Management and Investment Advisory	$1,948,733,754	$316,930,353	$2,265,664,107
Foundation and Endowment	$293,692,161	$15,002,077	$308,694,238
Other Fiduciary Accounts	$127,462,328	$1,291,780,695	$1,419,243,023
Total Fiduciary Accounts	$5,282,949,428	$6,590,694,983	$11,873,644,411
Custody and Safekeeping Accounts		$62,037,710,262	$62,037,710,262
Total Fiduciary & Custody/Safekeeping			$73,911,354,673

in $ thousands

Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all OCC-supervised institutions.

Asset Management Data

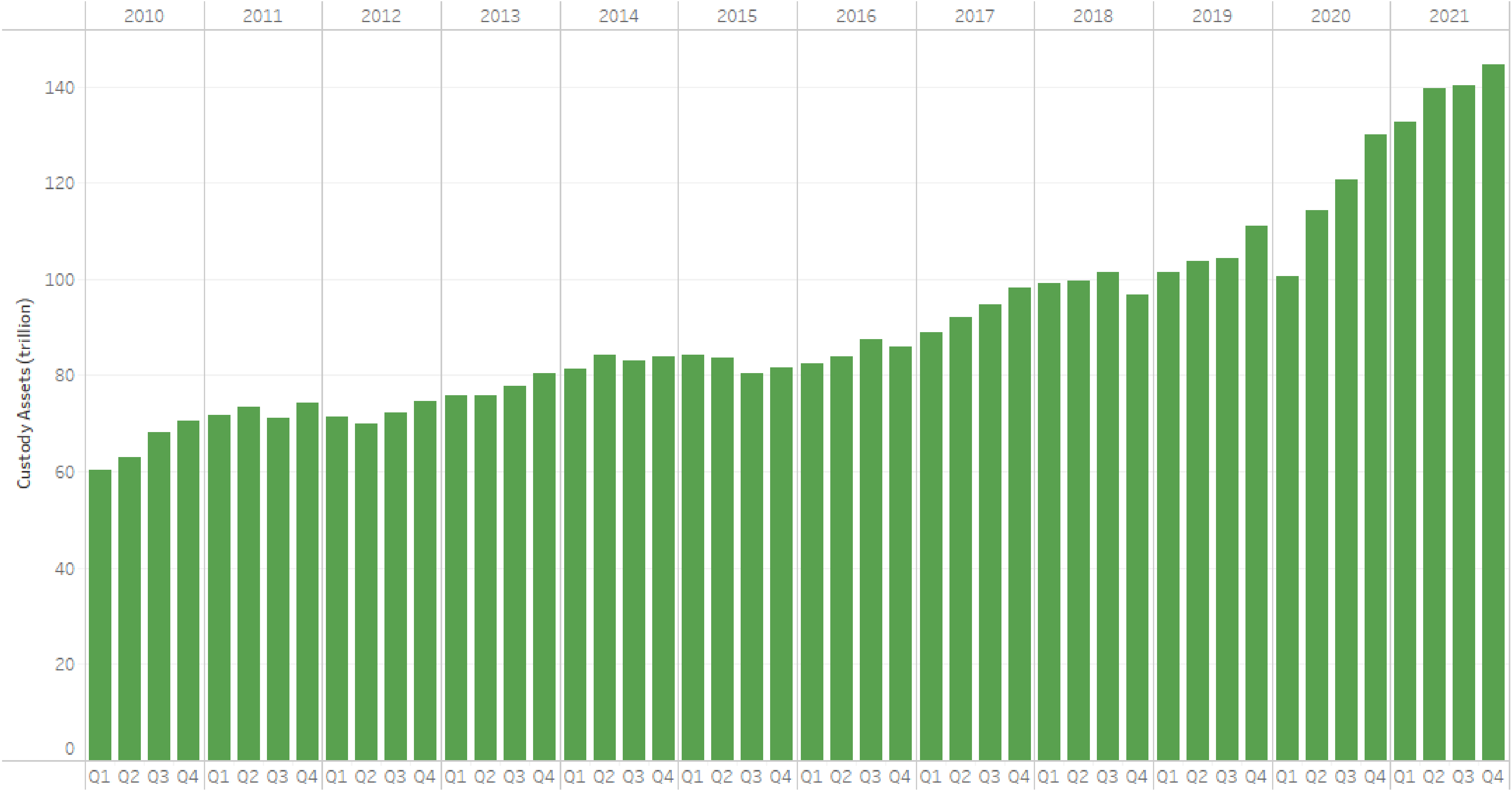
Total Fiduciary Assets
All Banks



Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

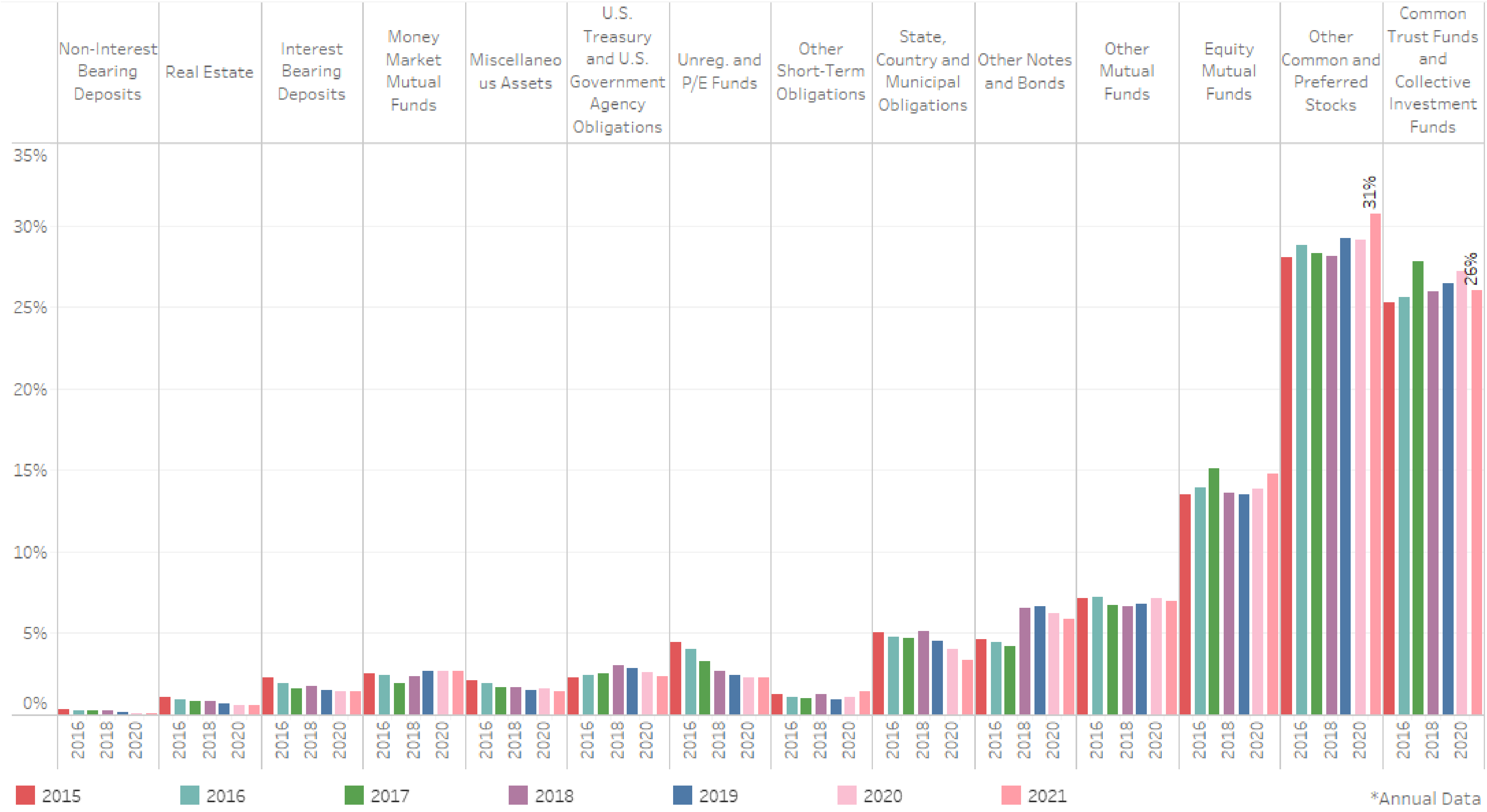
Asset Management Data

Total Custody Assets
All Banks



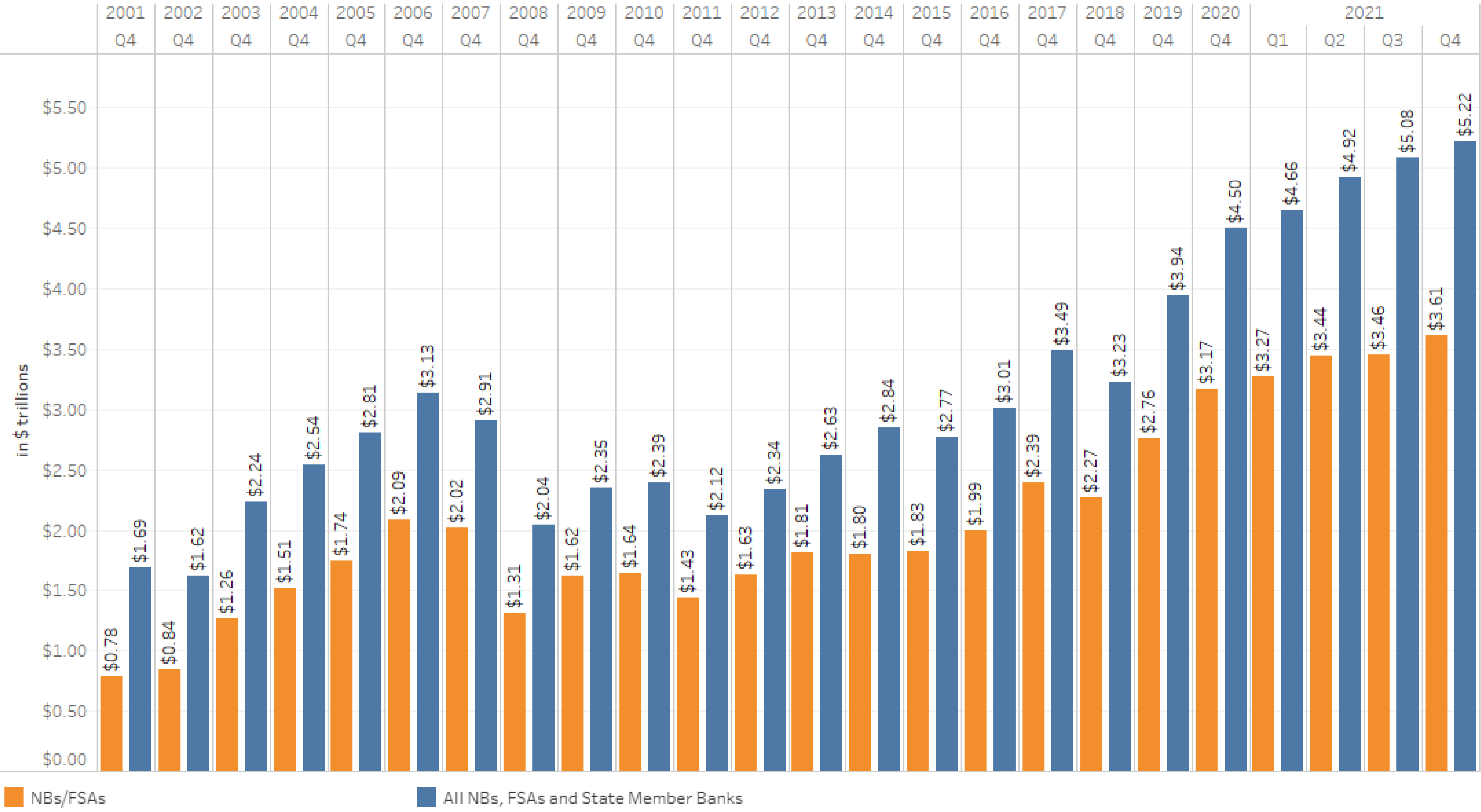
Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

Managed Fiduciary Assets by Asset Class
All Banks



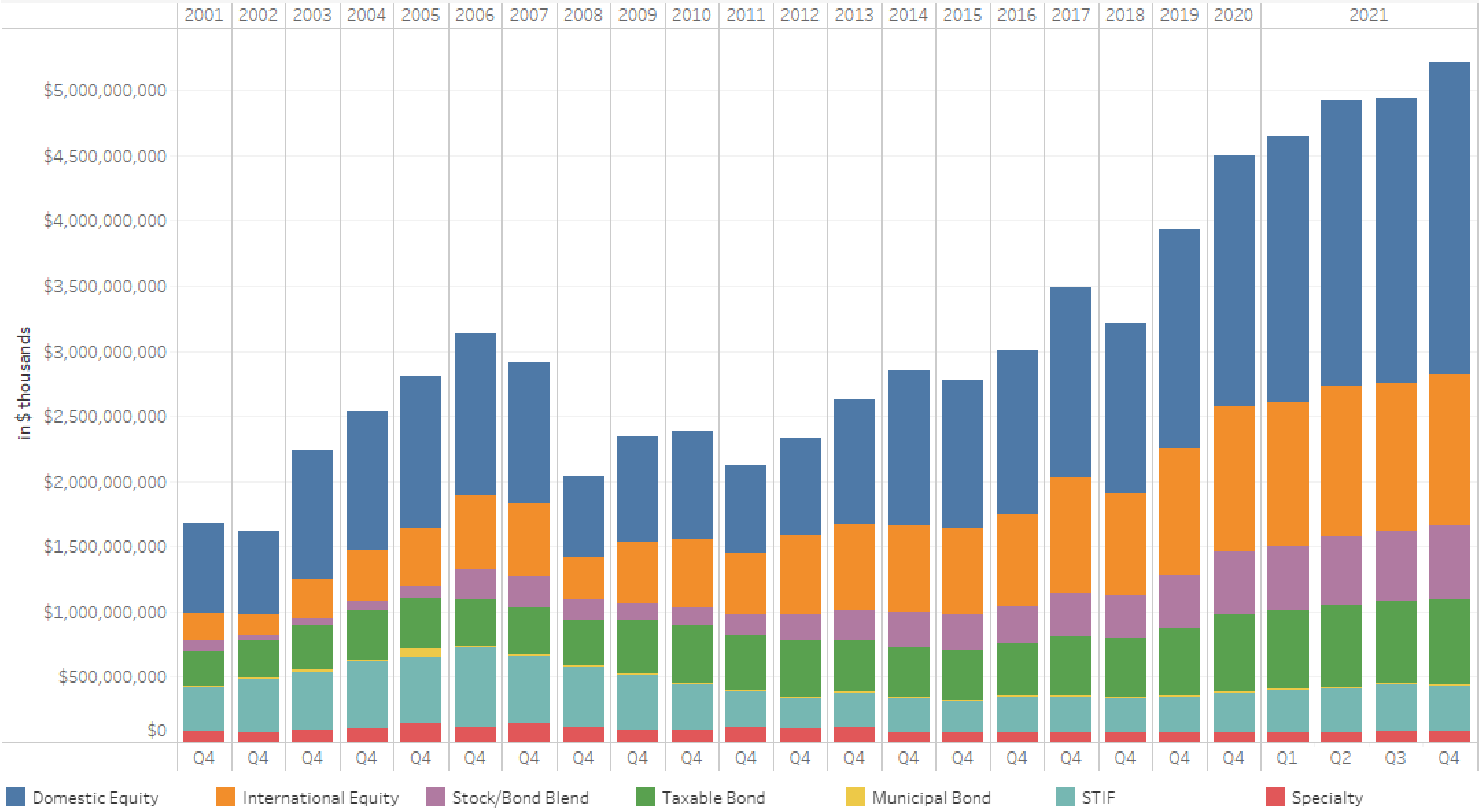
Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

Collective Investment Funds
All Banks



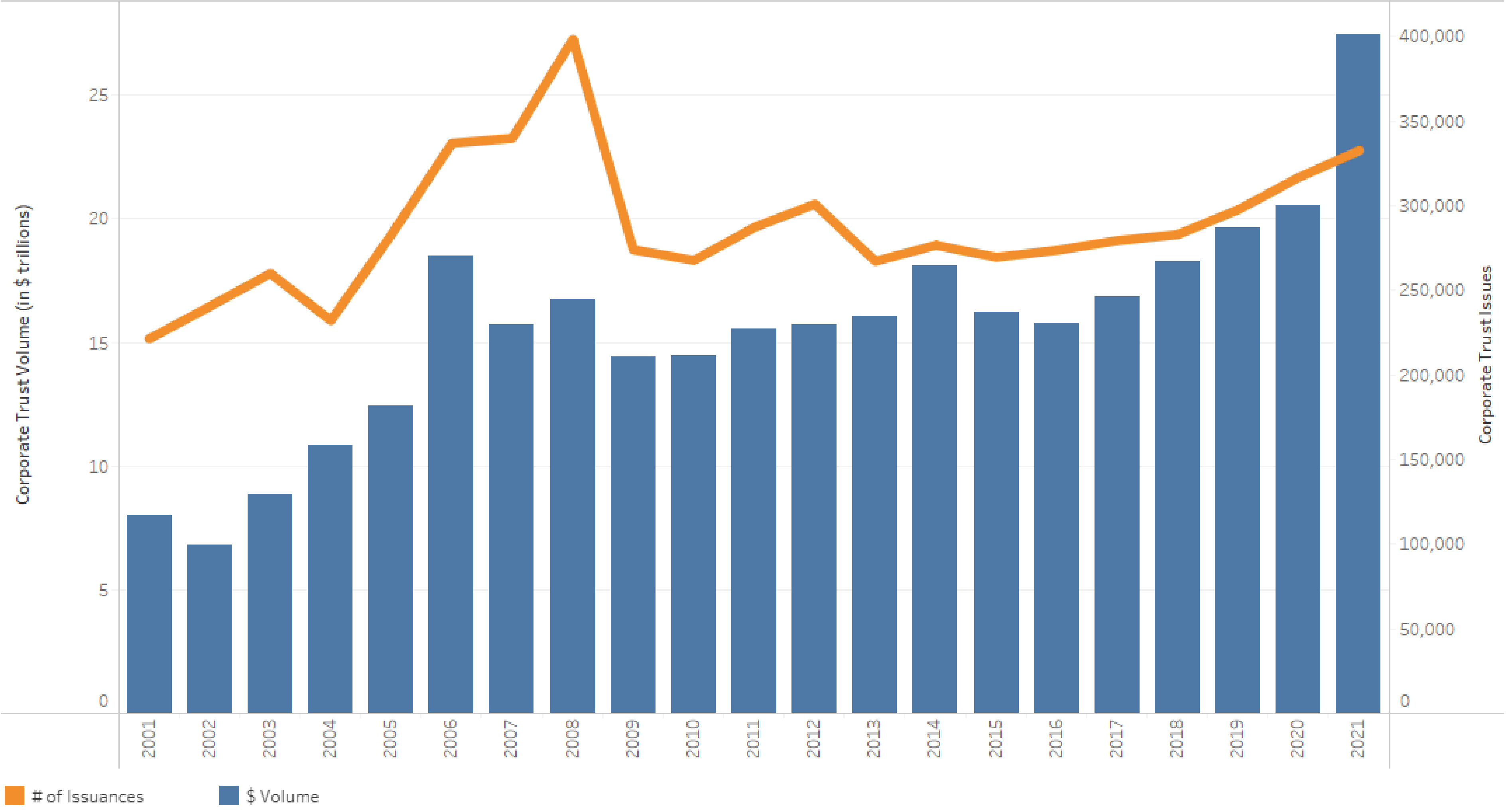
Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

Common & Collective Investment Funds by Asset Class
All Banks



Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

Corporate Trust Activity
All Banks



Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

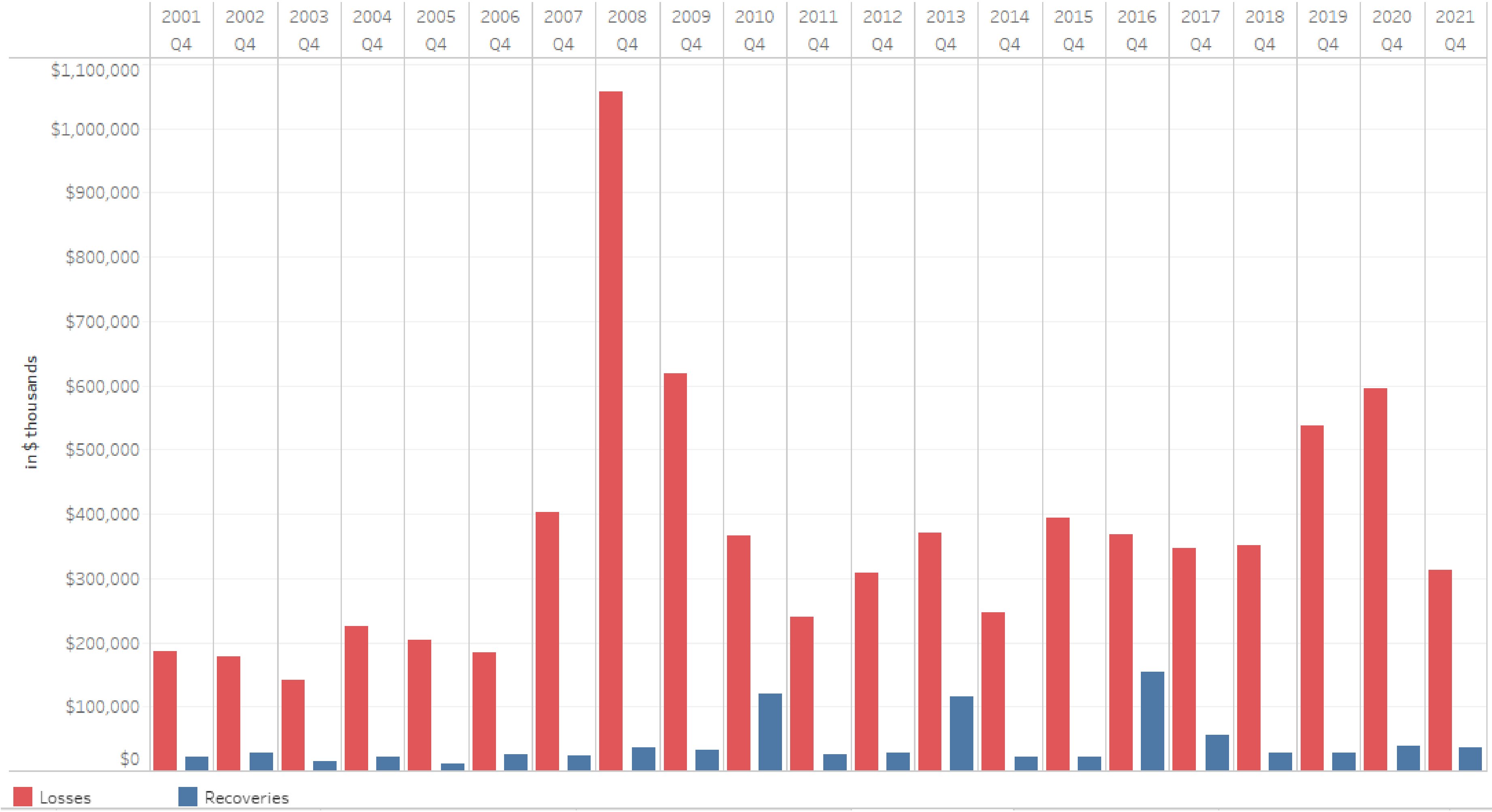
Corporate Trust Activity
All Banks, by total asset size

Corp Trust Issuances by Bank	# of Banks	# of Issues	$ Market Value	$ Avg. per Issue
Above $1 Trillion	7	225,762	$25,453,598,901	$112,745
$10B - $1 Trillion	17	98,650	$1,934,480,964	$19,610
$1B - $10 Billion	13	2,263	$44,278,503	$19,566
Below $1B Billion	96	4,278	$9,721,376	$2,272
Grand Total	133	330,953	$27,442,079,744	$82,918

Data in $ thousands

Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

Gross Fiduciary Losses and Recoveries
All Banks



Source: Call Report Schedule RC-T. Data as of 12/31/2021. Includes all banks except uninsured, state-chartered limited purpose trust companies. Excludes DTC, a state-chartered limited purpose trust co.

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

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 (2019)
- Large Bank Supervision (2019)
- Bank Supervision Process (2019)
- Corporate and Risk Governance (2019)
- Internal and External Audits (2019)
- Internal Control (2001)
- Insider Activities (2013)

Comptroller's Licensing Manual

- Fiduciary Powers (2017)
- Charters (2019)

Selected OCC Bulletins

- OCC Bulletin 2021-07, Libor Transition: Self-Assessment Tool for Banks” (2/10/2021)
- OCC Bulletin 2020-104, Libor Transition: Joint Statement on U.S. Dollar Libor Transition” (11/30/2020)
- OCC Bulletin 2020-74, Collective Investment Funds: Prior Notice Period for Withdrawals: Interim Final Rule
- OCC Bulletin 2020-68, Libor Transition: FFIEC Statement on Managing the LIBOR Transition and Guidance for Banks
- OCC Bulletin 2020-58, Activities and Operations of National Banks and FSA: Notice of Proposed Rulemaking (includes ANPR on the use of digital technology by National Banks and FSAs)
- OCC Bulletin 2020-22, Short-Term Investment Funds: Interim Final Rule and Order

Selected OCC Bulletins

- OCC Bulletin 2020-10, Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29
- 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 2020-10, 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 Bulletin 2011-11, Risk Management Elements: Collective Investment Funds and Outsourced Arrangements
- OCC Bulletin 2011-12, Supervisory Guidance on Model Risk Management
- OCC Bulletin 2010-37, Self-Deposit of Fiduciary Funds
- OCC Bulletin 2009-19, New Notice Requirements for Sweep Accounts
- OCC Bulletin 2008-10, Fiduciary Activities of National Banks: Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6(c)
- OCC Bulletin 2008-5, Conflicts of Interest: Risk Management Guidance Divestiture of Certain Asset Management Businesses
- OCC Bulletin 2007-42, Bank Securities Activities: SEC's and Federal Reserve's Final Regulation R

Selected OCC Bulletins

- OCC Bulletin 2007-21, Supervision of National Trust Banks: Revised Guidance: Capital and Liquidity
- OCC Bulletin 2007-6, Registered Transfer Agents: Transfer Agent Registration, Annual Reporting, and Withdrawal from Registration
- OCC Bulletin 2006-24, Interagency Agreement on ERISA Referrals
- OCC Bulletin 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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