

Power of the Basics – Account Reviews

Mary Ann Lowney
May 4, 2022

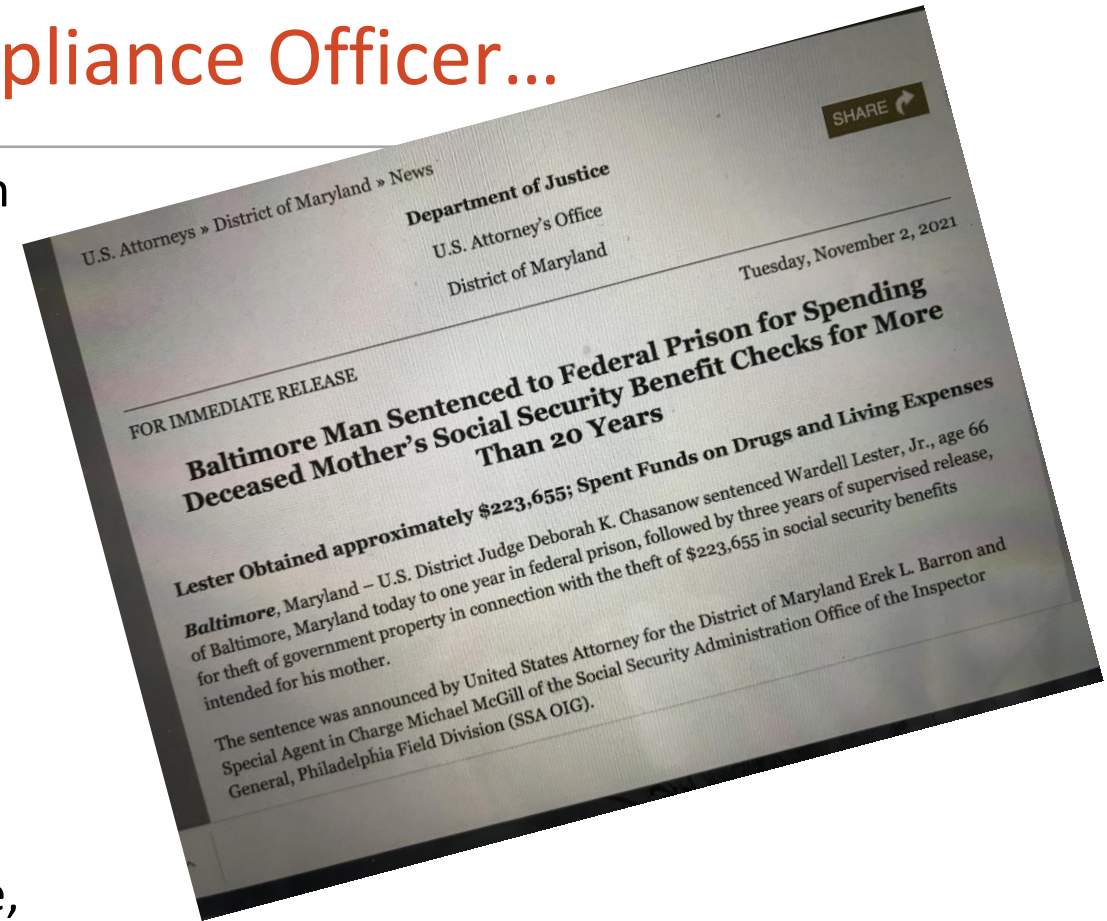
Hypothetical day in the life of a Compliance Officer...



Late in the day, Inspector Clouseau leaves a message with your fraud unit to report that Mr. Mahoney, a beneficiary of a trust administered by your bank, has been charged with fraud. The DOJ alleges that Mrs. Mahoney cashed social security checks made out to his mom, who passed away on March 17, 2012.

You log in, intending to take a quick look at the account. You see the instrument is quite old and you first need to laboriously piece together the 13 restatements.

You note that mandatory income payments have, and are, being sent to Mrs. Mahoney, and that the trust principal was to be split equally upon Mrs. Mahoney's death between her son and Charity: Water. The trust has been invested to generate a robust income stream for Mrs. Mahoney.



An effective account review program would have prevented the ensuing operational loss and reputational risk!

Today's Agenda

- I. Introduction
- II. Designing an Effective Program
 - A. Scope
 - B. Identify, Measure, Monitor, Control/Remediate
 - C. Fatal Design Flaw - Warnings
- III. Role of Second Line of Defense
- IV. Summary

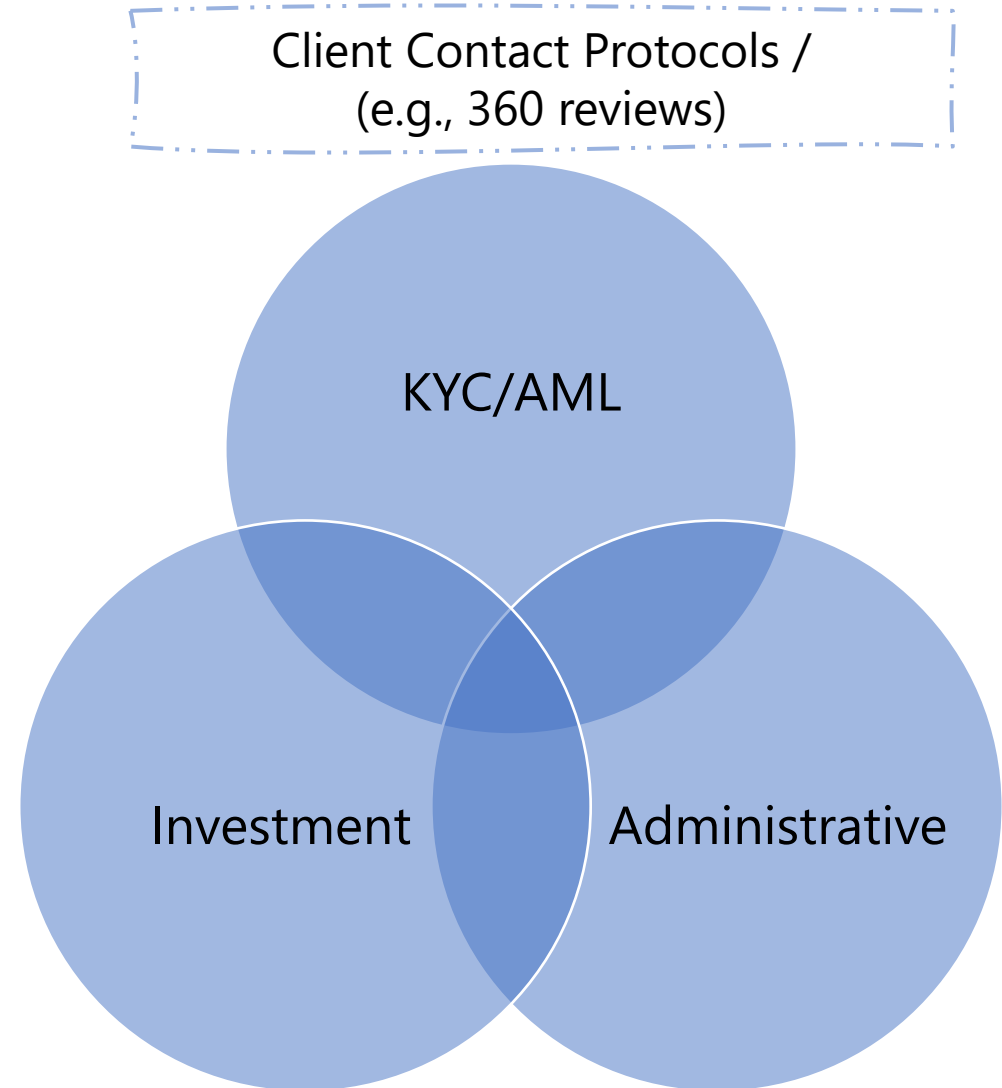
Opinions expressed are those of the author alone and not her prior (or any future) employer; fact scenarios and learnings are strictly hypothetical and any similarity to actual individuals, litigation or case law, is purely coincidental. Questions and comments may be directed to Marelowney@gmail.com.

Introduction

Purpose of account reviews is to ensure accounts are being administered in a manner that:

- exceeds client expectations by delivering services with excellence
- satisfies all legal and regulatory requirements
- Is efficiently executed (e.g., process excellence and profitability)

Certain account reviews are either required, or expected, by regulatory authorities (12 CFR 9; FDIC Statement of Principles)

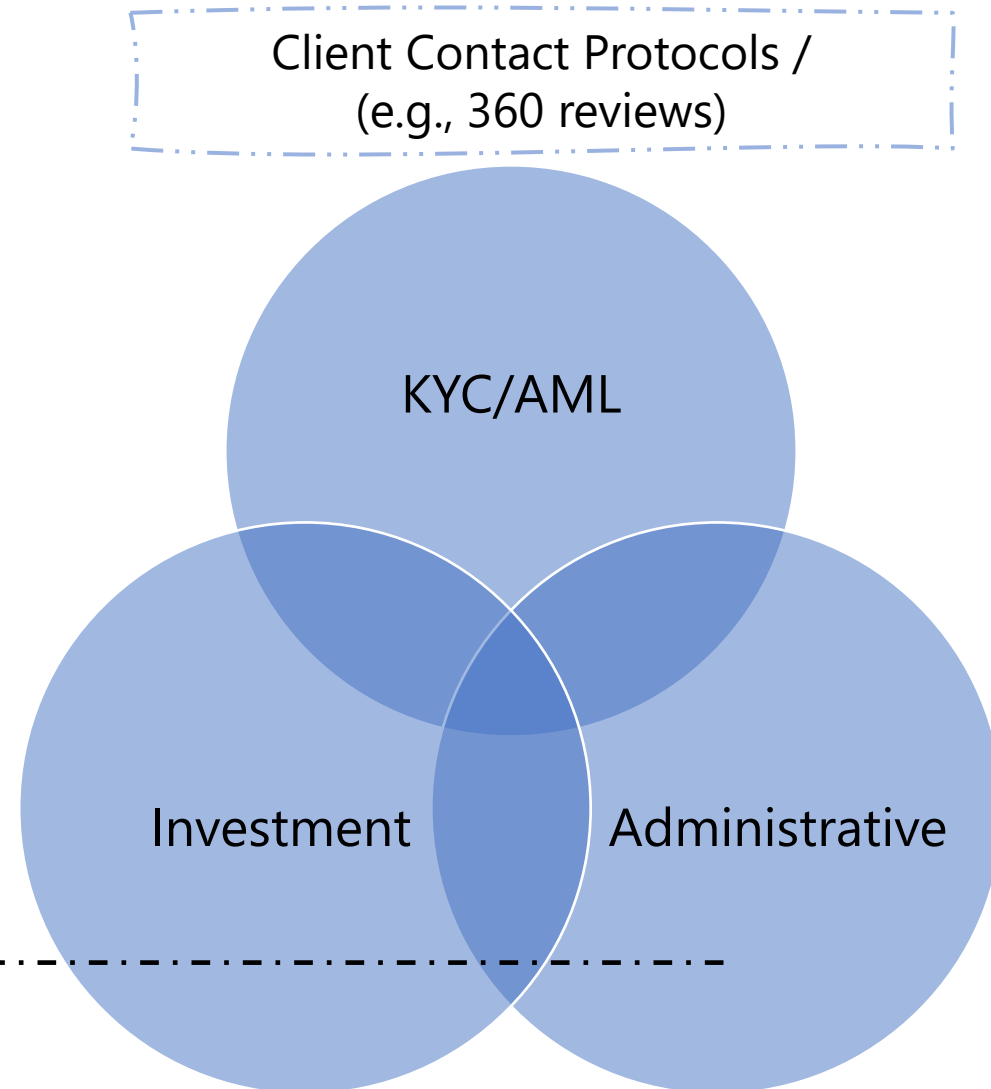


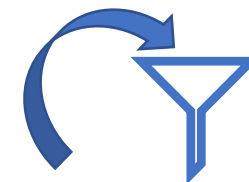
Designing an Effective Program

Bank fiduciaries have wide latitude to design a program. An effective program:

- Articulates **scope** of account review process, recognizing interdependencies with other processes
- **Risk/Reward.** Leverage available **resources** wisely to **identify, measure, monitor** and **remediate (control)** highest risks in the most efficient way possible

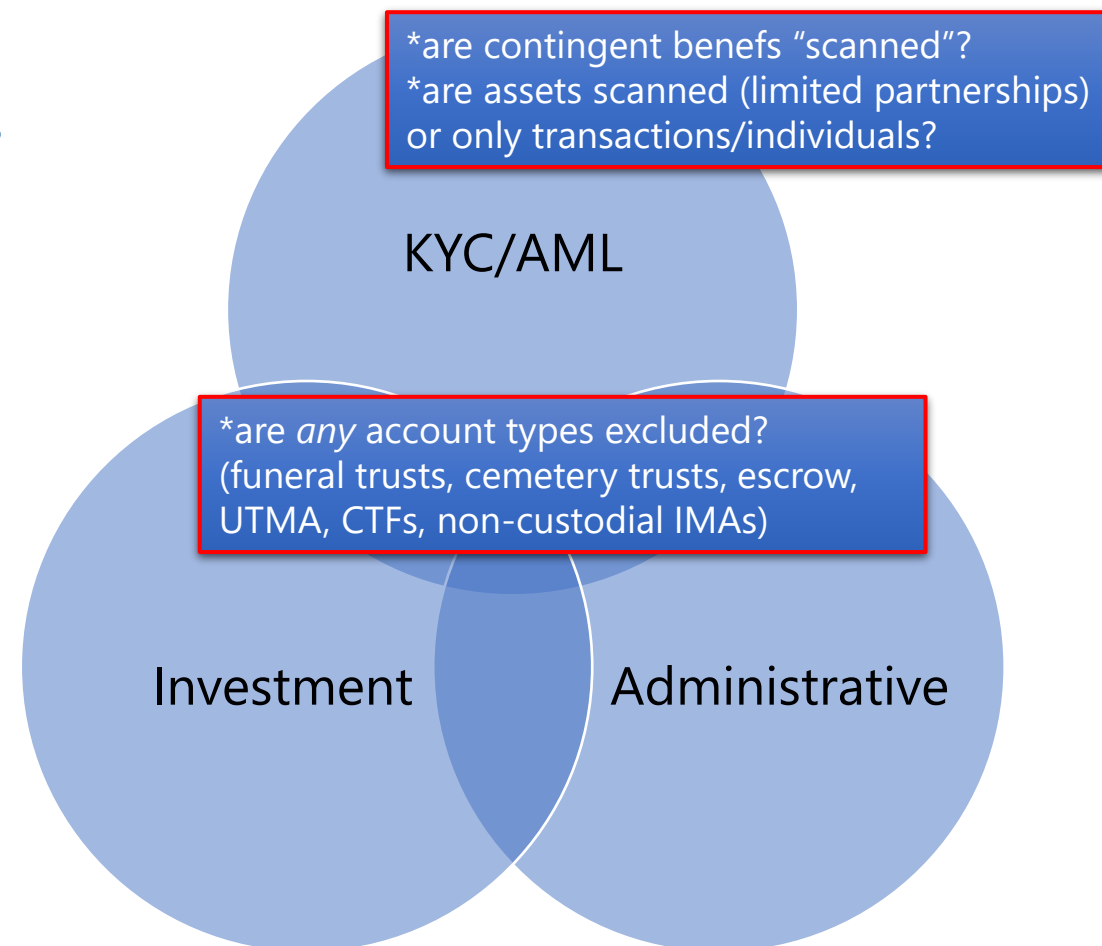
Administrative review = *typically*, a review of synoptic coding and administrative aspects to ensure compliance with applicable laws, regulations, policies, procedures and governing instrument; *typically* distinct from investment review process






Designing an Effective Program - Scope

- Understand the universe of accounts/ transactions/clients flowing into each process – what is, *or isn't*, going into the “funnel”?
- If certain account, asset or transaction types are being excluded from an account review process, what is the alternative process/control to address the specific risk or requirement?



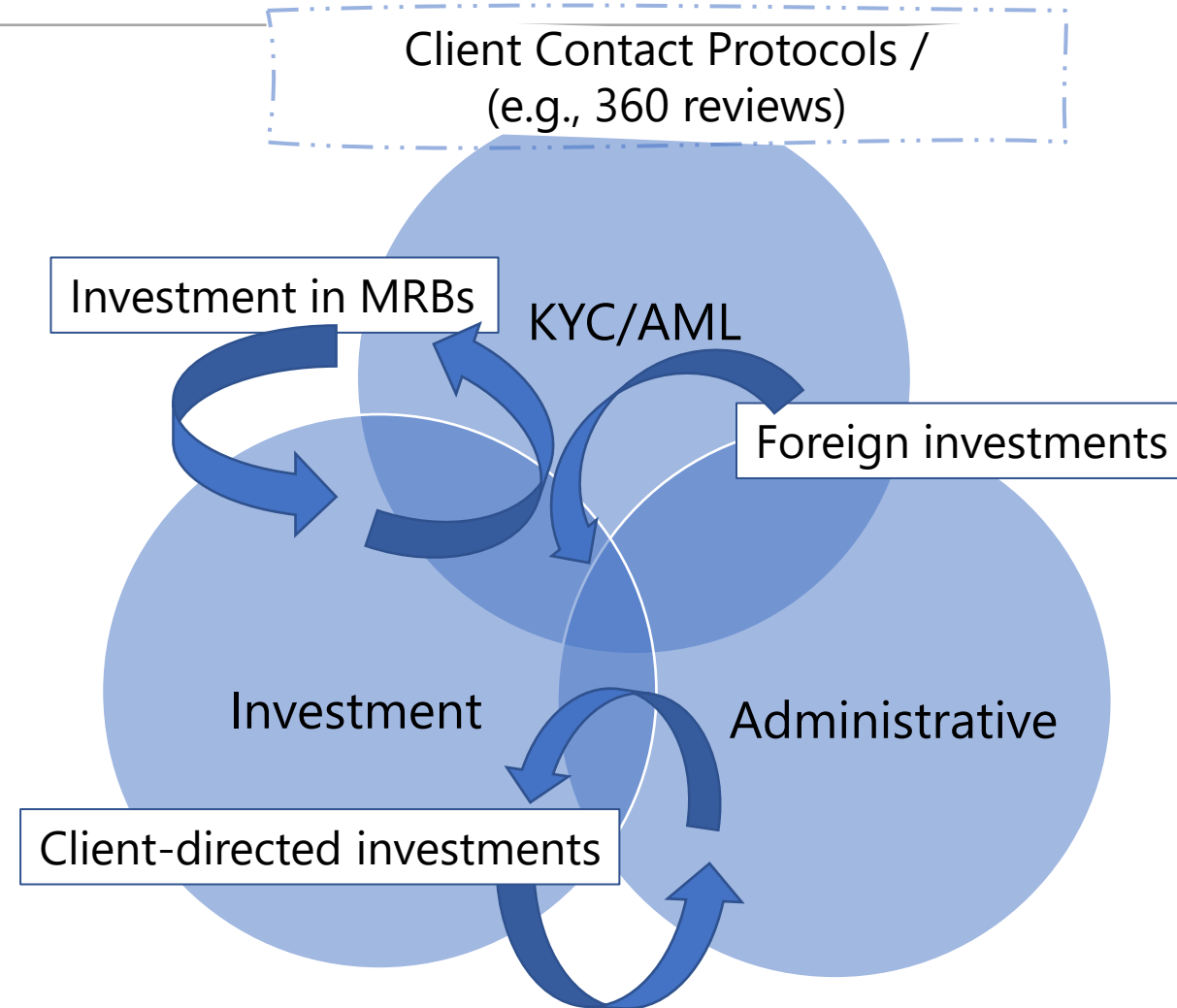
Watch items:

- “Terminating” or “Closing” accounts
- “Unfunded” or “Partially Funded” accounts
-  = market and compliance risk

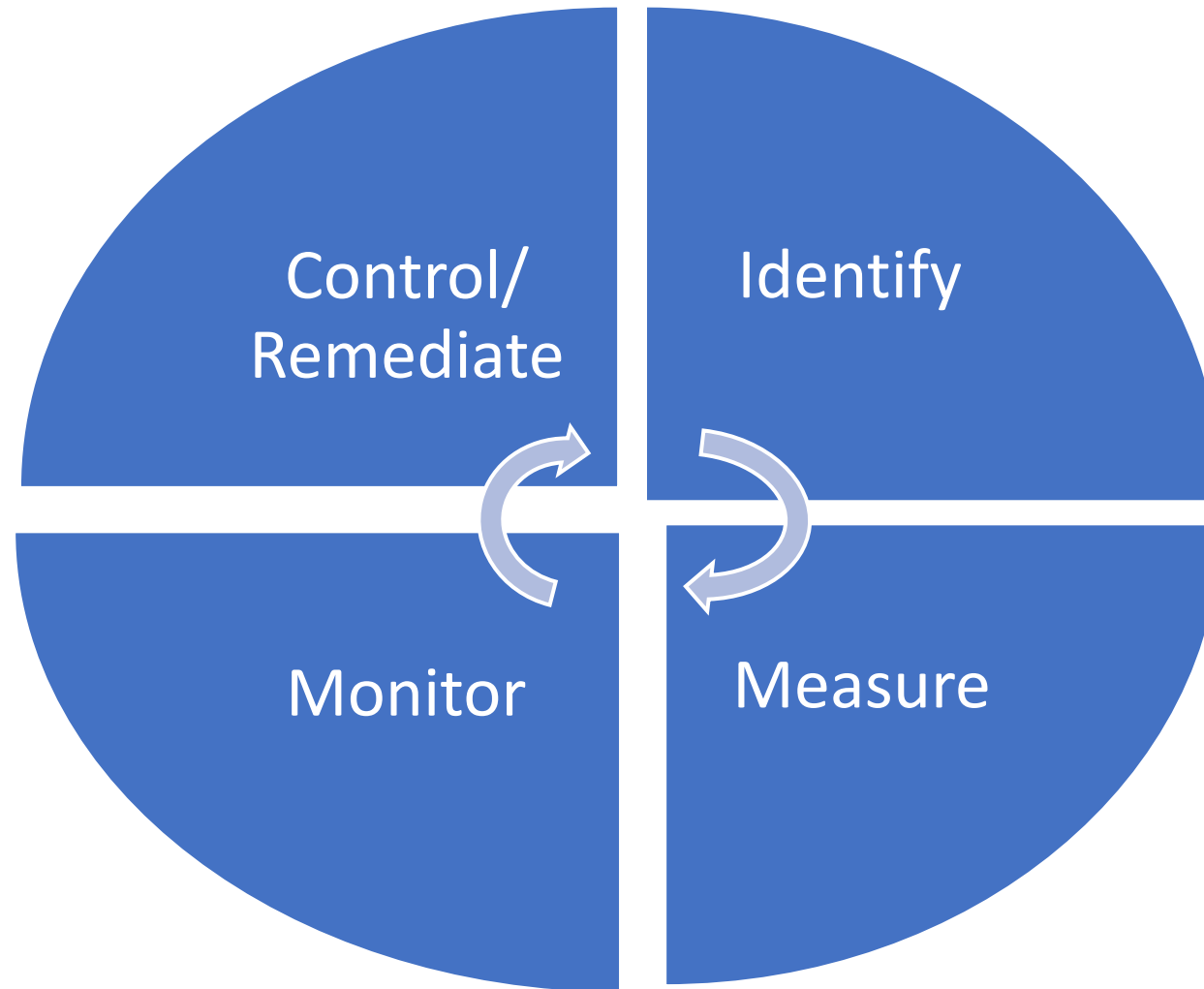
Designing an Effective Program - Scope



- What data is common to multiple processes?
- Information known to one unit of the bank (e.g., consumer banking) will be attributed to other units:
 - KYC/AML concerns
 - Death or incompetency of clients/beneficiaries
 - qualification for SCRA benefits
- Is there clear accountability for data management, data integrity, update of shared data? What is the “source of record” / “golden source”?



Designing an Effective Program – Risk/Reward Identify, Measure, Monitor and Control/Remediate

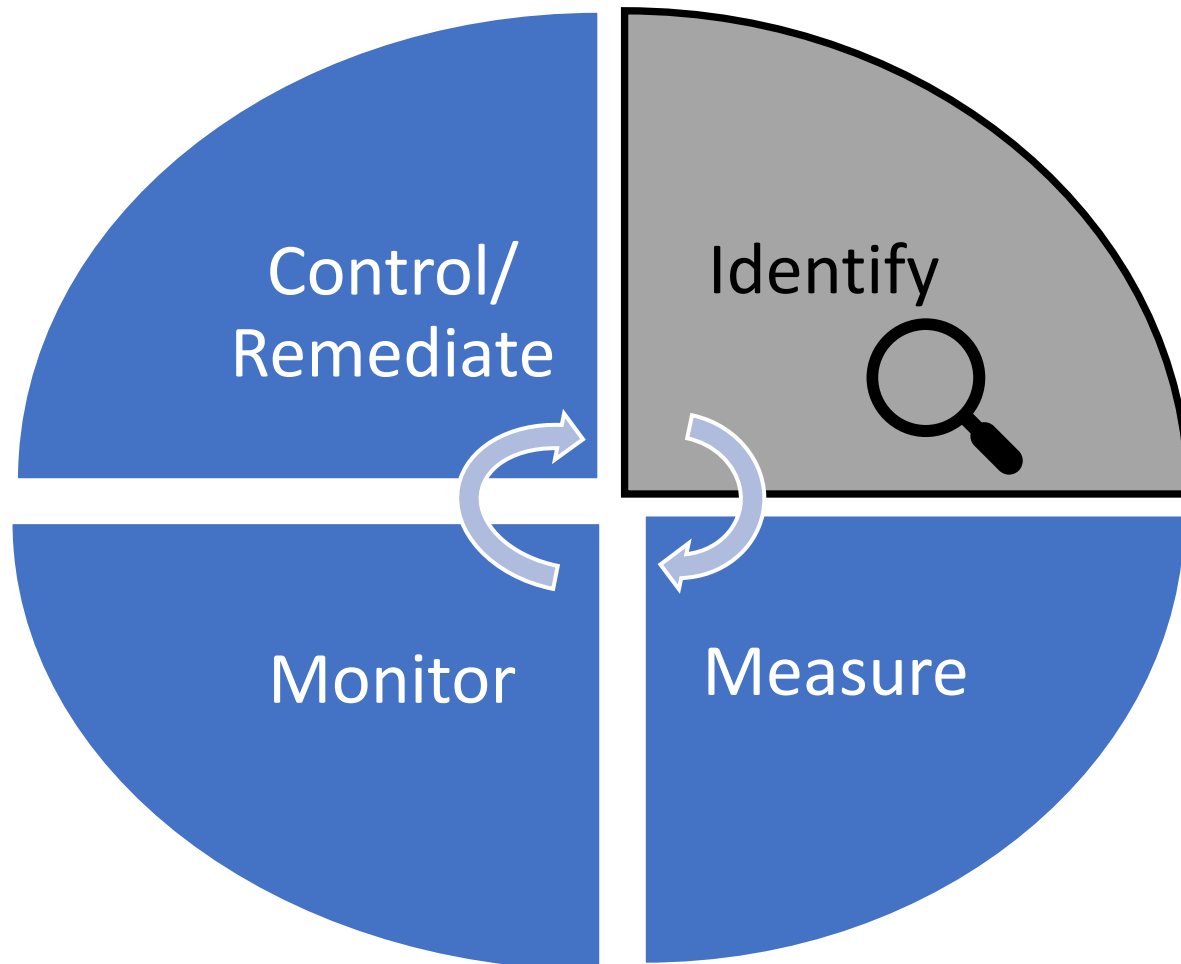


Designing an Effective Program – Risk/Reward

Identify Risks



Program must be dynamic /periodically reviewed



What are the risks based on **your** firm's profile?

- Acquisitions/mergers
- Pace of change; new products
- Systems conversions
- Range of account types/complexities
- Geographical footprint/state or foreign laws
- Feedback/results of process indicating a need for adjustment

What are **your** outcomes telling you?

- Issues – audit, self-identified, regulatory
- Tax fines/penalties
- Operational losses/litigation

What are **external** risks that need to be considered?

- Regulatory change or focus
- Other firm's experiences / losses

Designing an Effective Program – Risk/Reward

Identify Risks

For a particular risk, is the administrative review question intended to be the **primary control**, or a **secondary control**?

- Overdraft reporting
- Beneficiary loan collection
- Uncashed check research
- Returned statements
- UTMA age attainment

- How do other processes inform or interact with administrative review process?
- Should exceptions accelerate a full administrative review?

What role should **technology** play?

- Calendar account reviews based on account open date; varied frequencies, completion, aging
- Smart questionnaires – customize questions based on account type and responses
- Automatically route escalations / second approvers
- Track and age open action items/create ‘KRI reporting’
- Trend exceptions
- **Synoptic coding logic – if this then that (“continuous monitoring”)**
 - E.g., if investment responsibility = “no” then proxy voting = “no”

Designing an Effective Program – Risk/Reward

Identify Risks



Risk/Reward Levers

INDEPENDENCE

- Peer or manager review
- Centralized reviews
- Quality Assurance sampling
- Governance and oversight

FREQUENCY

- Cycle time based on risk posed by the account; timing of first post-acceptance review
- Complexity (custody vs. irrev trusts); tax filing status; shared or sole investment authority

EXPERTISE

Leverage subject matter experts to complete the administrative review (IRAs, charitable accounts) or to be accountable for specific questions (GST)

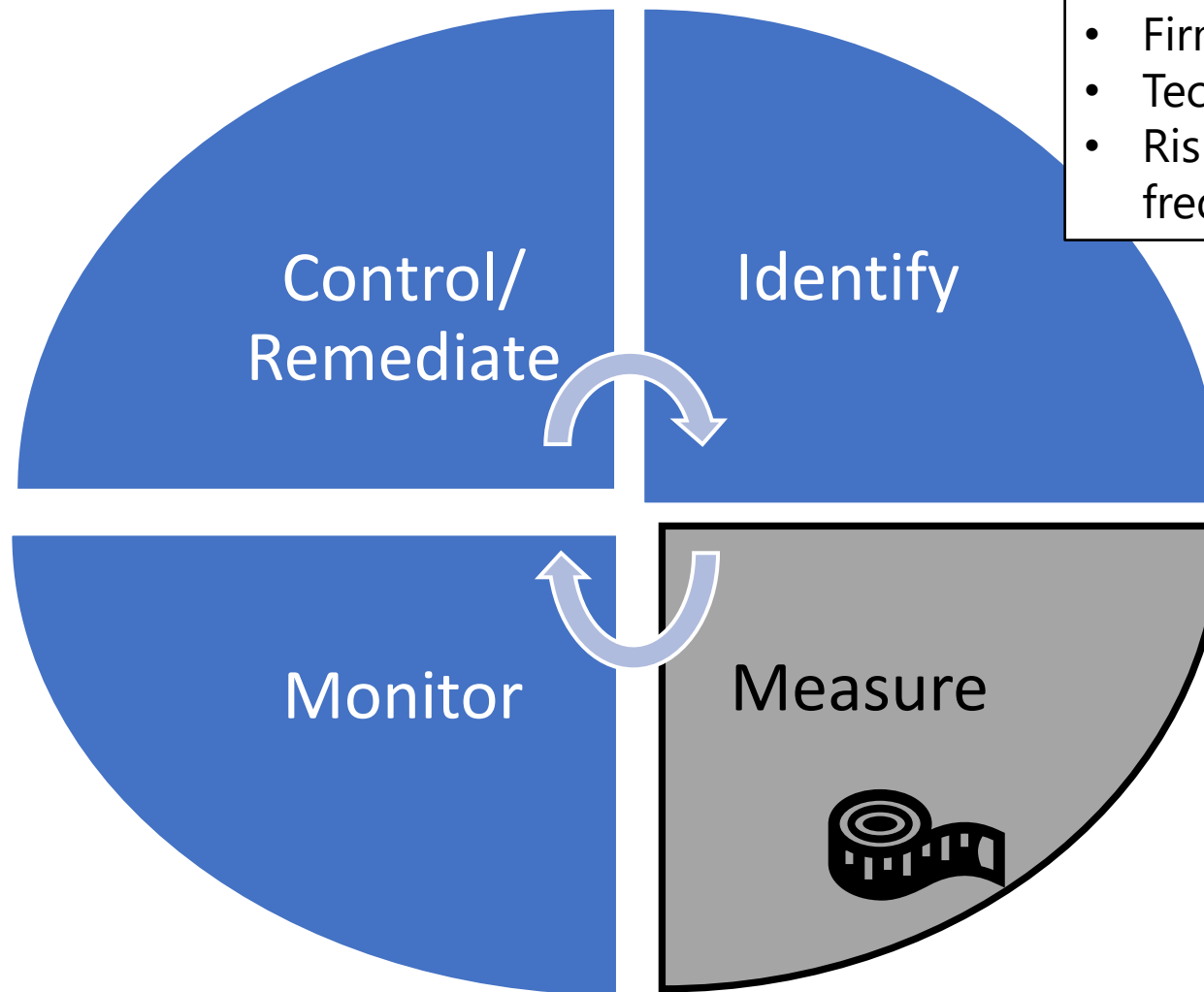


Without independence, once mis-construed, always mis-construed

Miscoding of custody accounts creates Reg 9 compliance risk

Designing an Effective Program – Risk/Reward

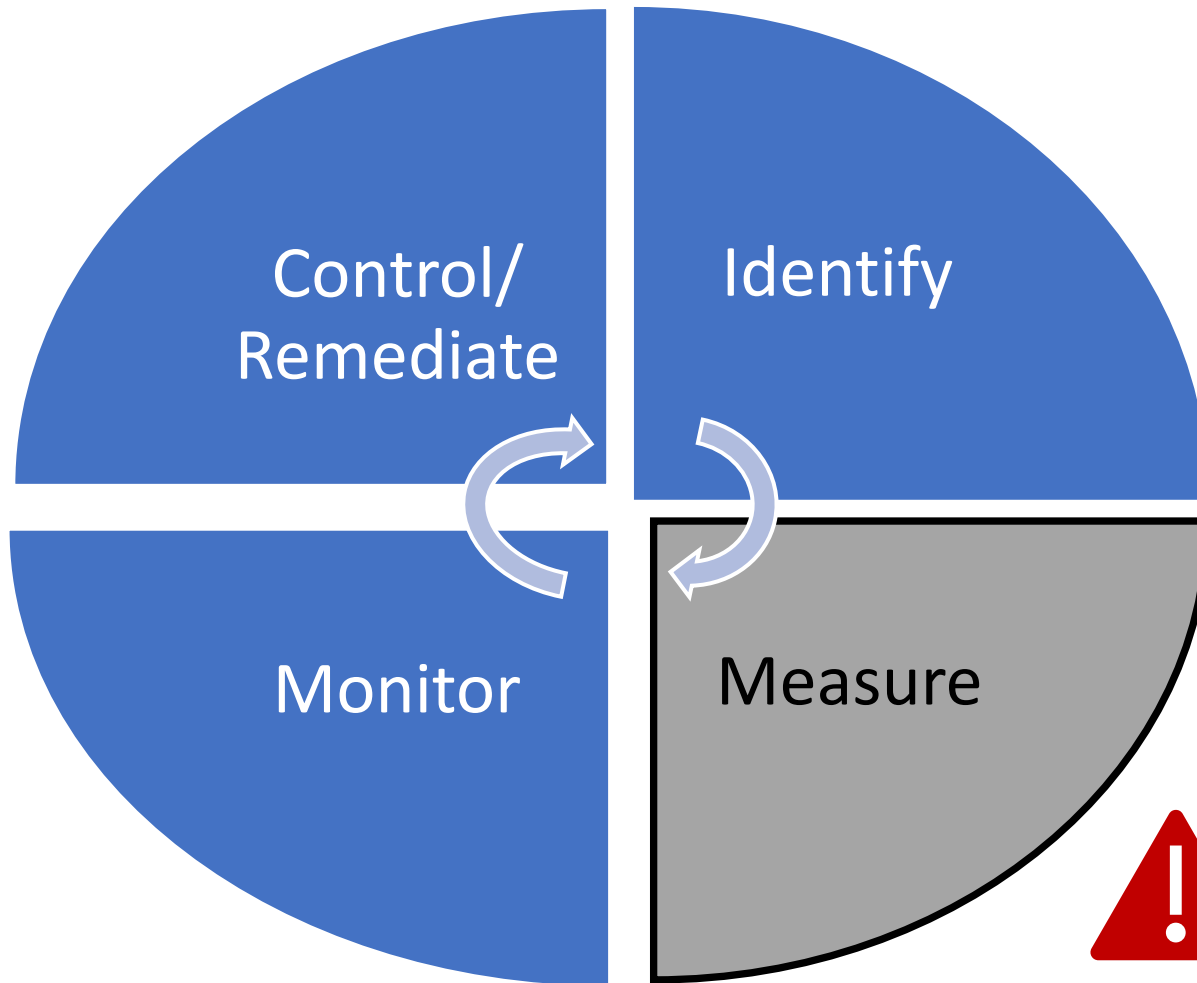
Identify, Measure, Monitor and Control/Remediate



- Firm's risk profile/processes
- Technology
- Risk levers: independence, frequency and expertise

Designing an Effective Program – Risk/Reward

Measure Risks



Define outcomes to be tracked at *account level* and at *portfolio level*:

- # Administrative reviews on target/overdue
 - Totals and by responsible officer
- Identified errors/action items with aging
- Trends by geography, topic, synoptic code

Establish triggers/limits for level of exceptions (risk appetite)

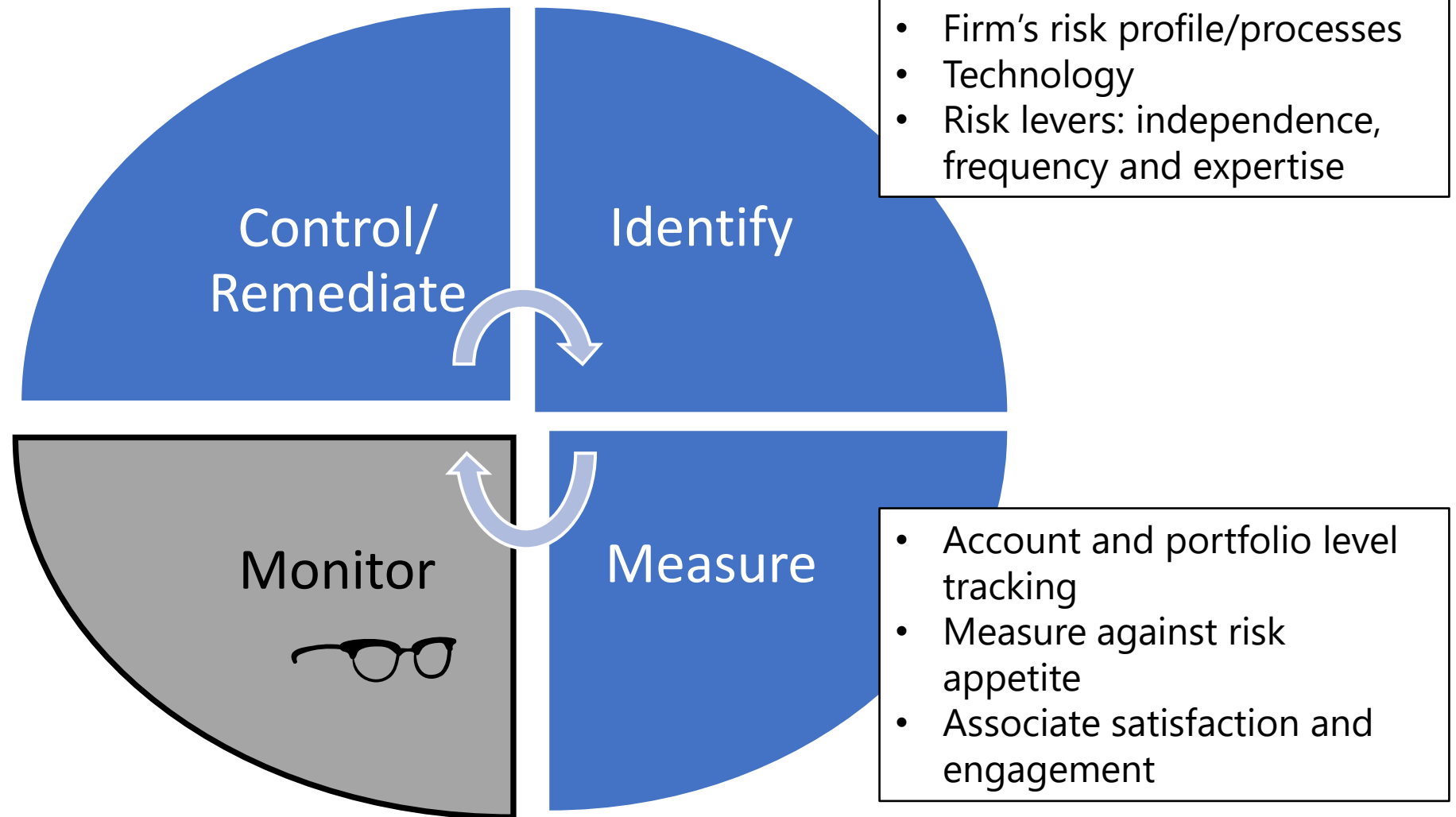
Are these items accurately captured and reported – to whom are the “Key Risk Indicators” reported?



- Action items should be encouraged and rewarded, not discouraged!
- Track # /type of reviews assigned per officer

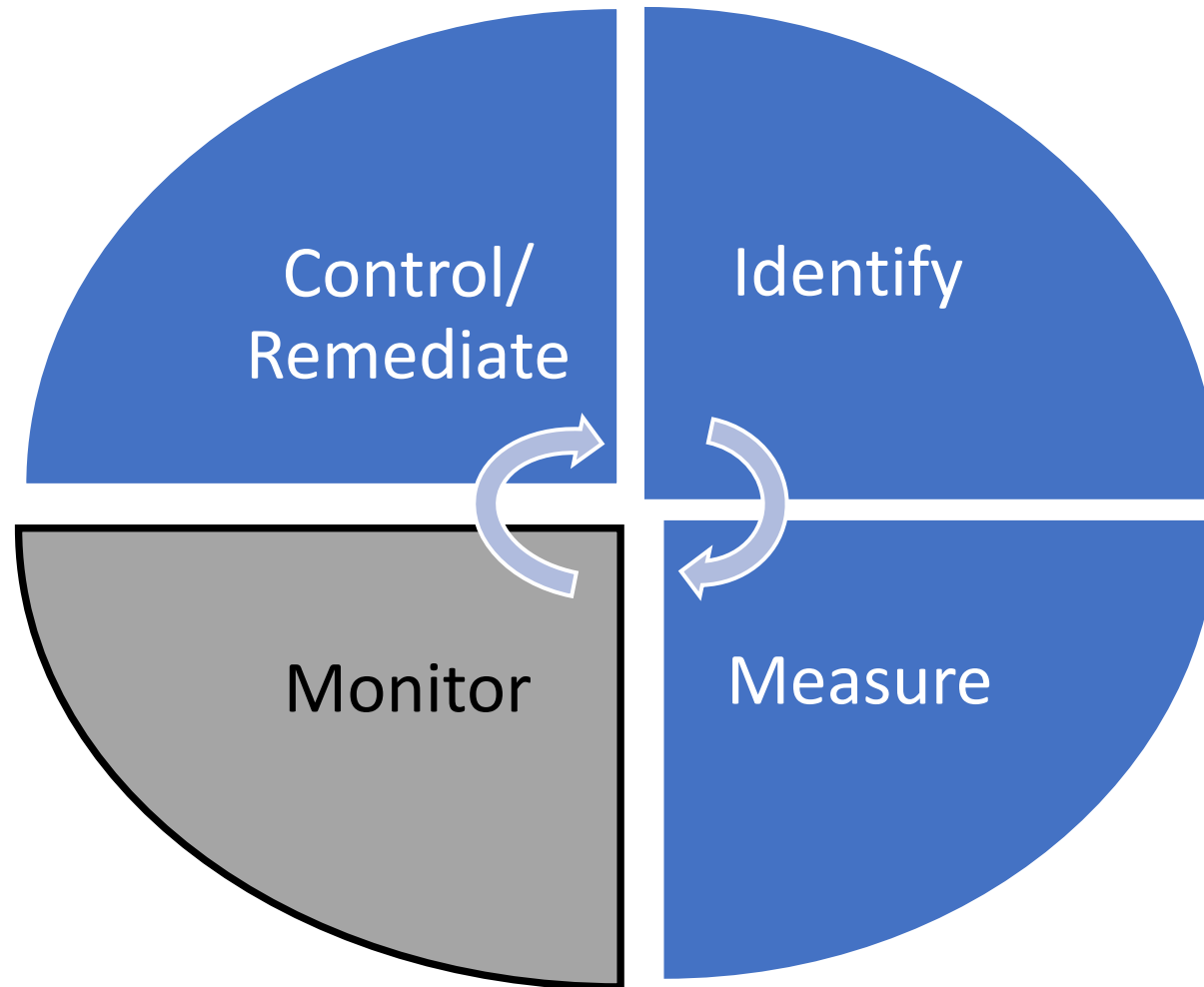
Designing an Effective Program – Risk/Reward

Identify, Measure, Monitor and Control/Remediate



Designing an Effective Program – Risk/Reward

Monitor Risks

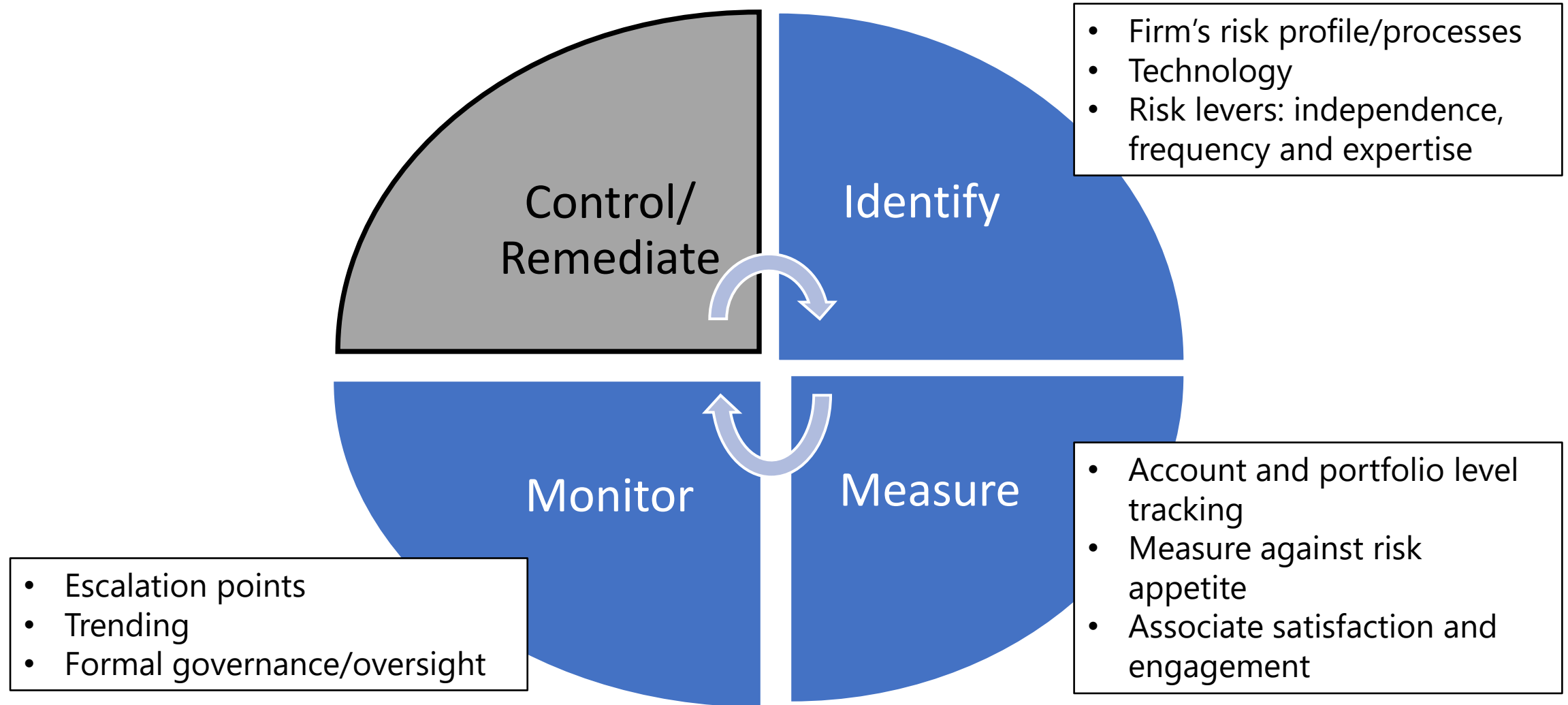


Define escalation points for *account/individual level* and *portfolio-level* escalations and trending.

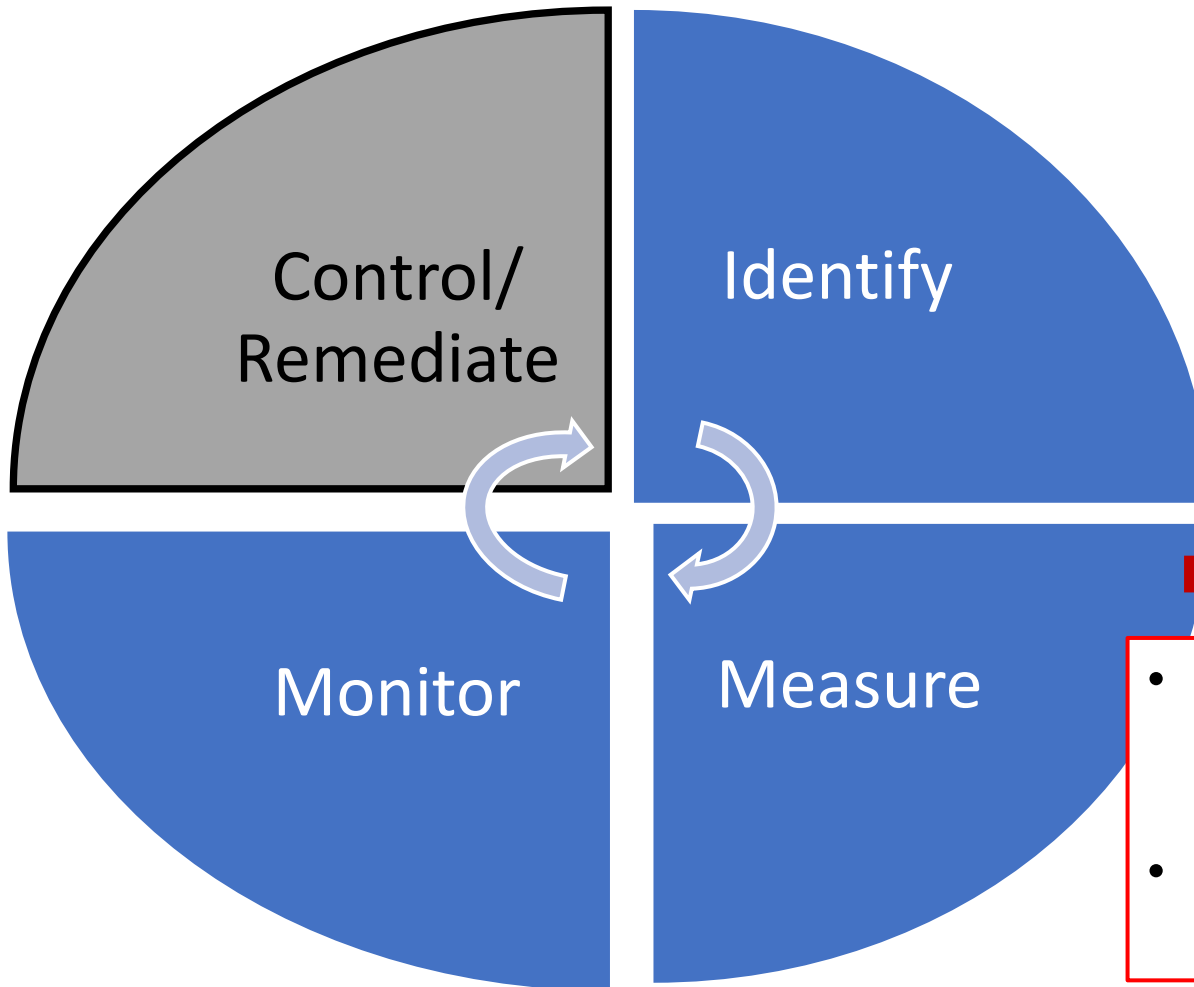
- Sufficiently senior level with perspective
- Independence from review process
- Meaningful reporting incorporating triggers/limits (KRIs) and trends; with data quality control
- Documentation of oversight (e.g. committee minutes or otherwise)

Designing an Effective Program – Risk/Reward

Identify, Measure, Monitor and Control/Remediate



Designing an Effective Program – Risk/Reward Control/Remediate Risks



For identified issues: what is the *client impact*?

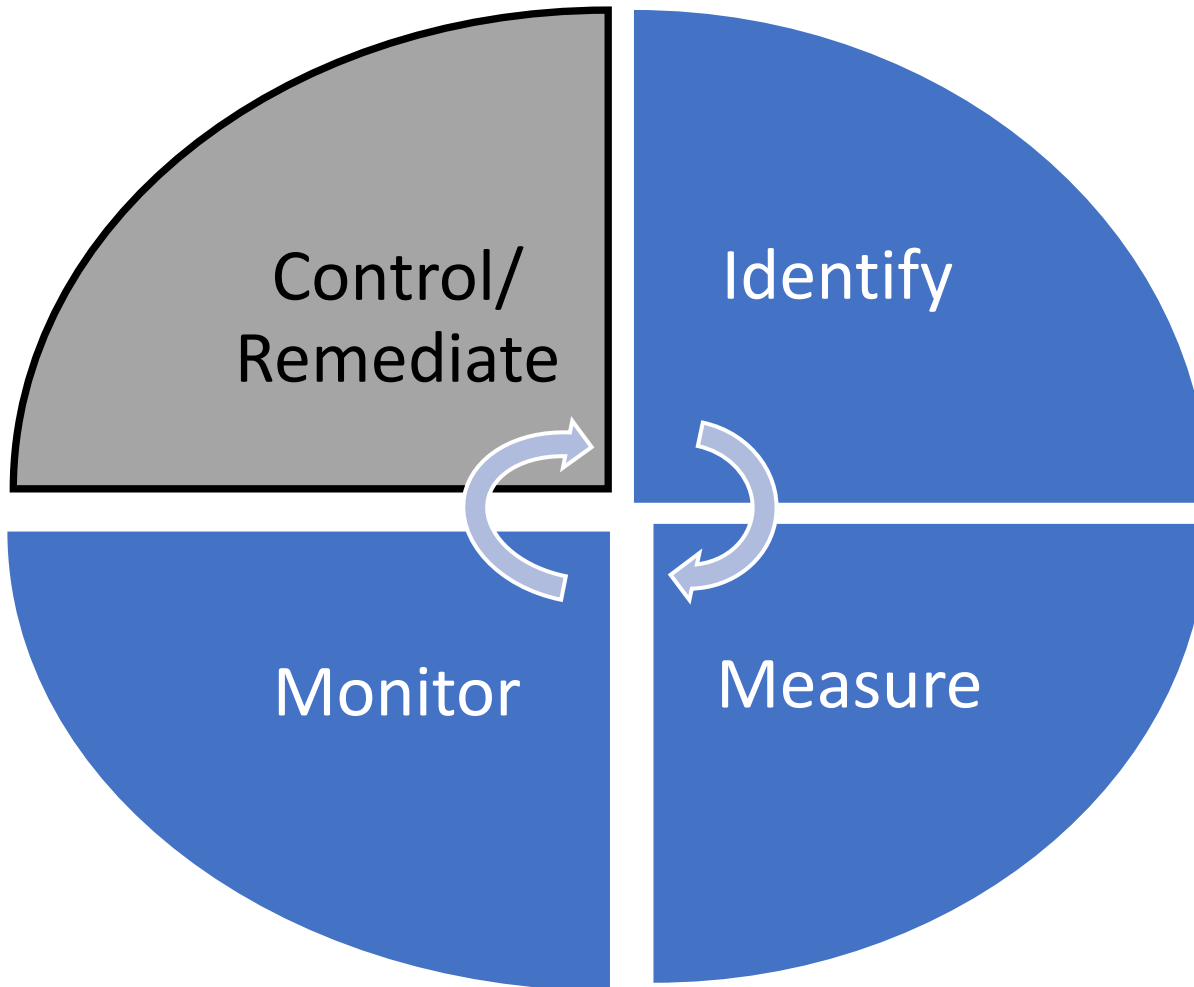
- Synoptic coding errors – were downstream processes impacted? (e.g., statements, tax reporting, asset allocation, probate accountings)
- Did the error result in a negative financial impact to the client or a beneficiary?
 - Reimbursements; client communication; look-backs



Public Service Announcement

- As issues are identified, be cognizant of when to bring in Legal and when attorney-client privilege may be needed
- Conduct periodic do's and don'ts of what / how to document files.

Designing an Effective Program – Risk/Reward Control/Remediate Risks



What actions need to be taken for **account-level** issue identified?

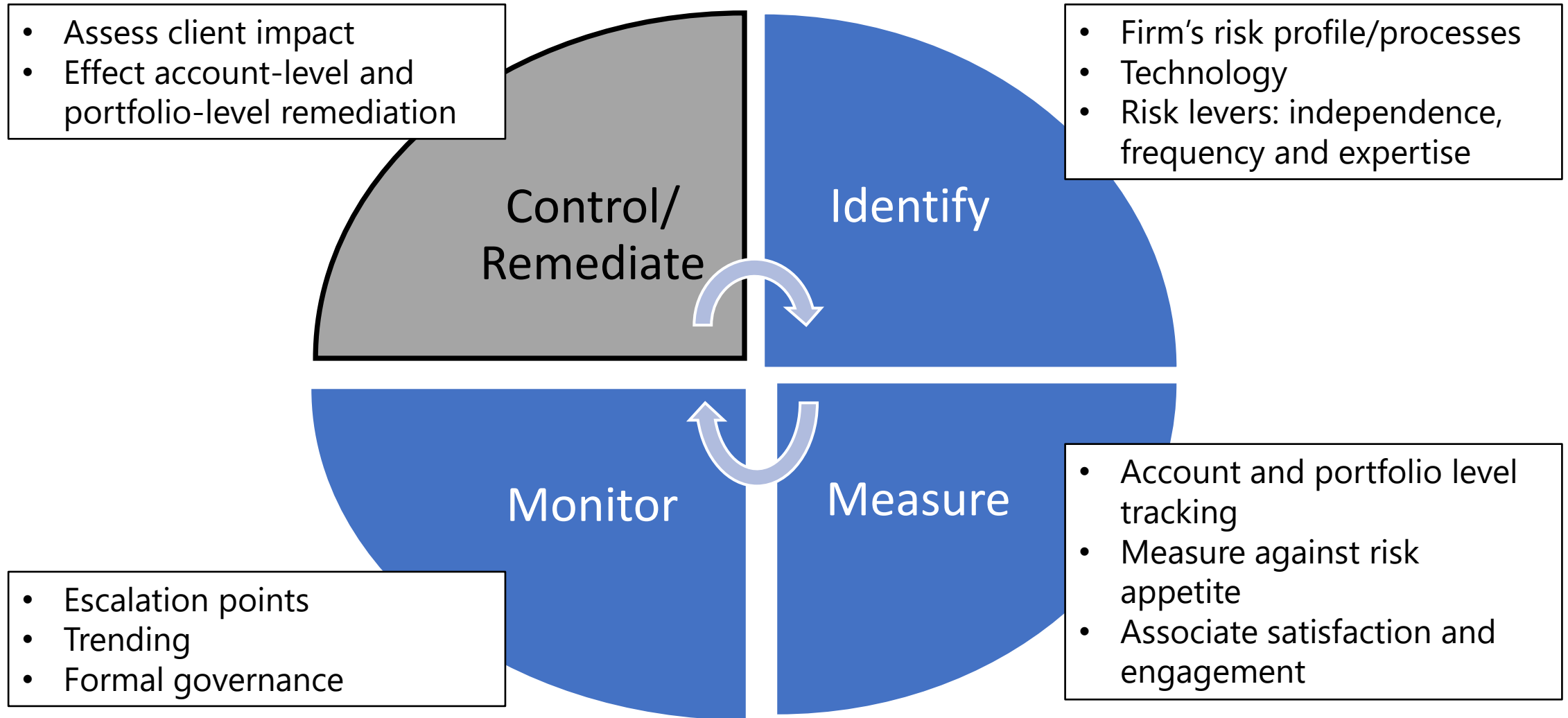
- Individual associate training, coaching, discipline or impacts to compensation? Are performance reviews and incentives aligned to fiduciary excellence?

What actions need to be taken for **portfolio-level** issues identified?

- Was there a control breakdown in a process?
- If the issue is indicative of a potentially broader issue, how are like accounts impacted?
- Is additional training warranted?
- What adjustments to program, policies or procedures may be needed? (Levers: add independence, frequency, expertise)

Designing an Effective Program – Risk/Reward

Identify, Measure, Monitor and Control/Remediate



Fatal Design Flaw - Warning #1 - Overengineering

Overengineering the administrative account review increases the risk of:

Can't see the forest for the trees syndrome.

Officers click-walking through the questions.



Most powerful questions are those that get to risks/issues that *cannot be found otherwise*.

Is the client/beneficiary alive and competent?

- Have you met with the client/beneficiary within the past 12 months?

Is the family tree up to date with accurate dates of birth for *all* beneficiaries; and are we making distributions as required by the trust terms?

- Age attainment – UTMA/ trust splits and terminations
- Beneficiaries who have been omitted

Are there document restrictions related to fees?

- Limiting total amount
- Unique allocation between princ. and income

Are there document restrictions related to investments?

- Is the language merely precatory
- Is there any directed hold, particularly as relates to concentrations; if so, is there a written plan for date of death

Fatal Design Flaw - Warning #2 – Ill-defined roles and responsibilities

Review of certain assets, transactions, data which could arguably be owned by multiple functions (including operations), or none at all....

- Client/beneficiary time horizon
- Non-financial assets held in non-discretionary accounts
- Royalties on music, art, copywritten materials
- Compliance with agreements pledging assets, esp. third party (notice of withdrawals, monitoring collateral value)
- Confirming tax qualification of non-profit beneficiaries; "skip persons"
- Non-custodial advisory account administrative issues
- Holdings subject to foreign tax withholding



Within the Administrative Account Review program itself:

- Who can approve clearing/closing the various types of exceptions or action plans?
- Whose role to keep policies/procedures current?
- Who owns periodic program review to react to internal and external risks?
- Who takes action if aging or trends are unacceptable?
- Who owns the *words on the page* of the review and the technology budget/requests for automation?



"Wait, what? I thought she was doing that..."

Today's Agenda

- I. Introduction
- II. Designing an Effective Program
 - A. Scope
 - B. Identify, Measure, Monitor, Control/Remediate
 - C. Fatal Design Flaw - Warnings
- III. Role of Second Line of Defense
- IV. Summary

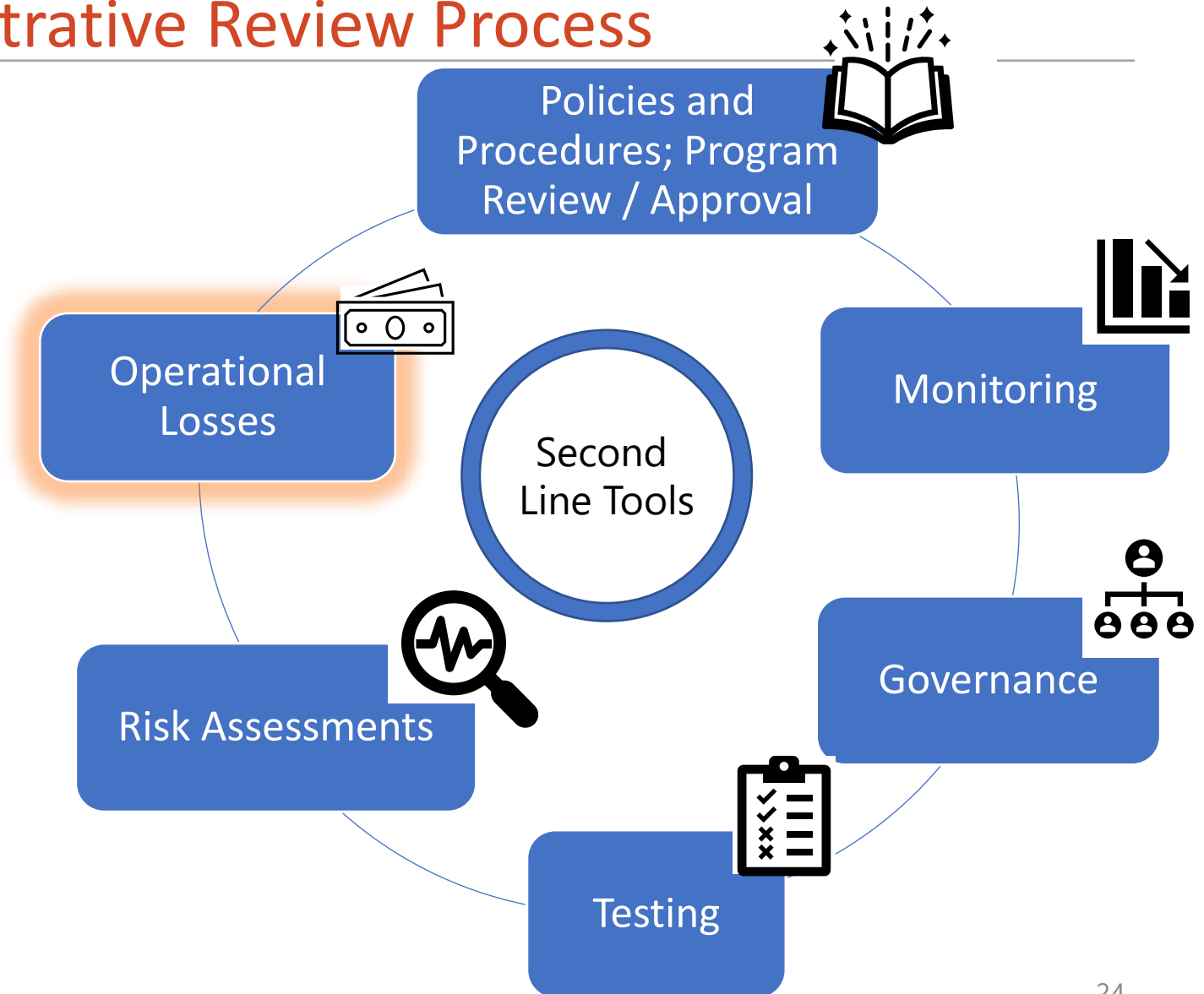
Role of the Second Line of Defense – Administrative Review Process

Front line is responsible for managing all aspects of their business including compliance and operational risk

- understand regulatory requirements
- establish processes, quality assurance to continuously inspect adequacy of control environment

Second Line is responsible for overseeing the Front Line's activities; understanding the compliance and operational risks in the business to drive compliant behaviors

- develop *independent* point of view of risks
- oversight and *challenge* of processes



Role of the Second Line of Defense – Administrative Review Process

Policies and
Procedures; Program
Review / Approval



Monitoring



Develop a deep understanding of the program and how it interacts with other processes; what is/isn't automated

Is management reporting fulsome and meaningful? (# of reviews completed/aged action items)

Have an independent POV; is the program adequate for your firm's risk profile

How is data flowing into the reporting tested for integrity and accuracy?

Is accountability for all parts of process (and overall process) documented and clear?

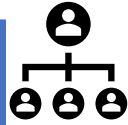
Ongoing review to identify trends and drive appropriate remediation and visibility

Is there a documented process for a periodic review of the overall program factoring in trends, operational losses, external factors, regulatory focus items, litigation, customer complaints, acquisitions, systems or technology changes



Role of the Second Line of Defense – Administrative Review Process

Governance



Participate actively in governance committees and challenge when appropriate

Has FLU established appropriate triggers and limits (especially aging)

Is escalation path appropriate and include individuals with sufficient skill, seniority, independence

Testing



Sampling / Reperformance

Risk based approach, for example, accounts:

- that passed through FLU's own QA process;
- with unique requirements
- with aged action items or overdrafts
- "closing" / "terminating" / "unfunded" accounts
- atty-drafted custody agreements; agreements with numerous amendments

Test controls in the process to confirm they are operating as intended (peer reviews; closing of action items)

Role of the Second Line of Defense – Administrative Review Process

Risk Assessments



Review rationale for account exclusions; are all intended accounts flowing into the process – reconciliations between reports and RC-T line item totals	Are common data elements across broader bank platforms, systems and processes being shared promptly (e.g., deceased customer) – how is data verified
Accounts overdue for review – any themes; are other processes continuing to execute	Review of issues, audit, regulatory findings against administrative review to understand any existing or recommended changes
Deep dive on aged <i>action</i> items – what market risk is being taken	Review technology changes over a prior period for impacts to synoptic coding

! The Second Line of Defense has a unique and valuable opportunity to provide perspective to processes that cut across units and business lines. Use as an opportunity to partner with other compliance and risk professionals in your organization to “connect the dots” (e.g., technology, investment, AML/KYC, legal)

Role of the Second Line of Defense – Administrative Review Process

Operational
Losses



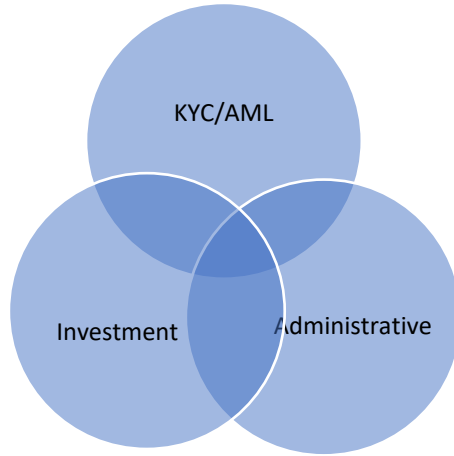
... and customer complaints and new and pending litigation

- What was process weakness?
- **Why didn't the administrative review (or other) process prevent or detect the weakness?**
- If the process did in fact detect an error or weakness, did the escalation process work?
- Is the issue systemic? Could it be common to other similarly situated accounts?
- What is the action plan and are the target date and proposed remediation sufficient?

Examples of potential remediation / outcomes

- Individual coaching or discipline
- Enhanced training
- Clarification of review question
- Adding new “flavor” of administrative reviews (e.g., IRAs)
- Introducing specialized or additional expertise on a particular question/issue
- Creation of brand new process, client agreement or disclosure
- Where systemic issue is identified, need for assessment of remediation/look-back
(remember ACP)

Summary



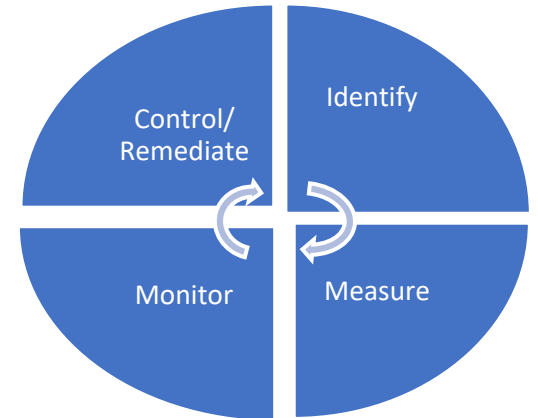
Know your processes -
How they interact / what's in and out / common data



Don't overengineer the process – make sure the
most impactful risks are covered



Know who's on first: clarity of roles and responsibilities,
accountability for process steps and high-risk clients,
transactions and assets



Be sure there is reporting and governance that drives identification, escalation
and remediation of portfolio-level trends



Leverage operational losses (and customer complaints/litigation) as your
breadcrumb trail to operational excellence



APPENDIX

OCC Handbook – Personal Fiduciary Activities, Feb 2015

Appendix C: Personal Account Review Worksheet

This worksheet is intended as a job aid. The worksheet is provided to assist examiners in reviewing personal fiduciary activities. The successful completion of this worksheet does not constitute an assessment of risk management or oversight. N/A means not applicable.

Personal Account Review Worksheet

Personal Account Review		
Bank name	Examination date	Examiner initials
Account administrator	Account name	Account number
Account type	Capacity	Current market value
Investment officer	Investment authority	Last Reg. 9 review date
Document date	Date account opened	

Account Synopsis			
Successor		Spendthrift	
Revocable		Irrevocable	
Investment Authority			
Sole		Directed	Shared/cotrustee
State trust statute		Broad powers	Unusual provisions
General retention authority		Specific retention authority	Silent re: retention
Distributions			
Income		Monthly	Quarterly
		Semiannually	Annually
To whom:			
Principal		Monthly	Quarterly
		Semiannually	Annually
To whom:			
Requested		Required	Bill payer
Termination			
Date		Remainderman	

Administrative Matters				
Y	N	N/A		Date (if applicable)
			Governing instruments executed by appropriate parties are on file.	
			Pre-acceptance review was properly performed.	
			New account properly approved.	
			Customer due diligence (enhanced due diligence/customer identification program) properly completed.	
			OFAC screening and AML monitoring done.	
			Distributions during exam period were allowable under the document.	
			Discretionary distributions during exam period were properly supported, with needs assessment, if required.	
			Crummey notices were sent both where and when required.	
			Fees are reasonable, conform to published fee schedules and/or amount stated in document.	
			Account coding is correct.	
			Proxy voting is handled properly.	
			Shareholders Communication Act disclosure was made; account is properly coded objecting beneficial owners/non-objecting beneficial owners (OBO/NOBO).	
			Statements are provided to appropriate parties.	
			Tax filings are done, and done timely (1099, IRS Letter).	
			Administrative reviews are done per bank policy.	
			Appropriate ticklers have been established.	

Conflicts of Interest				
Y	N	N/A		Date (if applicable)
			Account does not hold own bank/bank holding company stock.	
			Proprietary mutual fund holdings properly supported; fees rebated for managed accounts.	
			For third-party funds, 12b-1 or shareholder servicing fees are properly disclosed/authorized.	
			Account does not hold own bank/affiliate bonds, mortgages, or other products.	
			Use of own bank/affiliate money market deposit account is proper.	
			Any use of affiliated broker/dealer is properly authorized.	
			Any use of affiliated insurance affiliate is properly authorized.	
			There are no sales of assets/loans between accounts.	
			There are no loans/sales/dealings with bank officers, directors or employees.	

Investment Matters					
Stated Investment Objective					
Actual				Objective	
\$000s	%			\$000s	%
			Cash equivalents		
			Equities		
			Fixed income		
			Total		

Special Assets (List name, market value, date and source of valuation)				
Y	N	N/A		Date (if applicable)
			Actual asset allocation agrees with objective.	
			Assets conform to governing instrument and are otherwise suitable.	
			All assets are income producing.	
			All assets have been recently priced; i.e., no assets have stale prices.	
			Holdings are on an approved list, meet bond quality standards, etc.	
			There are no concentrations exceeding 10% of the account's market value.	
			The level of cash/liquid assets is reasonable (no overdrafts or excess).	
			Excessive trading has been avoided.	
			Written directions/approvals have been obtained where necessary.	

Special Assets				
Y	N	N/A		Date (if applicable)
			Closely Held Securities	
			Proper valuations are on file.	
			A recommendation either to sell or retain the asset was made.	
			Real Estate Assets	
			Environmental inspection completed before account acceptance.	
			Valuation appropriately supported (triennial appraisal or other approved method).	
			Appropriate insurance is in place; property taxes are paid.	
			Income producing real estate is leased at a market rate.	
			Mineral interests are properly valued and managed.	
			Real estate or other notes are current and collateral is adequate.	
			Other special assets are properly managed.	

Investment Reviews				
Y	N	N/A		Date (if applicable)
			Initial/annual Reg. 9 review is done timely.	
			Initial/annual Reg. 9 review detected/addressed issues.	
			Special assets are appropriately addressed in the review.	

Other				
Y	N	N/A		Date (if applicable)
			Other issues noted?	

Comments and Exceptions Noted				

Synoptic Information			
Bank name:		Charter number:	
Examination date:		Examiner:	
Account name:		Grantor:	
Account number:		Cotrustee:	
Account type:		Account officer:	
Revocable?		Portfolio manager:	
Bank's capacity:		Tax ID number, if available:	

New and Successor Accounts

Date account accepted:		If successor, indemnity in file?	
Account opening sheet used?		Pre-acceptance review date:	
Acceptance noted in minutes?		Customer Identification Program form & OFAC check?	
Executed document on file?		Customer ID determination?	

Investment Authority

Prudent investor rule:		General power of retention:	
Grantor directs:		Specific retention provisions:	
		Other (specify):	

Distributions

Income distributions?		When?	
Principal distributions?		To whom?	

Discretionary distributions?			
Emergency provisions?			
Spendthrift clause?			

Synoptic Records

Is synoptic sheet accurate?	
-----------------------------	--

Assets			
Money market (sweep):		Own bank securities/deposits?	
Fixed income:		If so, proper direction?	
Equities:		Any holdings over 10%?	
Real estate:		If so, diversification plan?	
Miscellaneous:		Mutual funds that pay fees?	
Total:	0%	If so, properly disclosed/approved?	
		Liquidity-overdrafts/excess cash?	
What is investment objective?	% Equity	% Fixed	Special assets?
Do assets conform with investment objective?		If so, adequately administered?	
		Excessive trading?	

Investment (Reg. 9) Review

Investment review date:		Include review of assets per Prudent Investor Rule?	
Review noted in minutes:		Did review identify/address issues?	

Distributions			
Were required distributions (i.e., income) made?		Do discretionary distributions conform to document?	
Were distributions properly supported?		Are discretionary distributions properly supported?	
Were principal invasions proper?			

Other Exceptions			
Approvals of cotrustee or others?		Transactions with insiders?	
Fee calculation:		Sales between accounts?	

Comments