January 8, 2001

To: Corporate Trust Industry

From: ABA Corporate Trust Committee

Re: **Request for Comment on Corporate Trust Risk Management Outline**

Comment Request

The American Bankers Association is seeking input from the corporate trust industry on the enclosed Corporate Trust Risk Management Outline. Please review the enclosed draft and send your comments by e-mail, fax, or letter to:

American Bankers Association
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Please provide ABA with your comments by Friday, March 9, 2001.

Background

The realm of corporate trust services continues to evolve and expand, and today it includes much more than the traditional trustee, registrar, transfer agent, and paying agent services. Corporate trust service providers are facing an increasing variety of responsibilities relating to securitized assets, financial document services, and escrow services, to name just a few areas.

At the June 2000 meeting of the ABA Corporate Trust Committee, the committee agreed to develop a corporate trust risk management outline that could serve as a management tool for corporate trust service providers. Members of the committee thought it would be useful to develop a risk management outline that reflects the various approaches to risk management in this ever-changing specialty. During the subsequent months, the outline was developed with input from the following institutions represented on the committee:

- Banc One Investment Management Group
- Bankers Trust Company
- The Bank of New York
- Chase Manhattan Bank
- Deutsche Bank
- First Union National Bank
- LaSalle Bank
- State Street Bank & Trust Company
- SunTrust Bank
- U.S. Bank
- Wells Fargo Bank

The Outline

This outline offers a starting point for risk management. It was prepared by the ABA Corporate Trust Committee and based on input from committee members, senior managers, and risk managers from both large and small banks around the country. The ABA and the committee wish to thank all participants for their input.

The outline is a framework for considering corporate trust risk management issues. It is important to note that the types of services offered and the types of accounts serviced vary significantly from one financial institution to another. Therefore, the outline is not intended to be a comprehensive, definitive, or exhaustive summary of risk management issues. Rather, each corporate trust service provider should revise and supplement these materials with a risk management approach that reflects its unique mix of services and account relationships.

The outline is divided into two parts:

Part One is an overview of risk management for the corporate trust area, based in part on the discussion set forth in Federal Reserve Board Supervisory Letter SR 96-10, “Risk-Focused Fiduciary Examinations.” These risk categories were also referenced in Federal Reserve Board Supervisory Letter SR 99-18, which addressed risk-based capital adequacy allocation, a high-level methodology for managing risk in complex financial institutions.

Part Two is an outline of primary risk factors in corporate trust set forth by risk category. The outline uses the nine risk categories defined by the Office of the Comptroller of the Currency. (See, for example, OCC Bulletin 96-2, "OCC Supervision by Risk Program," and OCC Bulletin 98-3, "Technology Risk Management Guidance for Bankers and Examiners.")

Please keep in mind that this outline is meant as a tool to stimulate thinking about risk in corporate trust activities. *Different* institutions, large and small, will have *different* risk considerations. They may also exhibit some factors not listed here, as well as have varying degrees of formality and process in place to manage and control risk. The ABA seeks to gather input on the outline and incorporate changes before publishing a final version. Thank you very much for providing your thoughts and ideas on these important issues.

Part One
Overview of Risk

This part of the outline is an overview of risk management for the corporate trust area, based in part on supervisory guidance issued by the Federal Reserve Board.

I. Management Oversight

A. Consider business management issues

1. Develop strategic and overall business plan that defines acceptable levels of risk

2. Maintain awareness of portfolio/customer base and mix

3. Implement new product development policy that includes management oversight and risk analysis

4. Facilitate audit and regulatory compliance process

B. Consider organizational management issues

1. Build organizational structure to promote operating leverage and efficiency and reduce likelihood of error

2. Manage mechanisms, such as committees and task forces, to ensure appropriate intrabank and/or divisional issue representation and management

3. Manage reporting structure to ensure adherence to risk profile and exception reporting procedures

4. Perform periodic risk management self-assessment and review for new or newly known areas of risk

C. Address human resources issues

1. Hire, develop, and retain skilled industry professionals

2. Develop and implement appropriate training programs

3. Create and manage process for assessing skill levels of staff members

II. Policies, Guidelines, and Procedures

A. Produce policies and procedures that are consistent with business unit goals, strategy, and management/staff experience

B. Establish accountability for managing business unit relationships

C. Ensure compliance with laws, regulations, and governing instruments

D. Verify that material areas of activity and risk are monitored and managed

E. Periodically review and affirm existing policies and procedures

III. Risk Monitoring and Management Information Systems

A. Set acceptable targets

B. Maintain monitoring and reporting tools

C. Establish appropriate oversight by function

IV. Internal Controls

A. Document control activities

B. Assign responsibility for activities and delineate levels of authority

C. Incorporate appropriate segregation of duties where feasible

D. Conduct adequate testing and review

E. Ensure timeliness of control activities

Part Two
Primary Risk Factors in Corporate Trust

This part of the outline sets forth areas of potential risk, using the categories of risk defined by the OCC. (See, for example, OCC Bulletin 96-2.) These risk areas are typical but not necessarily all-inclusive or applicable to all institutions or lines of business. They are listed here to point out areas for consideration during the risk management process.

I. Categories of Risk

A. Evaluate and Monitor Credit Risk

1. Obligation to fund
2. Unplanned shortfall from operating activity
3. Intra-day exposure
4. Disgorgement required by the Trust Indenture Act under default circumstances where loans exist with trustee institution

B. Evaluate and Monitor Legal Risk

1. Obligation to comply with contract
2. Litigation against or by trustee
    a. Decision against trustee
    b. Recovery of expense of litigation
3. Circumstances when counsel is desired
4. Lack of specificity or clarity as to duties or exculpation

C. Evaluate and Monitor Regulatory Risk

The following are some of the major laws, codes, and regulations that, together with legal precedents, govern the activities of trustees and provide regulatory guidance. Other requirements may apply, depending on jurisdiction, type of account, or situation.

1. Trust Indenture Act

2. Securities Act, Securities Exchange Act, and Securities and Exchange Commission regulations

3. Internal Revenue Service regulations

4. Uniform Commercial Code

5. Escheat rules and reporting/surrender requirements

6. Office of Foreign Asset Control requirements

7. Bankruptcy Code

8. Federal and state supervisory review and examination regulations

D. Evaluate and Monitor Market Risk

1. Interest rate fluctuations (for example, impact on level of business, float earnings)

2. Occurrences of default, including failures of obligors and related parties such as servicers or developers

3. Concentration

    a. Geographic concentration

    b. Industry concentration

    c. Account or asset class concentration

E. Evaluate and Monitor Fiduciary Risk

1. Exercise of fiduciary duties

2. Exercise of discretion (if required)

3. Conflicts of interest

4. Actions beyond those required by contractual terms

F. Evaluate and Monitor Reputation Risk

1. Negative publicity

2. Repercussions of trustee's or other party's failure to perform

3. Public or customer misunderstanding of role of trustee institution and scope of its responsibilities

G. Evaluate and Monitor Operating Risk

1. Technology failures

2. Securities and funds processing errors or omissions

3. Contract administration errors or omissions

4. Fraud

5. Business interruptions

6. Payment, transfer, and other servicing function errors or omissions

H. Evaluate and monitor other risks

This outline does not separately list liquidity and interest rate risk as major risk areas because, although they are normally considered banking institution risks, they do not usually affect corporate trust activities.

For example, it is possible that liquidity risk might come into play where lack of market liquidity impacts the ability to sell off collateral for a particular type of account. Interest rate risk could come into play where there are contractual commitments by a corporate trust institution to provide a defined rate of return on customer accounts, or an assumption is made regarding account profitability based on float earnings. Another example of interest rate risk would be a decline (or increase) in business levels attributable to the general interest rate climate for all or a particular type of securities for which the trustee institution acts under various capacities.

Therefore, you should keep in mind the possibility of liquidity or interest rate risk in specific circumstances that you may encounter.

II. Risk Mitigants

A. Institute appropriate policies and procedures

B. Hire, train, compensate, and retain, competent staff

C. Engage appropriate advisors, such as specialized counsel, appraisers, and so forth

D. Adopt appropriate levels of technology and processing automation

III. Risk Controls

A. Implement exception reporting system

B. Perform audit and reviews

C. Manage quality assurance

D. Identify and monitor key risk indicators