

# OCC Update BDUG Annual Meeting September 23, 2014

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- 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.
- I'll refer frequently to national bank and Federal savings association regulations and guidance – while similar in principle, you should refer to the regulations and guidance of your primary regulator.

- OCC Asset Management Supervision
- OCC Asset Management Regulation and Guidance
- Key Risks/Asset Management Supervisory Focus
- Appendix I: OCC Asset Management Guidance
- Appendix II: Asset Management Statistics

*“assuring the safety and soundness of, and compliance with laws and regulations, fair access to financial services, and fair treatment of customers by, the institutions and other persons subject to its jurisdiction.”*

- From Title III of the Dodd-Frank Act



# OCC Asset Management Supervision

## National Bank and FSA AM Activity

- The OCC regulates 1,159 national banks and 464 Federal savings associations (FSAs).
  - They range from large complex banks with global footprints to local community banks.
  - Includes 66 limited purpose national trust banks and 1 trust only FSAs.
- Approximately 43% of all national banks and 28% of FSAs have Asset Management (AM) activities, which include:
  - Fiduciary services including trust and investment management services;
  - Institutional custody and securities lending activities; and,
  - Retail brokerage activities.

## National Bank and FSA Combined Fiduciary and Custody Assets top \$44 Trillion.

(\$000s)	Total Fiduciary Assets	Total Custody Assets	Total Fiduciary & Custody Assets
LB	\$5,690,103,411	\$34,505,243,084	\$40,195,346,495
MB	\$1,007,727,306	\$586,868,376	\$1,594,595,682
NE	\$1,092,409,409	\$1,010,250,110	\$2,102,659,519
CE	\$77,963,907	\$43,145,144	\$121,109,051
SO	\$38,998,989	\$33,333,385	\$72,332,374
WE	\$26,300,450	\$12,794,117	\$39,094,567
<b>Total</b>	<b>\$7,933,503,472</b>	<b>\$36,191,634,216</b>	<b>\$44,125,137,688</b>

## AM Supervision and Policy

- Over 150 examiners with specialized Asset Management expertise perform ongoing supervision both on and off bank premises.
  - Large Banks – Midsize/Community Banks – National Trust Banks
- OCC AM Policy Group in D.C. works extensively with OCC's examiners on:
  - Policy guidance for the industry and examiners.
  - Internal training.
  - Bank-specific supervisory issues, including potential violations and matters requiring attention.
- Policy monitors trends in MRAs and violations for trends, and potential need for related guidance.
- AM Policy also works closely with OCC Legal and other internal and external groups on regulatory matters including Volcker Rule; FSOC issues; and interpretations of OCC Regs 9/150 and 12/151.



# OCC Asset Management Guidance

Recent and Upcoming OCC & AM  
Group Guidance

## Key OCC Initiatives Impacting AM

- Regulatory consolidation and EGRPRA review.
  - Consolidated NB/FSA regulations still in development, but EGRPRA review underway to reduce burden.
- Comptroller's Handbooks
- Risk Management Guidance: Third-Party Relationships
  - OCC Bulletin 2013-29
- OCC Proposed Guidelines for Heightened Expectations
  - Generally applies to banks with assets greater than \$50 Billion
- The Volcker Rule (covered funds)

## Comptroller's Handbooks

- Handbooks provide both examiners and the industry core expectations for each subject area.
- Includes a background on the product line and identifies the risks posed by the activities discussed.
- Specific examination procedures provide guidance to field examiners regarding many of the issues that warrant particular scrutiny.
- All booklets have recently been or will be revised.
  - Safety and Soundness
  - Asset Management
  - Consumer Compliance
  - Securities Compliance

## OCC AM Guidance

- Where possible, OCC and OTS bulletins and other guidance will be rescinded and incorporated into the revised HBs.
- While failure to comply with HB guidance is not the same as violating a regulation or statute, it reflects a bank's deviation from OCC expectations that
  - may be an unsafe or unsound banking practice.
  - may reflect a failure to meet OCC's expectations for bank's effective risk management.
  - may result in an MRA (matter requiring attention).
- Best practice – Gap analysis for new OCC issuances

## OCC Handbook Updates – Asset Management

- Retirement Plan Products and Services issued February 2014
- Collective Investment Funds issued May 2014
- Unique and Hard to Value Assets issued August 2012
- Currently Under Revision
  - Conflicts of Interest
  - Retail Sales of Non-Deposit Investment Products
  - Asset Management
  - Personal Fiduciary Services
  - Investment Management Services
- Other AM Handbooks
  - AM Operations and Internal Controls
  - Custody



## Retirement Plan Products and Services Handbook Highlights

- Provides updated references to, and discussion of, significant DoL issues.
- Expands discussion of compensation issues.
- Adds discussion of Bank Secrecy Act/anti-money laundering and Regulation R.
- Adds a discussion of board and senior management responsibilities for oversight of risk management.
- Updates expanded examination procedures and groups them by risk.
- Applies OCC Bulletins 2006-24 (ERISA Referrals), 2007-7 (Soft Dollars) and 2008-10 (Annual Reviews) to FSAs.

## Collective Investment Funds Handbook Highlights

- Cross references Part 9 for NBs and Part 150 for FSAs.
- Requires that banks ensure that a CIF is
  - in compliance with not only banking law requirements
  - is operated within the parameters of the securities laws
- Places greater emphasis on identification and mitigation of risks, particularly in the context of a fund's investment process. Enhanced focus on benchmarking and valuation issues.
- Places greater emphasis on identifying risks associated with third-party relationships; ensure robust risk management process is in place.
- Places heightened focus on conflicts of interest, particularly where CIF invests in own bank deposit products.
- Notes potential for enhanced pass-through of admission and withdrawal fees subject to specific OCC authorization.

## Conflicts of Interest HB

- Will apply guidance to current business practices.
- Will update guidance and references to applicable SEC regulations.
- Will address late trading and market timing in mutual funds and CIFs.
- Will update guidance for fiduciary purchase of securities underwritten by bank or affiliate.
- Will provide guidance for indenture trustees.

## Reasons for Updated Guidance

- Increasing risk and complexity of bank's use of service providers
- More outsourcing of critical bank activities
- Greater reliance by third-parties on subcontractors (often to foreign locations)
- Greater concentration for services provided by a single provider
- More interaction involving critical bank information and between third parties and customers
- Greater use of foreign service providers

## OCC Bulletin 2013-29 - Highlights

- OCC Bulletin 2013-29 – “Third-Party Relationships: Risk Management Guidance” Issued October 2013
- Provides OCC Expectations for
  - Risk management practices for third-party relationships involving critical activities.
  - Risk management practices throughout the lifecycle of a third-party relationship.
  - Board and senior management oversight.
- Applies to relationships with affiliates and subsidiaries
- Sets minimum standard for fiduciary activities delegated to third parties



## Oversight of Critical Activities – Asset Management

- OCC expects more rigorous and comprehensive oversight of critical activities.
- Applies to oversight of service providers that support significant bank functions, significant shared services, or other activities that
  - Could cause a bank to face significant risk if the third party fails to meet expectations.
  - Could have significant customer impact.
  - Require significant investment in resources to implement the third-party arrangement and manage the risk.
  - Could have major impact on bank operations if the bank has to find an alternate third party or if the outsourced activity has to be brought in-house.

## Oversight of Critical Activities – Asset Management

- Service providers that perform many AM activities will likely meet the definition of critical service providers.
  - Trust accounting and related systems
  - Trust operations
  - IRS reporting and fiduciary tax preparation
  - Investment management
  - Asset Custody
- Sets minimum standard for fiduciary activities delegated to third parties, including affiliates.

## Key Takeaways

- Banks should practice effective risk management regardless of whether the bank performs the activity internally or through a third party. Management must be knowledgeable of the outsourced activity.
- Bank must:
  - Adopt risk management practices that are commensurate with the level of risk and complexity of the third-party relationship.
  - Ensure robust oversight and risk management of relationships involving critical activities.
  - Adopt an effective risk management process that follows the third-party relationship through its lifecycle.
  - Ensure periodic independent review of bank's third-party risk management process.

## Muni Advisor Rule Milestones

- Dodd-Frank Act Section 975 –Regulation of Municipal Securities and Changes to the Board of the MSRB (July 2010)
- SEC Interim Final Temporary Rule (September 2010)
- SEC Final Rule: 17 CFR Parts 200, 240 and 249 (September 2013)
- OCC Bulletin 2013-36 – Registration of Municipal Advisors (Dec. 2013)
- SEC Frequently Asked Questions (Updated May 2014)
- Final Registration for temporary registrants: July 2014
- Registration required for new registrants: September 2014
- Final MSRB revised rules pending

## Municipal Advisor Rule Highlights

- SEC's final rule requires municipal advisors to register permanently with the SEC.
- The final rule does not provide a general blanket exemption for banks.
- Banks that register are subject to SEC supervision.
- Banks should analyze the application of this final rule to their operations.
  - Banks meeting the definition of municipal advisor must file Form MA-T with the SEC and then, when directed, file Form MA.
  - Banks are subject to a fiduciary duty standard with regard to any municipal entity they advise under the rule.
- Recent FAQs provide some relief for banks
  - Negative consent acceptable means to determine that accounts do not include muni bond proceeds.
  - Once in retirement plan account, funds no longer deemed "Bond proceeds"



## 12 CFR Part 30 – Appendix D

- Objective - to strengthen the governance and risk management practices of large financial institutions.
- Finalized September 2, 2014
- Generally applies to insured banks over \$50 Billion or banks who's parent company controls at least one other bank subject to the guidelines
- Guidelines establish provide minimum standards for
  - Bank's risk governance framework
  - bank board of director's oversight of the risk governance framework.

## 12 CFR 30 – Appendix D

- Defines and establishes role in risk management of
  - Front Line Unit (aka first line of defense)
  - Independent Risk Management (aka second line of defense)
  - Internal Audit (aka third line of defense)
- Defines key risk management terms
  - Risk governance framework
  - Risk profile
  - Risk Appetite.
- Establishes when a covered bank may rely on its parent's risk management framework.

## Implementation Timeframes

- Covered banks >\$750 billion - effective in 60 days
- Covered banks between \$100 billion and \$750 billion - 6 months
- Covered banks between \$50 and \$100 billion – 18 months
- Banks < \$50 billion that are covered banks because their parent company controls at least one other bank subject to the guidelines – bank on the effective date for the other bank.
- Banks that become covered have 18 months after effective date of Call Report in which its assets cross the threshold

## Asset Management - Covered Funds

- The final Regulation, implementing the Volcker Rule, adhering closely to the statute, was effective 4/1/2014; however, the FRB extended the conformance period until 7/21/2015.
  - With respect to the “covered funds” aspect of the rule, banks must implement good faith efforts to bring activities into compliance.
  - The compliance program must be appropriate for the types, size, scope, and complexity of the banking entity’ activities and business structure.
  - The FRB intends to extend conformance period for CLOs through 7/21/2017.
- Banks must develop and implement enhanced compliance programs during conformance period. The enhanced compliance program requires annual, written CEO attestation to primary regulator that the program is reasonably designed to achieve compliance.

## Asset Management - Covered Funds

- Two key prohibitions related to asset management
  - As **principal**, having an *ownership interest* in or sponsoring a *covered fund*
  - Engaging in “covered transactions” with sponsored or advised *covered funds*
- Various exclusions from *covered fund*
- Various “permitted activities”
  - Organizing and offering for AM customers
  - Market making and underwriting
  - Hedging
- Prohibition applies to *banking entities*
  - Includes insured depository institutions (except certain trust banks)
  - Includes affiliates of IDIs (except covered funds)
  - Broad definition of *affiliate* in BHC Act

# Key Risks & Asset Management Examination Focus

- Market Volatility/Low Interest Rate Environment
- Investment Management
- Potential conflicts of interest
- AM Operations
- Regulatory Change



## Market Volatility and Low Interest Rate Environment

- AM revenue - fee based, heavily dependent on market value of assets under management
- Majority of AM assets invested in the domestic and global equity markets.
  - Continued strong equity performance equates to higher fee income and overall earnings.
  - Any significant market correction therefore will be a direct blow to earnings

## Market Volatility and Low Interest Rate Environment

- Low interest rates
  - have contributed to the concentration of assets in equities.
  - when rates move, not only will there be losses in the remaining fixed income customer portfolios, but there may be losses as well in equities and other investment products used to enhance portfolio yields.
- Reach for yield
  - Banks have taken on higher risks by investing in alternative and structures products in order to gain enhanced yields for client portfolios.
  - An interest rate spike may rattle these markets as well causing additional losses.

## Investment Management Risks

- Government policies and politics will heavily influence markets
- Markets feel impact of economic and geopolitical uncertainty
- Investment Opportunities/Returns
  - Use of increasingly complex products
  - Reaching for yield
  - Potential conflicts of interest
- Need for Heightened Investment Risk Management
  - Initial and ongoing due diligence
  - Investment selection, retention and disposition process
  - Analytical tools and systems, with an emphasis on credit and interest rate risk
  - Valuation practices

## Conflicts of Interest

- Use of bank and affiliate mutual funds, ETFs, alternative funds, structured funds and other proprietary products
- Use of funds and products that provide incentives to a bank fiduciary
- Contractual relationships and outsourcing arrangements with affiliates and third parties in which bank trustee is incented to refer business or make investments with those entities

## Operations Risks

- Core Operational Processes – Capability/Capacity of Legacy Systems
- Manual Processes/“Work-Arounds”/User Developed Tools
- Conversion risks
- Internal Controls
  - Money Movement; Asset Custody; Reconciliations
- Oversight of Internal and Third Party Vendors
  - System providers
  - Outsourced operations providers

## Operations Risks

- Cyber threats
  - Cyber attacks on asset management clientele, particularly private banking
  - Attacks moving beyond phishing to hacking and outright takeover of accounts
  - Robust ID and verification procedures (e.g., mandatory callbacks) needed to confirm requested transactions were customer originated

## Regulatory Reform Risk

- Significant Regulatory Change
  - Dodd-Frank Implementation Continues
  - SEC and DOL regulations (money market reform, muni advisor registration requirements, potential SEC fiduciary standard, etc.)
  - CFPB’s Involvement in AM activities remains uncertain
  - Potential impact of capital and liquidity initiatives
  - Increase use of CCPS, collateral management requirements
- Resources and Infrastructure to Analyze and Implement Change
  - Oversight
  - Project teams
  - Reporting
- Legal, Audit, Compliance, Risk Management involvement



# AM Examination Issues and Findings

## AM Matters Requiring Attention

- Review of fiduciary accounts – failure to comply with 12 CFR 9.6/150 - pre-acceptance, initial post-acceptance, annual review
  - Inadequate account acceptance
  - Not including all assets in review
  - Adequacy of assets in meeting investment objective
  - Not meeting requirements of OCC Bulletin 2008-10
- Audit requirements – failure to comply with 12 CFR 9.9/150
  - Inadequate scope of audit – failure to include all significant fiduciary activities at appropriate intervals
  - Ineffective audit program
  - Failure to adhere to requirements for Fiduciary Audit Committee independence

## AM Matters Requiring Attention

- Account Administration
  - Adequacy of administrative review process
  - Discretionary distribution process
  - Self-directed IRAs
- Internal Controls - Asset/Money Movement
  - Free deliveries
  - Disbursement controls
- Vendor Management
  - Inadequate monitoring of third-party service providers



# Appendix I

## Selected OCC Asset Management Guidance

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

[www.occ.gov](http://www.occ.gov)

[OCC: Capital Markets: Asset Management](#)

## *Comptrollers Handbook for Asset Management* Booklets

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

## *Comptrollers Handbook for Safety and Soundness – Selected Booklets*

- Community Bank Supervision (2010)
- Large Bank Supervision (2010)
- Bank Supervision Process (2007)
- Internal and External Audits (2003)
- Internal Control (2001)
- Insider Activities (**2014**)
- Insurance Activities (2002)
- Retail Nondeposit Investment Sales (*1994*)

## Selected OCC Bulletins

- OCC Bulletin 2013-29, Third-Party Relationships: Risk Management Guidance
- OCC 2013-8, Short-term Investment Funds Reporting Requirements
- OCC 2012-31, Short-Term Investment Funds
- OCC 2011-11, Risk Management Elements: Collective Investment Funds and Outsourced Arrangement
- 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



## Selected OCC Bulletins

- OCC 2008-5, Conflicts of Interest: Risk Management Guidance
- OCC 2008-10, Fiduciary Activities of National Banks: Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6(c)
- Divestiture of Certain Asset Management Businesses
- OCC 2007-42, Bank Securities Activities: SEC's and Federal Reserve's Final Regulation R
- OCC 2007-21, Supervision of National Trust Banks: Revised Guidance: Capital and Liquidity
- OCC 2007-7, Soft Dollar Guidance: Use of Commission Payments by Fiduciaries

## Selected OCC Bulletins

- OCC 2007-6, Registered Transfer Agents: Transfer Agent Registration, Annual Reporting, and Withdrawal from Registration
- OCC 2006-24, Interagency Agreement on ERISA Referrals
- OCC Bulletin 2004-20, Risk Management of New, Expanded, or Modified Bank Products or Services: Risk Management Process
- OCC 2004-2, Banks/Thriffs 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

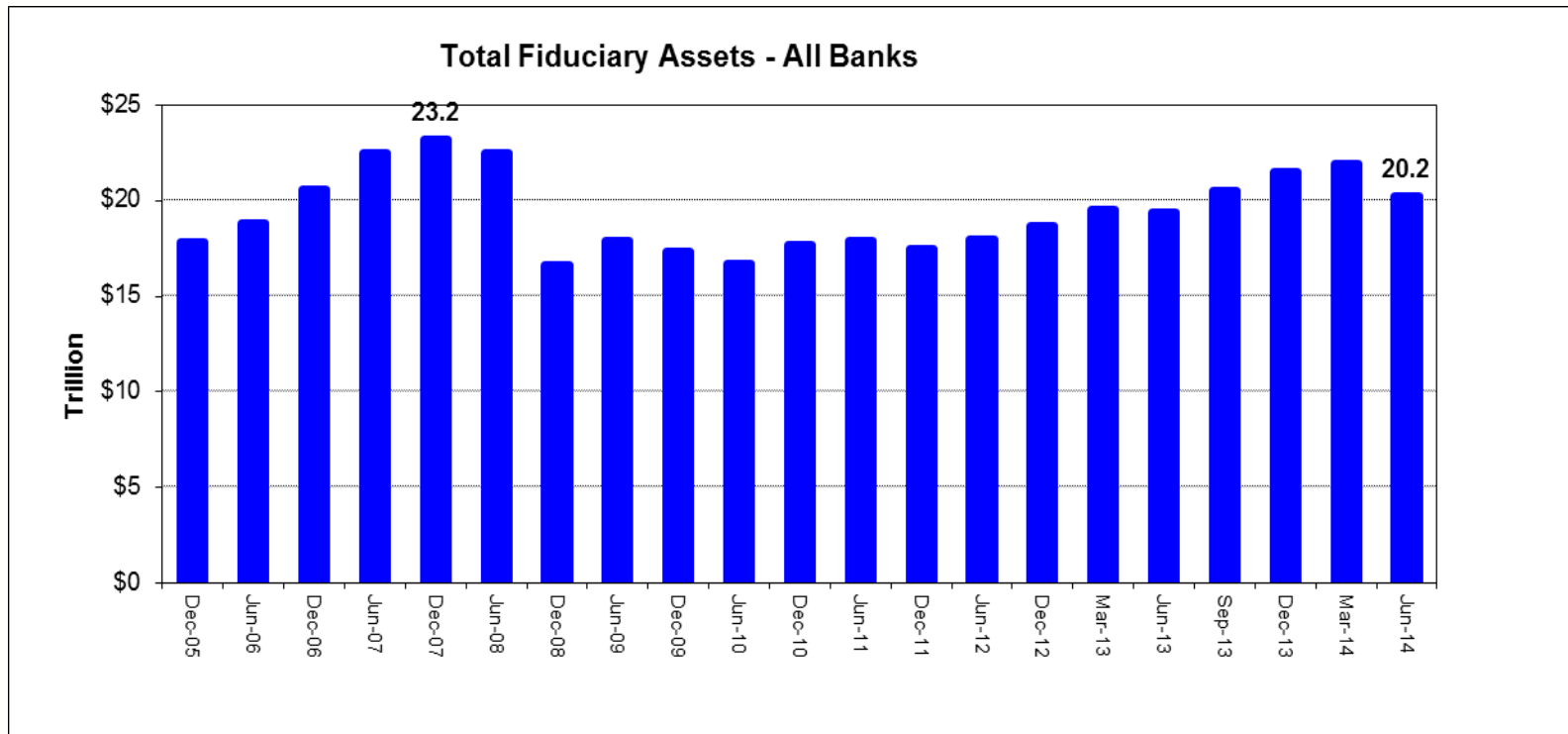
# Appendix II: Asset Management Statistics

**Fiduciary and Custody Assets total over **\$100 trillion.****

<b>FIDUCIARY AND RELATED ASSETS (\$000s)</b>	<b>Managed</b>	<b>Non-Managed</b>	<b>Total Assets</b>	<b>% of Fid Assets</b>
<b>Personal trust and agency accounts</b>	\$734,489,246	\$322,667,514	\$1,057,156,760	5%
<b>Employee benefit &amp; retirement related trust &amp;</b>				
Employee benefit - Defined contribution	\$914,653,235	\$2,241,481,752	\$3,156,134,987	16%
Employee benefit - Defined benefit	\$1,108,120,408	\$4,373,614,055	\$5,481,734,463	27%
Other employee benefit and retirement related	\$336,425,138	\$1,701,610,340	\$2,038,035,478	10%
<b>Corporate trust and agency accounts</b>	\$27,449,043	\$2,521,367,936	\$2,548,816,979	13%
<b>Investment management and investment advisory</b>	\$1,576,382,827	\$68,491,829	\$1,644,874,656	8%
<b>Foundation and endowment</b>	\$245,508,650	\$127,400,412	\$372,909,062	2%
<b>Other fiduciary accounts</b>	\$504,677,149	\$3,388,530,843	\$3,893,207,992	19%
<b>Total Fiduciary Accounts</b>	\$5,447,705,696	\$14,745,164,681	\$20,192,870,377	100%
<b>Custody and Safekeeping Accounts</b>		\$84,107,059,791	<b>\$84,107,059,791</b>	
<b>Total Fiduciary &amp; Custody/Safekeeping Accounts</b>			<b>\$104,299,930,168</b>	

Source: June 30 Call Reports – National Banks, FSAs, State Banks

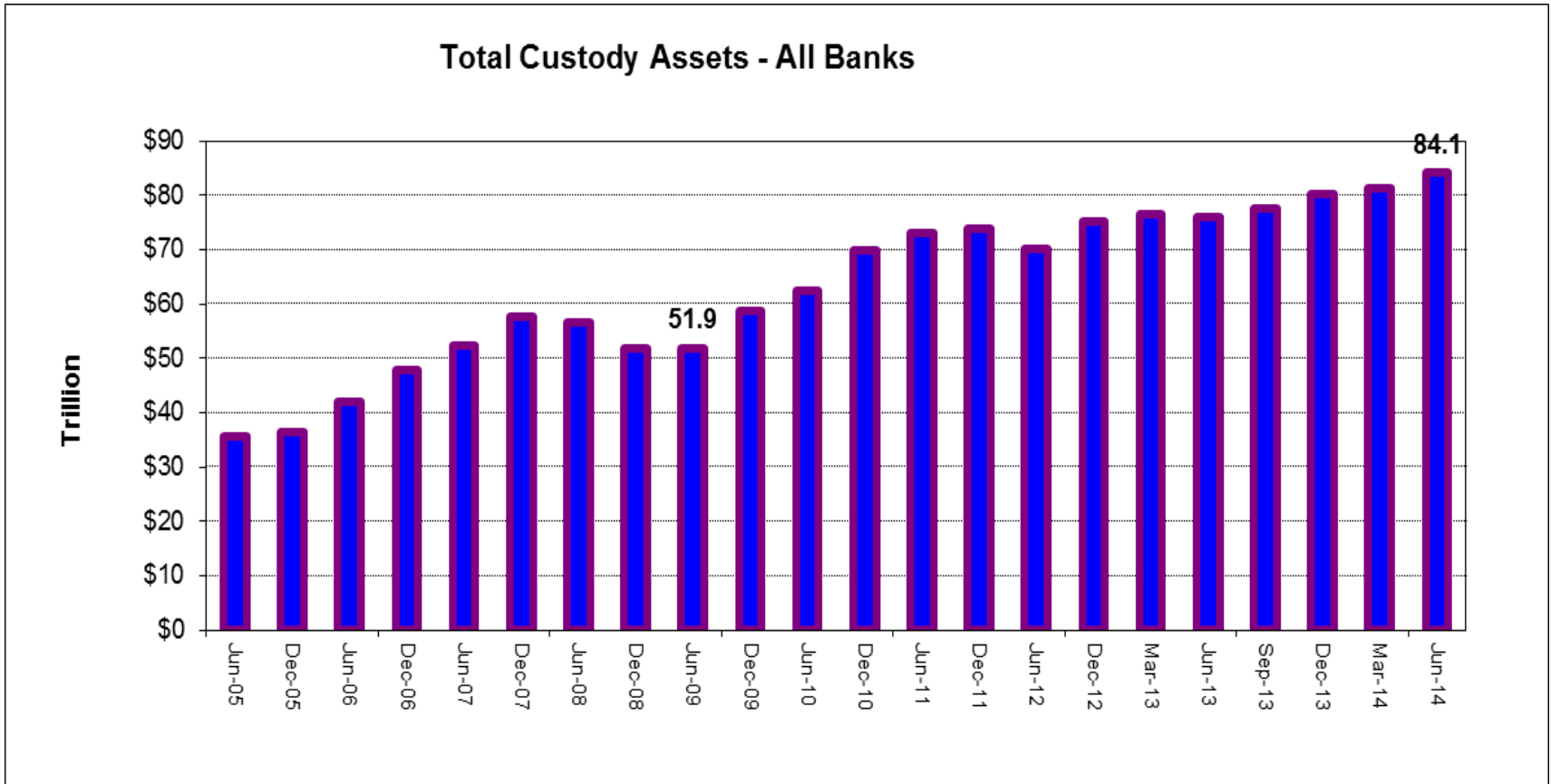
## Total Fiduciary Assets top \$20 Trillion



Total bank fiduciary assets have still not returned to the \$23.2 trillion peak reached prior to the market disruption in 2008. The real growth has been in Custody assets, shown on the next slide.

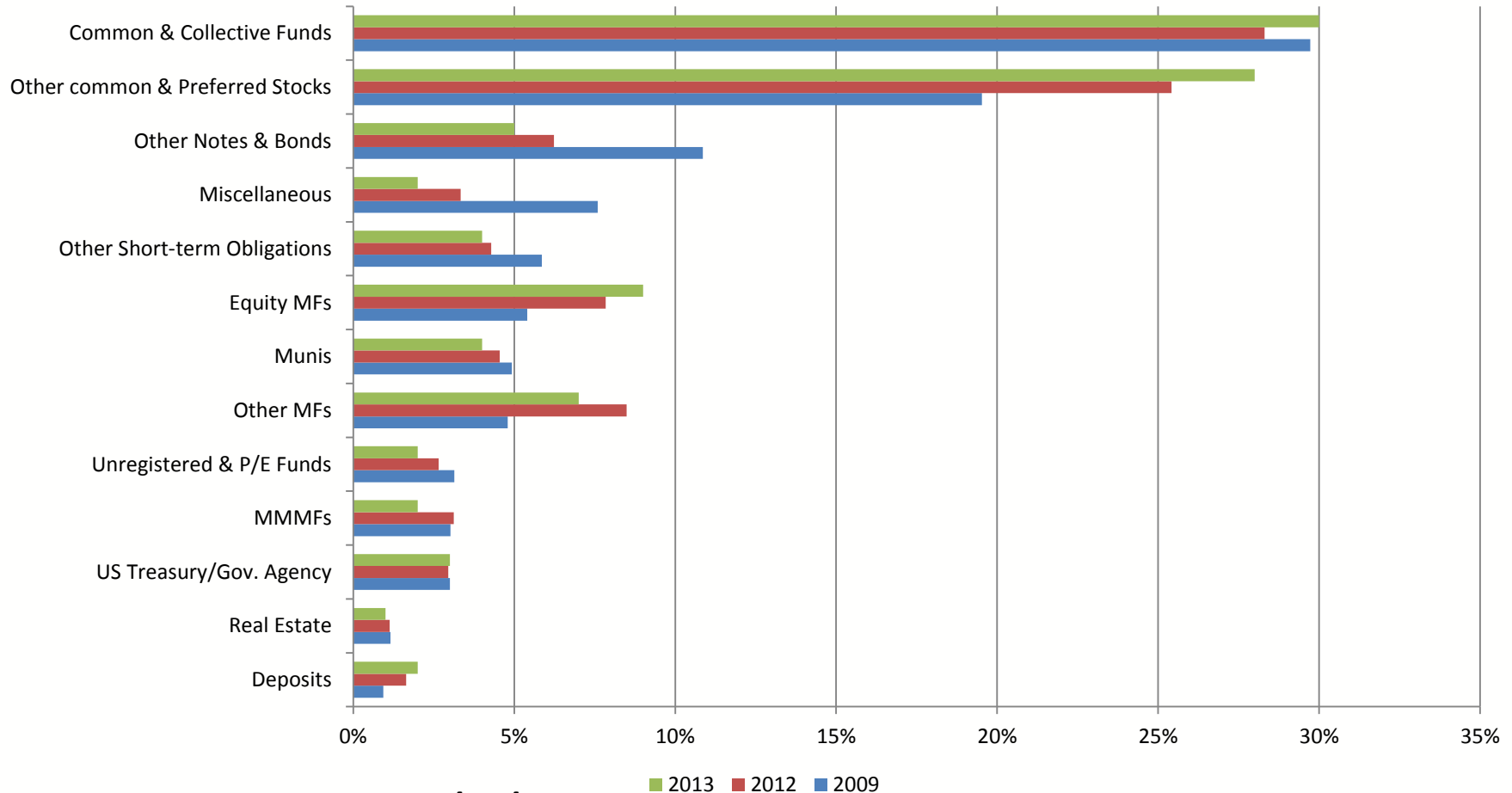
# Total Custody Assets

**Total custody assets now top \$84 Trillion**



Source: Call Report 6/30/2014 – All banks and FSAs

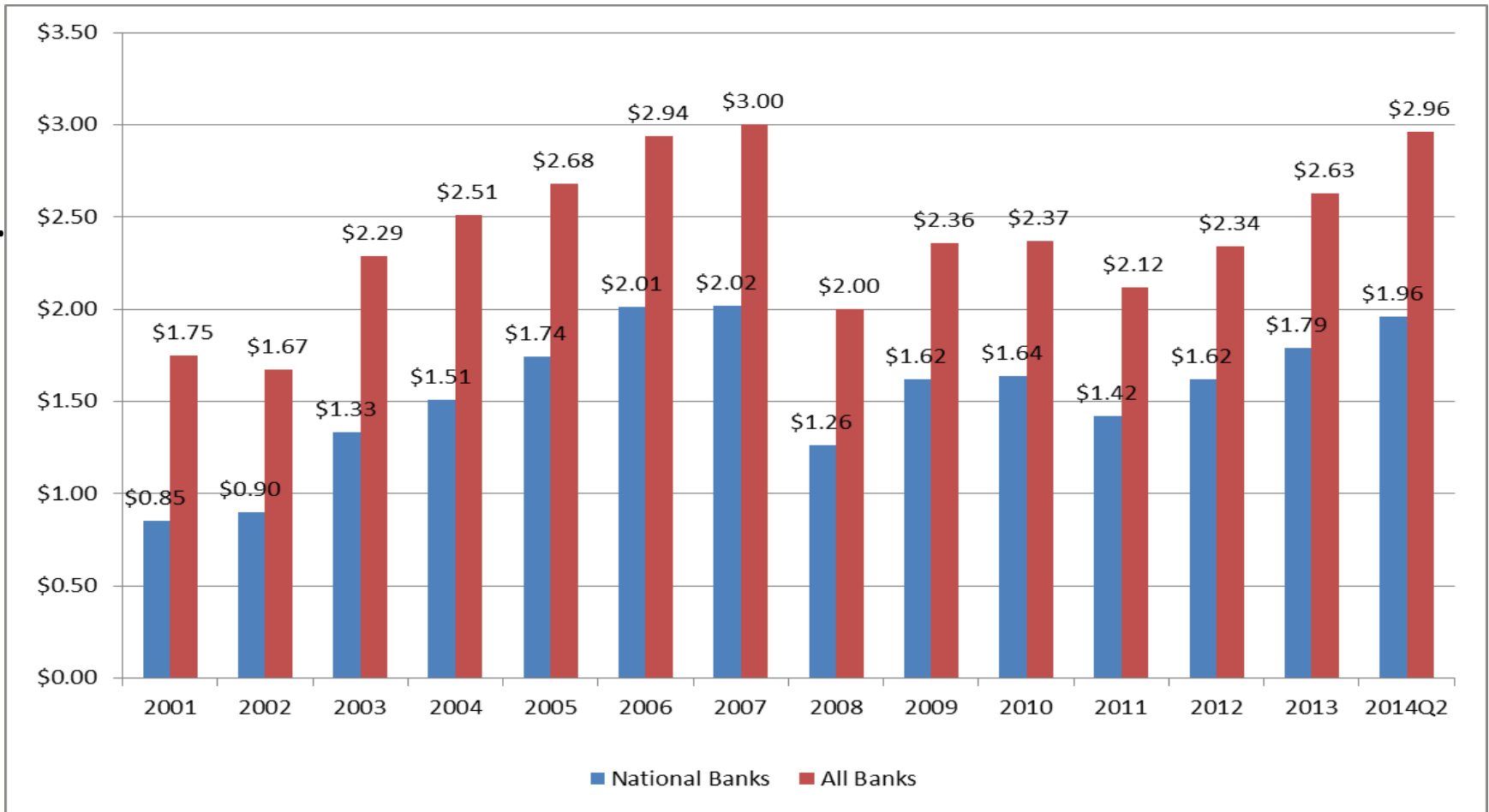
**Common & Collective Funds and Equities combined represent the majority of managed fiduciary assets.**



**Source: Call Report 12/31/2013**  
**All Banks and FSAs**

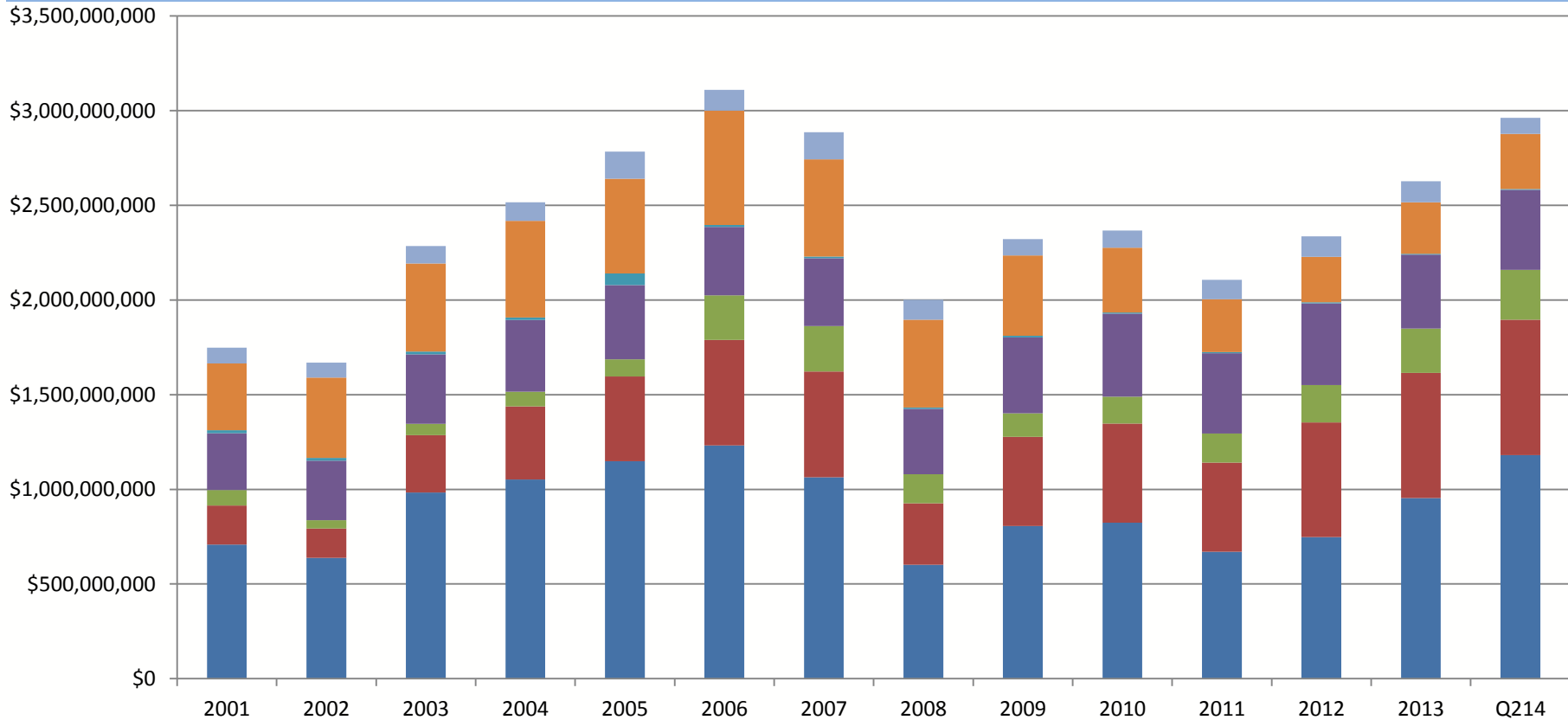


**National Banks/FSAs are trustee for \$1.96 trillion CIFs -  
State Banks are trustee for another \$1.0 trillion in CIFs**



Source: Call Report - All Banks and FSAs

**Over 40% of CIF assets are invested in Domestic Equities and another 24 % are invested in International Equities.**

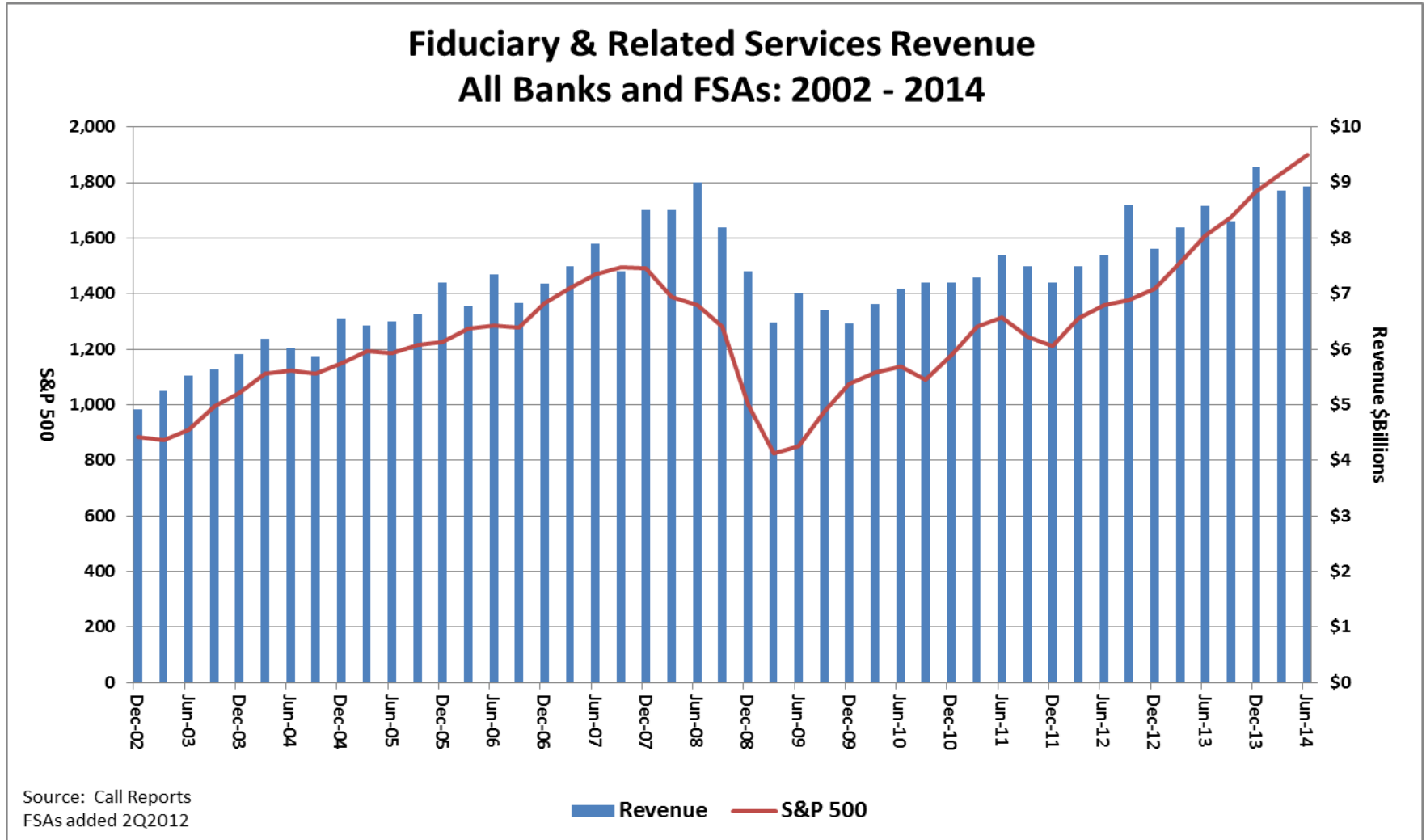


Source: Call Reports  
FSAs added 2Q2012

■ Domestic Equity ■ International Equity ■ Stock/Bond Blend ■ Taxable Bond ■ Municipal Bond ■ STIF ■ Specialty

# Fiduciary & Related Svcs Revenue

There remains a positive correlation between the S & P 500 and fiduciary revenue.



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