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## **CORPORATE FIDUCIARIES: DUTIES, COMPENSATION, REGULATION AND EXAMINATION**

For over one hundred and fifty years, banks and trust companies have provided fiduciary services to trusts, individuals, families, charitable organizations, employee benefit plans, and government entities in the United States. The creation, obligations, and limitations of trusts, trustees, and the fiduciary standard are chiefly a matter of state statutes and common law. State law confers the authority to act as a corporate trustee exclusively to banks and trust companies.<sup>i</sup> State law also defines the highest fiduciary standard that applies to banks and trust companies when acting in a fiduciary capacity, including when offering investment advice for a fee.<sup>ii</sup>

Before offering fiduciary services, a bank must apply for and be granted trust powers from its appropriate regulator. In its application, both national and state banks must show that they have the minimum capital and surplus that is required under state law. The bank must also demonstrate that it is in sound financial condition and that there is a need in the community for the fiduciary services. Lastly, the bank must submit the credentials and other background information about the trust management personnel so that the regulator can assess their qualifications and experience.

### **Fiduciary Accounts**

Fiduciary accounts are those accounts that are administered by a bank or trust company acting in a fiduciary capacity. Fiduciary capacity means acting as a trustee, executor, administrator, registrar of stocks and bonds, transfer agent, as well as assignee, receiver, or custodian under the uniform gifts to minors act. In addition, fiduciary capacity includes a bank acting as investment adviser for a fee, any other capacity in which the bank possesses investment discretion on behalf of another, or any other similar capacity that the banking regulators authorize.

### **Fiduciary Duties**

Corporate trustees are subject to fiduciary duties. In fulfilling these duties, corporate trustees provide investment management services, safekeeping of assets, management of real property, business interests and mineral interests, as well as tax planning, preparation and tax payment services. These fiduciary duties include:

- *Duty of loyalty.* A trustee has a fundamental duty to administer a trust solely in the interests of the beneficiaries. A trustee must not engage in acts of self-dealing.
- *Duty of administration.* The trustee must administer the trust in accordance with its terms, purposes, and the interests of the beneficiaries. A trustee must act prudently in the administration of a trust and exercise reasonable care, skill, and caution, as well as properly account for receipts and disbursements between principal and income. A trustee can properly “incur and pay expenses that are reasonable in amount and appropriate to the purposes and circumstances of the trust.”<sup>iii</sup>

- *Duty to control and protect trust property.* The trustee must take reasonable steps to take control of and protect the trust property.
- *Duty to keep property separate and maintain adequate records.* A trustee must keep trust property separate from the trustee's property and keep and render clear and accurate records with respect to the administration of the trust.
- *Duty of impartiality.* If a trust has two or more beneficiaries, the trustee must act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests.
- *Duty to enforce and defend claims.* A trustee must take reasonable steps to enforce claims of the trust and to defend claims against the trust.
- *Duty to inform and report.* A trust must keep qualified trust beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Some jurisdictions also impose a duty to provide an accounting to qualified beneficiaries.
- *Duty of prudent investment.* A trustee who invests and manages trust property has a duty to "invest and manage trust property as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust."<sup>iv</sup> This duty is tied to the duty to use reasonable care and skill to make the trust property productive.

## **Fiduciary Compensation**

Whether set by state statute, custom, the courts, or the terms of the governing instrument, fiduciary fees are required to be reasonable. Generally, corporate fiduciaries use a graduated fee schedule of percentages of the assets in the account, which can be customized for the specific circumstances and needs of the trust or estate. A fiduciary may charge a minimum annual fee, as well as an additional fee for any extraordinary services provided to the trust or estate.

## **Regulation of Corporate Fiduciaries**

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, or by state banking regulators.

### Segregation of Fiduciary Assets

By law, assets held in fiduciary 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. 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 fiduciary cash held in insured deposit accounts are entitled to FDIC insurance, generally up to \$250,000 per owner per ownership capacity. Through December 31, 2010, the FDIC provides unlimited coverage for noninterest-bearing transaction accounts at FDIC-insured institutions participating in the agency's Transaction Account Guarantee Program. Beginning December 31, 2010 through December 31, 2012, pursuant to the Dodd-Frank Act, deposits held in noninterest-bearing transaction accounts will be fully insured, regardless of the amount in the account, at all FDIC-insured institutions.

Revocable and irrevocable trust accounts that are held in insured deposit accounts may receive additional coverage based on the number of owners of the account and the number of beneficiaries of the account. Here is the FDIC summary of coverage for these accounts (for more information go to <http://www.fdic.gov/deposit/deposits/dis/index.html>):

<b>Revocable Trust Accounts</b>	\$ 250,000 per owner per qualified beneficiary up to 5 beneficiaries (more coverage available with 6 or more beneficiaries subject to specific limitations and requirements)
<b>Irrevocable Trust Accounts</b>	\$ 250,000 for the non-contingent, ascertainable interest of each beneficiary

### Bank Regulations<sup>v</sup>

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 fiduciary accounts, 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. In addition, the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code, as well as implementing regulations, largely govern the operation, structure and administration of employee benefit plans.

#### *Segregation of Duties<sup>vi</sup>*

To safeguard fiduciary assets, bank trust departments segregate and often rotate the duties of their employees who work in fiduciary accounts. Under such a regime, no one individual is able to authorize, execute, and review the processing of 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.

#### *Strict Regulation of Self-Dealing and Conflicts of Interest<sup>vii</sup>*

Bank regulations significantly restrict self-dealing and other conflicts of interest. Unlike the obligations in an agency relationship (such as with a registered investment adviser), bank fiduciaries may not simply disclose conflicts of interest in order to engage in certain transactions. Self-dealing is prohibited unless the consent of all beneficiaries has been obtained, is specifically allowed under the terms of the trust or state law, or is authorized under court order. Even when the duty of loyalty is waived, trustees must still comply with their many other fiduciary duties, including the duty to invest prudently.

#### *Annual Reviews of Fiduciary Accounts<sup>viii</sup>*

In addition to reviewing a fiduciary account before acceptance to determine whether it can be properly administered, a bank must annually review *all* of the assets in each fiduciary account. This annual review must evaluate whether the investments are appropriate, individually and collectively, for the particular account.

#### *Record Keeping Requirements<sup>ix</sup>*

In addition to records for tax and accounting purposes, corporate fiduciaries 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.

#### *Annual or Continuous Audits<sup>x</sup>*

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 of the board of directors may not contain any officer who participates significantly in the administration of the bank's fiduciary activities.

#### *External Audits*

FDIC-insured institutions with more than \$500 million in assets 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.

### **Corporate Fiduciary Examination<sup>xi</sup>**

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 large institutions have examiners onsite within the bank's premises throughout the year to examine fiduciary activities continuously.

During an examination, examiners obtain and review a number of important trust department documents, including: (1) most recent committee minutes and information packages; (2) asset management organizational chart; (3) most recent financial reports, including budget and variance reports; (4) policies and procedures if significant changes or additions have been made since first examined; (5) the bank's asset management risk assessment; and (6) audit and compliance reports. In addition, examiners take a risk-weighted sample of fiduciary accounts, weighted towards more complex accounts or accounts with unique assets, to determine whether the accounts were opened in compliance with applicable law and bank policy and whether the risks of the account comport with the bank's business plan and risk tolerance.

### **Information on Corporate Fiduciaries**

All FDIC-insured institutions, as well as OCC-chartered trust companies, 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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<sup>i</sup> In 1913 under the Federal Reserve Act, national banks were given authority to provide fiduciary services to the extent to which state banks and trust companies are permitted to act.

<sup>ii</sup> In other words, banks that provide investment advice for a fee through their trust departments are held to a higher fiduciary standard than registered investment advisers providing investment advice for a fee.

<sup>iii</sup> Restatement (Third) of Trusts § 88.

<sup>iv</sup> Uniform Prudent Investor Act § 2(a).

<sup>v</sup> See generally 12 CFR Part 9. State banking regulators look to OCC Regulation 9 as a guide for state chartered institutions.

<sup>vi</sup> 12 CFR §9.13.

<sup>vii</sup> 12 CFR §9.12.

<sup>viii</sup> 12 CFR § 9.6.

<sup>ix</sup> 12 CFR § 9.8.

<sup>x</sup> 12 CFR §9.9.

<sup>xi</sup> See OCC Handbooks on Asset Management, FDIC Trust Examination Manual, and OTS Trust Examination Manual.