

Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

Introduction to Corporate Trust

Corporate trust and agency services are normally performed by a trust department in connection with the issuance, transfer or redemption of securities, pursuant to an agreement between the department and the issuer (usually a corporation or state or local governmental body). It is not uncommon for a single trust agreement (indenture) to be the creating instrument for both the corporate trust and related corporate agencies. Performance as *Trustee Under a Bond Indenture* is normally the only true trust relationship administered by a corporate trust department. Under the indenture, there is only one trustee for a given bond issue but several agents or coagents may be created to serve the same issue. The most common corporate agency activities include: stock transfer agent, registrar for stock or bond issues, paying agent for bond interest or stock dividends, dividend reinvestment agent or depository. This section focuses on institutions acting as trustee for bond issues, the relationship most commonly found in the corporate trust area of a savings association.

Financial institutions serve in a dual capacity when administering many of the corporate trust relationships that have evolved over the years. They have responsibilities to both the party issuing the securities under the provisions of the indenture and to the individuals and institutions that have purchased the securities. The trustee's primary responsibility, however, is to act at all times on behalf of, and for the protection of, securityholders.

The party that hires the institution and pays the account administration fees is typically the issuer of the securities. The institution, as trustee or agent, is ordinarily responsible to the issuer for such functions as: investing funds on deposit (such as construction funds or monies deposited for future bond payments); maintaining bondholder records; preparing accountings; effecting transactions; and other ministerial activities. At the same time, one of the primary reasons for the creation of the trust indenture and appointment of a corporate trustee (which must be independent from the issuer) is the protection of the securityholders (bondholders, stockholders, etc.). To provide this protection, the trustee must ensure that the issuer complies with all the provisions of the indenture agreement. This is accomplished through such steps as: the timely collection and payment of interest and principal; the perfection and maintenance of the institution's clear title to any collateral; the filing of tax information; the monitoring of indenture default provisions; and other specified duties.

Corporate agency services are provided by a department in connection with both equity and debt securities. These services may or may not be performed in conjunction with corporate trustee services.

Corporate Trust Accounts

As with other types of accounts, the corporate trustee's specific duties and responsibilities are contained in the governing instrument, called an indenture. Among the more important duties that should be addressed in the indenture are those relating to:

- ensuring compliance with the terms of the indenture agreement;
- arranging for the printing and issuance of the securities;
- paying principal (bond redemption and maturity) and interest;
- funding instructions for specialized funds (e.g., depreciation or reserve funds);

- maintaining special funds required by indenture (i.e., sinking, construction funds, etc.);
- maintaining insurance coverage;
- reports required (to issuer and bondholders);
- holding beneficial title to collateral (if any);
- safeguarding and appraising collateral;
- use of the funds for the payment of the issuer's obligations (including the temporary investment of those funds and their allocation to special accounts);
- monitoring for default under the indenture during the life of the bonds; and
- identifying and reacting properly if a default occurs.

The administration of corporate trust accounts and agencies generally does not require that the trustee/agent exercise as many discretionary decisions and actions as other types of relationships. Nevertheless, proper administration does require that a higher level of documentation and recordkeeping sophistication be maintained and that department personnel possess a detailed knowledge of securities and securities-related functions. The trustee must also exercise caution that it does not have any conflicts of interest that would prevent it from acting with undivided loyalty.

Proper administration of underlying collateral is vital, including identification and control of environmental risk where real property is concerned. While the courts have not held a trustee liable for environmental hazards that it did not create or contribute to during the trusteeship, caution must still be exercised by the trustee concerning potential environmental hazards. Extreme care must be taken by the trustee regarding the timing of collateral foreclosure so that the interests of all parties to the indenture are fairly served. It is important to realize that a trustee's failure to perform properly in protecting the bondholders before, during and after a default, can result in liability and loss to the trustee that frequently is not assessed by the courts until years later. Proper maintenance of the collateral, including periodic verification or continuance of Uniform Commercial Code (UCC) filings, is required. Should the trustee prematurely foreclose on collateral, the obligor may incur liability. If foreclosure is inordinately delayed, bondholder interests may suffer severe loss of value.

Many bond trusteeships involve the maintenance of separate funds to be used for such things as sinking funds, construction monies and building maintenance expenses. The assets of these funds are invested according to the provisions of the bond indenture. The institutional trustee usually has minimal discretion over such investments. Proper separation and administration of the various funds is required and proper investment of the assets is essential.

The trustee must not only provide reports and recordkeeping for the obligor but must also protect the interests of the bondholders. Reporting of distributions, interest and dividend payments to both tax authorities and security holders is required of the trustee.

Many bond issues have become exceedingly complex, imposing a host of additional duties on trustees. For instance, credit enhancements such as letters of credit and municipal bond insurance may have their own requirements for the trustee. Interest rates may be indexed to other indices. Derivative issues have also become common. These kinds of bond issues have imposed new types of risks for trustees. Trustees must have sufficient knowledge to be aware of their responsibilities and adequate policies and procedures in place to manage the risks to the bondholders.

The trustee must also exercise prudent judgment to identify and control any conflicts of interest that would prevent it from acting with perceived or actual undivided loyalty. For bond issues subject to the Trust Indenture Act of 1939, prohibited conflicts must be identified in the indenture. Section 310(b) of the Trust Indenture Act (15 U.S.C. Section 77jjj(b)) establishes procedures for the disqualification of the indenture trustee in certain instances involving the trustee's conflict of interest in certain situations. Section 311 of the Act (15 U.S.C. Section 77kkk) provides procedures with respect to situations in which the indenture trustee has a creditor interest in the indenture securities. For bond issues not covered by the Trust Indenture Act of 1939, the question of conflicts of interest is still of importance and trustees have been held liable where it was felt they acted other than in the best interest of the bondholders.

A potentially high-risk situation for an institution is where it is both a corporate trustee and a creditor of the obligor. In this instance, if an obligor becomes insolvent and a default occurs under an indenture, the question arises whether the institution can simultaneously serve its stockholders and the issue's bondholders. By attempting to improve the institution's credit position or chances of repayment it may fail in its responsibility to protect the interests of all bondholders. A similar situation may be encountered where the institution acts as trustee for more than one debt issue (senior vs. subordinate or secured vs. unsecured) of an issuer. These kinds of conflicts are permissible for issues subject to the Trust Indenture Act of 1939 so long as the issue is not in default. However, once a default occurs, and unless the default is cured within the ninety-day period set in Section 310(b) of the Trust Indenture Act, the trustee is required to resign.

These potentially conflicting relationships should be identified and resolved prior to account acceptance and reviewed during the life of the bond issue. Some institutions make prior arrangements to resign in favor of another trustee in the event of default. Often, the successor trustee requires indemnification for the original trustee's acts.

Trust Indenture Act of 1939 and Trust Indenture Reform Act of 1990

The Trust Indenture Act of 1939, as amended by The Trust Indenture Reform Act of 1990 (TIA), was adopted (in part) to protect bondholders from breaches of fiduciary duty by trustees, to provide a mechanism to enable bondholders to unite for the protection of their interests, to assure bondholders that they will be served by a disinterested and responsible trustee and to establish minimum standards of responsibility and accountability for trustees and obligors.

Below is a summary of the more significant provisions of the TIA. However, due to its complexity and the limitations of space, the TIA itself should be consulted for more detailed explanations, and for exceptions and limitations to particular rules.

- Certain types of securities cannot be offered or sold to the public unless they are "qualified" by the SEC.
- The TIA is applicable to indentures that provide for a total issuance in excess of \$10 million in principal value (with certain exceptions such as U.S. Government and agency securities and municipal bonds).
- A financial institution must be appointed as trustee for the bondholders.
- If a default occurs, a conflicting interest will "disqualify" a trustee (make it ineligible to be an indenture trustee) or require it to resign, unless the conflicting interest is eliminated.
- A number of situations are specified that will constitute a conflicting interest. Basically, they involve relationships of the trustee with either an obligor or an underwriter. The relationships include (all with

exceptions and rules of special application) acting as trustee under more than one indenture of the same obligor, being under the direct or indirect control of an obligor, having common directors with an obligor, owning more than a specified percentage of stock of the obligor by the trustee or vice versa and other similar relationships.

- Certain financial statements and reports must be filed by the obligor and given to the trustee, who in turn, notifies the bondholders. The trustee must also keep a list of all bondholders and notify them if any change in its relationship with the obligor have occurred.
- The TIA spells out duties and responsibilities prior to, during and after default. For example, one of the duties in the event of a default is to act in accordance with the prudent man standard.

Corporate Agency Accounts

Some of the most common types of corporate agency services provided are: stock transfer, stock registrar, mutual fund transfer, fiscal or paying agent, dividend disbursement, escrow, conversion, exchange and/or subscription.

Stock Transfer Agent

Stock transfer agents usually perform three functions. First, they act on behalf of the issuer of securities to countersign the securities and monitor issuance (e.g., original issues, stock dividends, splits) to prevent unauthorized issuance. Second, they maintain records of who owns the shares of stock, how many shares are owned and which certificates are owned. Third, they perform the function of cancellation and re-issuance of certificates to reflect changes in ownership.

In connection with the latter, certificates submitted are checked for authenticity and appropriateness of accompanying documents, canceled and replaced by the issuance of new certificates. The transfer agent sends the canceled certificates and corresponding newly issued certificates to the registrar for verification. This involves only an in-house transmittal when the institution acts both as transfer agent and registrar. After registration, the newly issued certificates are sent to the registered owners or their representatives and appropriate disposition (destruction, return of canceled certificates to the issuer or cancellation and retention in a controlled area) is made of the canceled certificates. The securities industry is relying increasingly on “book-entry only” securities whereby no physical securities are delivered to the owners but ownership is represented by bookkeeping entries in the owners’ brokerage account. Master or “jumbo” certificates representing the entire outstanding bond issue are maintained at a depository.

A bank can either be a registered or a nonregistered transfer agent. Whether or not a transfer agent needs to be registered is governed by Section 17A of the Securities Exchange Act of 1934, which also addresses reporting, recordkeeping and timing for transfer agent activities.

Stock Registrar

As registrar, an institution performs the critical duty of guarding against over or under issuance of the security, which is sometimes referred to as an out-of-proof or out-of-balance condition. In addition to checking original issues, the registrar checks each transfer made by the transfer agent for genuineness of the certificates presented for transfer, cancellation of the old certificates and that the number of shares represented by the new certificates does not exceed the number of shares represented by the old (canceled) certificates. In the case of bonds, the indenture trustee normally performs this function. New York Stock

Exchange rules permit one institution to act as both transfer agent and registrar for listed securities other than its own.

While unusual, financial institutions are sometimes appointed only registrar of a stock issue without the more typical dual appointment of transfer agent as well.

Mutual Fund Transfer Agent

A mutual fund transfer agent performs the functions of both stock transfer agent and stock registrar. It maintains ownership records, transfers shares and ensures the number of shares is kept in balance. The mutual fund's official transfer agent is identified in the mutual fund's prospectus.

Two characteristics of mutual fund transfer operations are very different from stock or bond transfer operations. Mutual funds normally do not issue certificates to evidence ownership. Instead, entries on the books of the mutual fund or its transfer agent identify the owners and record the number of shares owned. In addition, open-end mutual funds do not have a limit on the number of outstanding shares. Therefore, the "registrar function" handles an ever increasing and decreasing number of shares outstanding, depending upon subscriptions and redemptions.

Despite the general statements in the above paragraph, there are exceptions to both. Some mutual funds allow the issuance of share certificates on special request, such as when a customer wants to pledge fund shares as collateral for a loan. While most mutual funds are open-end, with no set number of shares issued and outstanding, "closed-end" mutual funds do have such limits.

Every mutual fund transfer agent must be a registered transfer agent. In addition, operations of mutual funds are primarily subject to the Investment Company Act of 1940.

Paying or Fiscal Agent

When the trust department is serving as paying or fiscal agent for corporations and municipalities, the obligor deposits the necessary payment amount with the thrift. The trust department then prepares and issues checks, credits established accounts or wires funds for the payment of interest, dividends or redeemed or matured bonds. For bearer bonds, payment is made upon presentation of coupons. In the case of registered bonds, payment is sent to the owner of record.

Dividend Disbursing Agent

The functions of a dividend disbursing agent are similar to those performed by paying agents, in that a trust department will forward dividends on equity issues directly to the shareholder of record. Closely related to this function is that of serving as dividend reinvestment agent, where dividends are paid by the dividend disbursing agent to the reinvestment agent (often the same institution) to be used to purchase additional shares of the corporation.

Corporate Trust Examination Program

Examination Objectives

To determine the adequacy and effectiveness of the trust department's administration of corporate trust accounts. Consider whether:

- effective policies, procedures and internal controls have been established;
- there is sufficient management and staff expertise to administer these accounts;
- the legitimate needs of security holders and other interested parties are met in a professional and timely manner;
- policies and procedures ensure compliance with governing instruments, applicable law and accepted fiduciary principles; and
- deficiencies are identified and corrective action promptly initiated.

Examination Procedures

Wkp. Ref.

Level I

Level I procedures first focus on a review of the examination scoping materials. The next step consists of interviews with trust department personnel to confirm their qualifications and levels of expertise; to determine if the trust department's practices conform to written guidelines; to establish whether any significant changes in personnel, operations or business practices have occurred; or whether new products or services have been introduced. If items of concern are uncovered during Level I procedures or if problems are identified during the preexamination monitoring and scoping, the examiner may need to perform certain Level II procedures.

1. Review examination scoping materials related to corporate trust accounts. Scoping material should include:
 - Risk profile
 - Pertinent PERK documents
 - Previous trust and asset management examination report
 - Workpapers from the previous examination

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- Examination reports of subordinate, functionally regulated entities
 - Board of director and other applicable committee minutes
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2. Determine the account types and volumes of accounts currently being administered. Identify any changes in product and service offerings since the previous examination. If applicable, determine that necessary approvals, notifications or registrations have been filed.
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3. Determine whether management and staff have the expertise to effectively manage corporate trust accounts.
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4. Review policies, procedures and practices related to the administration of corporate trust accounts. Identify any significant changes since the last examination. Determine their adequacy relating to:
- acceptance of accounts;
 - administration of accounts;
 - termination of accounts;
 - conflicts of interest;
 - monitoring for instances of default; and
 - compliance with escheat laws.
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5. Review internal risk management, audit and compliance programs for adequate coverage of corporate trust activities.
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6. Consider whether the following risk contributors have been addressed:
- Does management fully understand all aspects of risk associated with corporate trust accounts?
 - Has the board implemented appropriate policies, procedures, practices and internal controls covering all facets of account administration?
 - Have comprehensive and effective audit, compliance and risk management processes been established?
 - Does management exhibit familiarity with applicable law and accepted fiduciary principles?
 - Are appropriate management reporting systems in place?
 - Does the trust department exhibit consistency in account administrative practices?
 - Are standards in place governing account documentation?
 - Are there material unresolved corporate trust account issues noted in audit, compliance or examination reports?

The completion of Level I procedures may provide sufficient information to make a determination that no further examination procedures are necessary. If no determination can be made, proceed to Level II.

Level II

Level II procedures focus on an analysis of trust department documents, such as reports and outsourcing contracts. The examiner should complete the appropriate Level II procedures when the completion of Level I procedures does not reveal adequate information on which to base a conclusion that the trust department meets the examination objectives. Neither the Level I nor the Level II procedures include any significant verification procedures.

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1. Review the trust department's account set-up procedures and practices. Consider whether:
 - all appropriate documentation is obtained and reviewed;
 - accurate synoptic information is assembled and maintained; and
 - necessary tickler systems are in place.

2. Review procedures for processing interest and dividend payments, lost securities, maturities, early redemptions, splits and dividend reinvestments. Confirm compliance with SEC standards for control, turnaround, documentation and reporting.

3. If there are unresolved exceptions present from internal or external audit reports, compliance reports or examination reports, discuss corrective action with management.

4. Review controls over dormant accounts or unclaimed funds. Consider whether:
 - appropriate controls are in place;
 - funds are segregated and periodically reconciled; and
 - proper disposition of funds has been made either through return to the obligor or escheatment to the appropriate state authority.

5. Determine if procedures address the filing of necessary approvals, notifications or registrations.

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6. Ensure that there are procedures for determining the status of alleged lost, missing or stolen securities, e.g. proper notification procedures with the Securities Information Center (SIC).

7. Determine if there have been any losses from improper or untimely reporting of tax information.

8. If necessary to validate an assertion, finding or concern arising from the completion of the Level I and II procedures, judgmentally select a limited number of accounts for review considering the degree of risk to the institution. Not all types of accounts need to be reviewed to arrive at a well-founded conclusion.

If the examiner cannot rely on the trust and asset management Level I and Level II procedures, or data contained in department records or internal or external audit reports, proceed to Level III.

Level III

Level III procedures include verification procedures that auditors usually perform. Although certain situations may require that Level III procedures be completed, it is not the standard practice of the Office of Thrift Supervision (OTS) examination staff to duplicate or substitute for the testing performed by auditors.

1. Select a sample of bond trustee accounts. Review the account files to determine compliance with applicable law or accepted fiduciary standards, as well as internal policy and procedure. Confirm that the trust department is complying with the terms of the trust indenture.

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2. Select a sample of corporate agency accounts. Review the files to determine compliance with applicable law or accepted fiduciary standards, as well as internal policy and procedure. Confirm that the trust department is complying with the terms of the governing instrument.

3. Select a sample of mortgage-backed pass-through securities accounts. Review the files to determine compliance with applicable law or accepted fiduciary standards, as well as internal policy and procedure. Confirm that the trust department is complying with the terms of the governing instrument.

4. Review successor appointments to determine whether acts of prior fiduciaries are reviewed, assets are properly received and other appropriate documentation is obtained.

5. Identify all bond trustee accounts where instances of default have occurred. Determine that appropriate actions have been initiated according to the governing instruments.

6. Verify the accuracy of audit, compliance and risk management report findings.

7. Review and verify the accuracy of any applicable management exception reports.

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Examiner's UITRS Rating, Summary, Conclusions and Recommendations:

References - 750P

Laws

Trust Indenture Act of 1939
Trust Indenture Reform Act of 1990

Code of Federal Regulations

12 CFR 550 Trust Powers of Federal Associations (General)
12 CFR 550.410 Recordkeeping

Office of Thrift Supervision Publications

Other

UCC Article 9

Workpaper Attachments - 750P

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Optional Topic Questions

The following list of questions is offered merely as a tool and reference for the examiner and is not a required part of the examination process.

Acceptance of Accounts

<ul style="list-style-type: none">• Has all necessary documentation been obtained and reviewed?
<ul style="list-style-type: none">• Are the duties and requirements of the trustee identified?
<ul style="list-style-type: none">• If necessary, has a legal opinion regarding the indenture been obtained?
<ul style="list-style-type: none">• Has the ability of the trust department to perform its responsibilities been assessed?
<ul style="list-style-type: none">• Has the likely repayment capacity of the issuer/obligor been analyzed?
<ul style="list-style-type: none">• Has the relationship been reviewed for conflicts of interest?
<ul style="list-style-type: none">• Has the integrity of the issuer/obligor been assessed?
<ul style="list-style-type: none">• For real estate collateral, have any environmental issues been addressed?
<ul style="list-style-type: none">• Has the profitability of the account been considered?
<ul style="list-style-type: none">• Has the account been approved by the appropriate committee/individual as per policy?

Account Set-up Procedures

<ul style="list-style-type: none">• Has the following documentation been obtained:<ul style="list-style-type: none">• Original or certified copy of the trust indenture, including any amendments or supplements?• Evidence of recordkeeping, as required by state or local law?• Certificate of incorporation of the issuer?• Authorizing corporate resolution by the board of the issuer?• Opinion of counsel supporting the legality of the issue, if deemed necessary?• Authorization of stockholders, court officials, creditors or other bondholders, as necessary?• Specimen signatures of authorized corporate personnel of the issuer?• Approvals of any regulatory authorities, as necessary?• Identification and authentication of all collateral?• Evidence of title to the collateral or documentation that the appropriate lien position has been recorded in accordance with state or local law?• Evidence that appropriate insurance of collateral is in place?• Any other necessary documentation as indicated by the trust indenture?
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- Evidence that the above documentation was reviewed and approved for acceptance by the appropriate committee?

Annual and Administrative Reviews

• Is synoptic information confirmed to be accurate?
• Are tickler systems functioning properly?
• Are all administrative duties performed in accordance with the terms of the indenture?
• Have instances of default been appropriately identified and addressed?
• Have conflicts of interest been appropriately identified and addressed?
• Are accurate records on security certificates (blank, unissued, issued, outstanding, returned, destroyed) properly maintained?
• Are reviews performed in a timely manner, in accordance with regulation and internal policy?
• Have timely payments of principal and interest been made?
• Are payments to any special funds created under the instrument, such as sinking funds being made?
• Are only authorized investments being utilized?
• Has appropriate documentation and authorization been maintained for the receipt, retention or release of collateral?
• Is adequate insurance in force?
• Are the receipt and review of obligor's annual financial statements, annual reports or other documentation performed and documented?
• Are real estate, or other applicable property or tangibles, tax payments current?
• Have completion certificates been received?
• Have annual officer affidavits been received?
• Has documentation supporting construction advances been obtained?
• Are appropriate reserves being maintained?

Successor Appointments

• Is proof obtained of the prior trustee's removal or resignation?
• Are original or certified copies of governing instruments obtained?
• Does the department verify that all governing documents and essential supporting documentation has been received?
• Do department personnel obtain and review accountings by prior trustee(s)?
• Is a reconciliation perform to ensure that all assets, as well as income thereon, have been received?

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| <ul style="list-style-type: none">• Does the trust department obtain indemnification from the prior trustee? |
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Mortgage-backed Pass-through Securities

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| <ul style="list-style-type: none">• If the trust department acts as trustee or agent for mortgage-backed pass-through securities, are any of the pools privately insured? |
| <ul style="list-style-type: none">• Is the insurer in sound financial condition and appropriately licensed? |
| <ul style="list-style-type: none">• Is the amount of the insurance adequate to satisfy the loan if the underlying mortgage goes into default? |
| <ul style="list-style-type: none">• Is the trust department in compliance with the duties and responsibilities described in the governing instrument? |
| <ul style="list-style-type: none">• Do the trust department or qualified outside parties review the adequacy of loan documentation? |
| <ul style="list-style-type: none">• Does the trust department review appraisals of the underlying properties to verify that such appraisals have been conducted and are adequate? |
| <ul style="list-style-type: none">• Are there any conflicting relationships with the mortgage banker and, if so, are the savings association's policies and procedures sufficient to protect itself in the event of default of the debt? |

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