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This document and any attachments are superseded by Comptroller's Handbook - Asset Management.

Fiduciary Duties

In a fiduciary relationship the fiduciary/trustee owes certain duties and responsibilities to the creator (grantor/settlor) of the trust, to the trust account and in some cases, to the beneficiaries of the trust. While acting as trustee, savings associations are subject to various laws, regulations, standards and guidelines including (but not limited to):

- The provisions of the will, pension plan or trust document;
- The common law of trusts (or "accepted fiduciary standards"), which is a body of principles adopted by state courts over the years;
- State and federal statutory law and regulation;
- Rulings and orders from the local court of jurisdiction (probate court or other relevant court having jurisdiction over such matters); and
- Rules and regulations promulgated by an institution's state or federal regulatory agency, which has further codified or established fiduciary principles as they apply specifically to financial institutions.

The more significant duties of a fiduciary are to:

- Take possession and maintain control of fiduciary assets;
- Keep fiduciary assets separate and distinct from all other assets of the institution;
- Maintain clear and accurate accounts and records;
- Provide information to beneficiaries in a timely manner;
- Exercise the same care and skill in administering the trust, as a person of ordinary prudence would exercise in dealing with his or her own property. This is generally referred to as the "prudent man" or "prudent investor" rule (states have adopted versions of one rule or the other); and
- Administer the trust solely in the interest of the beneficiary, which is referred to as the duty of loyalty. This duty prevents the fiduciary from putting itself in a position where its corporate interests conflict with those of the trust that it is representing.

Fiduciary Risks

Risks associated with a savings association's exercise of its fiduciary powers can be generally categorized as resulting from:

Reputation Risk - where the risk to the savings association arises from negative public opinion. Negative publicity can be caused by many factors, including failure to address and manage the other risks addressed below. Increased reputation risk can affect the savings association's ability to establish client relationships and/or service existing relationships.

Strategic Risk - where the risk to the savings association arises from improper business planning, poor decision-making, failure to implement decisions or inadequate responses to changes in the industry. This

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risk focuses on management's ability to develop sound business strategic goals, implement processes compatible with these goals and deploy appropriate resources to achieve them. Management should implement policies, procedures and practices to ensure that the savings association's fiduciary activities are conducted in compliance with applicable law. Management should also ensure that appropriate risk assessment and monitoring systems are in place to identify and control risks resulting from fiduciary activities.

Transaction/Operational Risk - where the risk to a savings association is unacceptable operating losses or legal liability arising from operations' policies or practices (or the lack thereof), inadequate controls and other safeguards over fiduciary assets, erroneous recordkeeping, excessive costs, inadequate revenues, fraud, embezzlement or other similar deficiencies in operations. Transaction risk is inherent in each product and service offered.

Compliance/Legal Risk - where the risk to a savings association is exposure and legal liability arising from noncompliance with applicable law, sound fiduciary principles, internal policies and procedures or the failure to identify and manage conflicts of interest and ethical standards.

Financial Risks - where the risks are inherent in the fiduciary activities of the savings association, especially where the institution has discretion over account assets or provides investment management services for a fee. Financial risk has an adverse affect on the value of account portfolios, which could further impact the capital levels of the institution. Financial risk includes: credit risk, the risk to the value of the account portfolio arising from failure to meet the terms of any contract; price risk, the risk to the value of the account portfolio arising from changes in the value of the underlying financial instruments; liquidity risk, the risk to the value of the account portfolio arising from the accounts inability to meet obligations and achieve account objectives; interest rate risk, the risk to the value of the account portfolio arising from movements in interest rates; and foreign exchange risk, the risk to the value of the account portfolio arising from foreign currency exchanges.

The earnings and capital of savings associations with significant reliance on trust and asset management revenues may be adversely affected when financial markets experience a significant and sustained downturn. Since trust departments are dependent on transaction volumes and market values of assets under management; revenue, and hence earnings, may decline substantially during periods of adverse market movements. Savings associations could ultimately find themselves funding trust department capital when unfavorable market conditions exist.

Further, risks associated with fiduciary activities can be distinguished in part from those associated with commercial activities, in that the potential liability from fiduciary activities can exist for the life of the account, through successive generations of beneficiaries. Conversely, commercial risk lasts only as long as the commercial transaction lasts. As previously mentioned, fiduciary liability is not always as easily quantifiable as commercial liability, in that fiduciary liability can increase or decrease based on the market value of the account assets in question.

Fiduciary Liabilities

A savings association acting as a fiduciary can be held liable if it:

- Violates any applicable law;
- Does not comply with the terms of the will, trust or pension plan or, in some instances, court rulings and orders; or

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- Fails to properly discharge any of its duties or responsibilities or abuses any of its powers.

Any present or future beneficiary, or a cofiduciary, can institute legal action against a fiduciary. The remedies that can be sought are several, depending upon the alleged violation but commonly include compelling the fiduciary to perform its duties; enjoining the fiduciary from committing a further violation; compelling the fiduciary to make restitution for the violation; removing the fiduciary; and/or disallowing the fiduciary from ever serving in another fiduciary capacity. If found liable, the fiduciary is said to have committed a "breach of trust." If the fiduciary is found to have committed a breach of trust, it will be held liable: for any loss or depreciation of the account that results from its actions or inactions; for any profit made by the fiduciary through its actions; or any profit that would have accrued to the account if there had been no breach. The amount by which the fiduciary is required by a court of law to pay to the "breached" fiduciary account is known as a "surcharge."

While there are numerous sources of fiduciary liability, the most significant ones generally involve:

Imprudent management of account investments, including: the purchase or sale of speculative securities such as, naked put options or fixed-income securities that are rated below an investment grade quality; retention of nonincome producing assets such as vacant land and/or a noninterest bearing note; undue concentrations and/or failure to properly diversify account assets, such as investing a majority of the account assets in one type of security; or imprudently investing in affiliated products.

Failure to manage cash, including: leaving large amounts of cash uninvested for an unreasonable length of time and/or allowing or creating overdrafts.

Imprudently engaging in self dealing or other conflicts of interest, including: making investment decisions not in accordance with applicable law, particularly investments such as the purchase of the savings association's own stock or mortgages; investing in corporations in which directors have an interest; engaging in insider trading; or imprudently using an affiliate's investment products or brokerage service.

Failure to properly manage real property, including: the failure to insure the property, the failure to pay taxes or the failure to maintain properties (residential or commercial) in proper repair.

Mismanagement of an account, including: making improper or unauthorized distributions; the failure to make timely court accountings or tax filings; and the improper allocation of principal and/or income receipts.

Improper delegation of duties, including: allowing or delegating the investment discretion to someone such as an investment advisor without appropriate oversight and the failure to supervise acts of agents such as property managers.

Taking actions without approval, including: those actions that require the consent of beneficiaries, prior approval of the grantor or cofiduciaries or from a local court with jurisdiction.

Current Liability Environment

The trust and asset management business continues to come under increasing scrutiny due to the applicability of certain federal and/or state laws. For example, the Employee Retirement Income Security Act of 1974 (ERISA) generally imposes the highest standard of fiduciary liability on fiduciaries administering assets of employee benefit plans. There has been substantial growth in employee benefit plan assets serviced by financial institutions in recent years and with increased growth arguably comes increased risk. As another

example, environmental liability issues are a matter of increasing concern due to the potential risk and substantial liability that may arise in connection with the enforcement of state and federal laws and regulations applicable to real estate interests held by trust accounts.

The trust and asset management industry itself continues to undergo dramatic change. Fiduciary services were historically offered by financial institutions in order to provide full-service banking and were thus viewed as a "loss leader." While that motivation has not disappeared, the industry has largely shifted to a fee-based, profit center type of industry with increased competition. This increased competition has increased the potential for exposure, in that service might be sacrificed to cut expenses. Due to cost cutting measures, risk from operations-related areas such as clerical and processing functions has increased.

Another reason for increased loss potential is that society itself has changed. Customers are more informed and sophisticated regarding an institution's responsibilities and are more apt to initiate legal actions. Illustrative of the new customer attitude is the increase in the number of class-action suits being brought against financial institutions by trust account beneficiaries.

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Risk Management

Risk management plays an increasing role in trust departments due in large measure to the risks and liabilities discussed above. Standards of fiduciary responsibility and potential liability continue to evolve under new legislation and legal theories. Management decisions, whether they are legal, operational or administrative in nature, seldom have a predictable outcome. Thus, each decision involves some degree of risk or uncertainty. A common thread woven throughout this handbook is that senior management should consider risk, and the management of risk, in developing its organizational structure and as part of the decision-making processes. OTS strongly encourages management to develop strong risk management programs to identify and control fiduciary risks.

Effective risk management guards against liability that can result from lawsuits or poor administrative practices and/or supervision. A risk management program identifies those areas where there is potential for exposure and then attempts to quantify the risks associated with that area or practice. Through such a program, management has identifiable criteria by which to evaluate the consequences of a decision. Thus, for example, the degree of risk associated with offering a new trust or asset management service may play a significant role in deciding whether or not to offer that service. An effective risk management program can act as an early warning system to anticipate and hopefully prevent potential problems from arising that may result in unanticipated loss to the institution.