

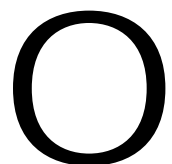


Comptroller of the Currency
Administrator of National Banks

Consigned Items and Other Customer Services

Comptroller's Handbook

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Consigned Items and Other Customer Services

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Background

Banks historically have offered a variety of customer services that do not result in the recording of an asset or liability on the general ledger of the bank. These services include the issuance of consigned items, such as U.S. savings bonds and commemorative coins; customer safekeeping activities, such as the rental of safe deposit box facilities and the safekeeping of collateral; and collection department services.

Although these customer services do not affect a bank's general ledger, they do result in the assumption of a contingent liability. Accordingly, banks must have in place proper internal controls, strong operating procedures and safeguards, and sound audit coverage if they are to offer these services prudently. Although not always profitable, these services enable banks to offer customers a full range of banking services and provide an additional source of noninterest income.

Risks Associated with Consigned Items and Other Customer Services

For purposes of the Office of the Comptroller of the Currency's (OCC) discussion of risk, the OCC assesses banking risk relative to its impact on capital and earnings. From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on the bank's capital or earnings. The OCC has defined nine categories of risk for bank supervision purposes. These risks are: *credit, interest rate, liquidity, price, foreign exchange, transaction, compliance, strategic, and reputation*. These categories are not mutually exclusive; any product or service may expose the bank to multiple risks. For analysis and discussion purposes, however, the OCC identifies and assesses the risks separately.

The applicable risk associated with consigned items and other customer services is transaction risk. Transaction risk is the risk to earnings or capital arising from problems with service or product delivery. This risk is a function of internal controls, information systems, employee integrity, and operating processes. Transaction risk exists in all products and services.

Transaction Risk

Transaction risk, also known as operational risk, can adversely impact earnings as related to consigned items and other customer services because of the typically heavy volume and record keeping nature of the activity. It is imperative for the bank to have controls and systems in place to ensure the accuracy of records and to guard against fraud. In addition, customer safekeeping and holding items on consignment or for resale requires stringent physical and inventory controls, as well as prudent dollar limits on inventory.

Risk Management

All banks must employ sound fundamental principles which identify risks, establish controls, and provide for monitoring systems for consigned items and other customer services. In many cases, banks may choose to establish and communicate these sound principles in writing. The OCC fully endorses putting these principles in writing to better ensure effective communications throughout the bank. If, however, management follows sound fundamental principles and governs the risk in these areas, the OCC does not require a bank to have a written policy for consigned items and other customer services. If management does not practice sound principles, however, the OCC may require management to establish written policies in order to formally communicate risk parameters and controls to the appropriate levels of the bank.

Sound fundamental principles for consigned items and other customer services include proper internal controls, operating procedures and safeguards, and audit coverage. These principles are explained throughout this booklet.

Common Activities

The following paragraphs provide a brief description of common activities associated with consigned items and customer

services.

Customer Safekeeping

Safe Deposit Boxes

In this activity, a bank and a customer contract to rent safe deposit boxes of various sizes for a fee. In return for that fee, the bank assumes the responsibility of exercising reasonable care and precaution against loss of the box's contents. If a loss occurs, the bank may be liable unless it can demonstrate it has acted in accordance with the required standard of care. The required standard of care is defined as that which would be taken by a reasonably prudent and careful person engaged in the same business. The bank must also preserve privacy of entry into the boxes. Two different keys are required to open the box; the customer and the bank each have one key. The customer is not required to disclose the contents of the box to the bank. Only upon a court order may the bank gain access to the box without the consent of the customer.

Safekeeping

In addition to items held as collateral for loans, banks occasionally hold customers' valuables for short periods of time. Although the bank's commercial department may administer safekeeping services, most banks choose to offer these services through a separate trust department. Regardless of the way in which such customer services are offered, management should establish a specific fee schedule for safekeeping services. In exchange for payment of the fee, customers receive assurance that their assets will be protected. Customers may also use safekeeping services to hold assets under escrow.

Controls over items placed in safekeeping generally should be the same as those for handling collateral. Two employees should work together to inventory items the bank will store. They should then keep the items under dual control in the bank's vault. They should also prepare safekeeping receipts with a full description of the items accepted. The bank should never accept sealed packages with contents unknown for safekeeping.

If the items held for safekeeping are U.S. government securities, 17 CFR 450 requires special handling, record keeping, and auditing procedures.

Custody Accounts

Banks may act as custodians for customers' investments, such as stocks, bonds, or precious metals such as gold or silver. This involves merely holding the investments and recording sales and purchases, and collecting dividend and interest payments. A bank offering custody accounts should use signed agreements that clearly define the functions it will perform, in order to limit its potential liability. If the bank offers any additional service, such as managing the customer's assets or providing investment advice, it has established a fiduciary relationship, which requires the bank to have the authority to engage in fiduciary activities.

All national banks that hold or safekeep U.S. government securities for customers must comply with 17 CFR 450. These regulations apply when a national bank holds the customers' securities directly or maintains the customers' securities through another institution.

The Treasury Department has determined that the rules and standards of the OCC that otherwise apply to government securities held in a fiduciary capacity are adequate to meet the requirements of 17 CFR 450. Thus, a national bank will be exempt from 17 CFR 450 requirements provided two conditions are met. First, the bank must adopt policies and procedures that subject its custodial holdings to all the requirements of 12 CFR 9. Second, the bank's custodial holdings must be subject to examination by the OCC for compliance with these fiduciary requirements. (See 17 CFR 450.3(a).) For more information on the requirements relating to the custodial holding of government securities, see the section on bank dealer and brokerage activities in the *Comptroller's Handbook*.

Collection Items

The collection department is one of the most diversified areas in the bank. It engages in receiving, collecting, and

liquidating items, which generally require special handling. The customer normally receives credit only after the bank receives final payment. Some of the common types of collection items include drafts, notes, acceptances, bonds, or bond coupons presented for payment, and contracts in which the bank, on behalf of the holder, collects proceeds. As far as collection items are concerned, the bank acts as agent for its customers or correspondents and receives a fee for that service. General ledger accounts rarely are used in the collection process. The importance and value of customer assets under bank control, however, demand the use of accounting procedures adequate to provide a step-by-step historical summary of each item processed. The bank must also maintain an audit trail to substantiate the proper handling of all items and to reduce the bank's potential liability.

Consigned Items

The most common items held on consignment by banks are unissued traveler's checks, food stamps, U.S. savings bonds, and U.S. commemorative coins. Traveler's checks have gained widespread popularity because of the possibility of refund if they are lost or stolen. A bank issuing traveler's checks shares a fee or commission for issued checks with the consignor. Although the bank does not receive a fee for issuing United States savings bonds or food stamps, it does have use of the sale proceeds which it deposits in the Treasury tax and loan account until such time as a Federal Reserve Bank calls for them. Stocks of U.S. savings bonds are found only in a very few banks that provide payroll processing service to a large number of customers. The bonds are on computer printable stock and are generally stored in the computer operations area. Physical security and inventory controls should be sound; they should be similar to the controls in place for the bank's own supply of negotiable forms.

National banks may not speculate by purchasing coins, such as rare coins, the value of which is based upon such factors as rarity, age, condition, a mistake in the minting, or other intangible factors. They may, however, hold commemorative coins on consignment or purchase them for resale. Commemorative coins are minted by the Bureau of the Mint for the Treasury Department. The price of commemorative coins is based on the value of the metal and production and distribution costs. Banks may take these coins on consignment and act as selling agent for the Treasury. The bank may also purchase an inventory of this type of coin for sale to its customers.

Banks generally maintain a working supply of all consigned items at the teller line or selling station. They also maintain a reserve supply under dual control in the bank's vault. The bank is responsible for all unissued items and must maintain accurate inventories and accounting records on sales. Management should strive to maintain an inventory, which provides customers with adequate selection, without being excessive.

A law specifically prohibits banks from handling lottery tickets. As defined in 12 USC 25a, this prohibition includes making, taking, buying, selling, redeeming, or collecting lottery tickets. Banks may, however, accept deposits of state-sponsored lottery ticket sales proceeds.

Internal Controls

Because the bank assumes a contingent liability for engaging in these activities, it must maintain proper internal controls, strong operating procedures and safeguards, and sound audit coverage. Banks accomplish the necessary control and review of consigned items through the use of nonledger control or memorandum accounts. These nonledger control accounts may consist of ledger cards for customer safekeeping and safe deposit box facilities; inventory listings for traveler's checks, U.S. savings bonds, and commemorative coins; and registers for collection items. In all cases, employees must generate control totals and balance the function(s) daily. Periodically, employees must perform a physical inventory of the items to prove the control totals.

Banks must maintain adequate bonding on all employees wherever contingent liabilities exist. This coverage will include protection against claims arising from mishandling, negligence, mysterious disappearance, or other unforeseen occurrences.

Accounting

In accordance with the instructions for the Consolidated Reports of Condition and Income (call reports), a bank should report fee income from customer safekeeping and safe deposit, consigned items, and collection services as "other noninterest income," in the subcategory "other fee income." The instructions require commemorative coins purchased for resale by a national bank be recorded as "other assets." The bank's books should reflect the lower of cost or market value with adjustments made at least quarterly. This is consistent with the accounting treatment of bullion and bullion-type coins.

General Procedures

These procedures are intended to determine the adequacy of the bank's policies, procedures, and internal controls as they relate to consigned items and other customer services. The extent of consigned items and other customer services testing and procedures performed should be based upon the examiner's assessment of risk. This assessment should include consideration of work performed by internal/external auditors and other internal compliance review units, formalized policies and procedures, and the effectiveness of internal controls.

Objective: Determine the scope of the examination of consigned items and other customer services.

1. Review the supervisory strategy in the OCC database and Scope Memorandum issued by the bank examiner-in-charge (EIC).
2. Review previous consigned items and other customer services examination findings. Determine if appropriate corrective action has been taken to address any previously identified problems. If not, determine why.
3. Obtain from the examiner assigned internal/external audit, a copy of any significant deficiencies for consigned items and other customer services. If internal/external audit is not part of the overall scope of the examination, review the work performed by internal/external auditors in this area and obtain a list of any deficiencies noted in their latest review. Determine whether management has taken appropriate corrective action. If not, determine why.
4. Obtain and review:
 - A listing of consigned items and other control accounts.
 - Remittance records for unissued traveler's checks, food stamps, and U.S. savings bonds, if applicable.
5. Review consigned items and other customer services operating policies or practices, paying particular attention to any material changes since the previous examination.
6. Review internal bank reports on the consigned items and other customer services department. Determine any material changes in types of products, volumes, and changes in market focus.
7. Based on performance of the previous steps, and discussions with the EIC, determine the scope of the examination and its objectives.

Note: Select from among the following examination procedures, as necessary, to determine the level of risk and test the risk management process for consigned items and other customer services.

Quantity of Risk

Conclusion: The quantity of risk is (low, moderate, high).

Objective: Determine the types and level of activity of products offered by the consigned items and other customer services department.

1. Review internal bank reports on the consigned items and other customer services department. Identify and determine the significance of any material changes in volume, types of products offered or changes in market focus.
2. Scan control accounts for any significant fluctuations, and determine the cause of fluctuations.
3. Determine the level of compliance with applicable laws, rulings and regulations.
 - 12 USC 25a — Prohibition on handling of lottery tickets
 - 17 CFR 450 — Safekeeping of U.S. government securities
4. Compare bank control records to remittance records for unissued traveler's checks, food stamps, and U.S. savings bonds.
5. Verify the accuracy of bank records for consigned items and other customer services. Select from among the following procedures, as necessary, to determine the level of risk for each consigned item and other customer services area.

Safe Deposit Boxes

- Compare the number of rental contracts in force to the total number of safe deposit boxes. Reconcile any differences.
- In the presence of a bank official, inspect and reconcile the following to inventory control records maintained by the bank:
 - Keys for unrented boxes.
 - Extra locks and keys kept for replacement purposes.
 - Contents of any drilled safe deposit boxes.
- Determine the reasonableness of documentation associated with any drilled. Boxes may be drilled for nonpayment of rent; upon written request of lessee; and for a special administrator, with proper legal authority, in search of a will.

Safekeeping and Custody Accounts

- Obtain the safekeeping register, verify that receipt forms are issued in numerical sequence and that all numbers are accounted for, and check unused forms for the next number to be issued. Also, test the completeness of the numerical sequence of unissued forms.
- Select a sample of items and test for the following. Resolve any differences.
 - Examine the contract and check for the customer signature for each account selected.
 - In the presence of a bank official, examine the items selected, agreeing the vault contents to the receipt copies on hand.
 - Review transactions, and determine compliance with written contractual authorizations.

- If any items selected for examination are held in safekeeping elsewhere, confirm their existence by direct communication.
- If any items selected for examination appear altered or there appears to be a discrepancy between the receipt and what is held in the vault, confirm the items with the customers.
- Select a sample of closed accounts (released items) and test for the following. Resolve any differences.
 - Examine the register form and the customer's release.
 - Compare the customer's signature on the release to the other signature copy on file.
 - If any of the items appear altered or unusual, confirm the correctness of the information with owners.

Collection Items

- If memorandum control accounts are maintained, prepare or request that the bank prepare, under your supervision, a trial balance of each account controlled. Resolve any differences.
- In the case of unusual, altered, or longstanding items, prepare and mail confirmation requests to customers.
- Select a sample of representative items and:
 - Review all supporting documents
 - Satisfy yourself about the authenticity of each item selected, and trace and clear each item through final payment including the posting of the appropriate credit to the customer.
- Test postings of collections on detailed records to determine that disbursement of funds collected is in accordance with customers' instructions.

Consigned Items

- In the presence of a bank official, inventory unissued and spoiled items on hand, and agree totals to memorandum controls maintained at each issuing location.
- Compare and reconcile memorandum records to the latest consignor statement.
- Prepare and mail to consignor a confirmation request on items inventoried.
- Follow up and clear satisfactorily any confirmation exceptions.

Other Nonledger Control Items

- Review nonledger accounts to determine the maximum elapsed time for closing out entries or clearing items. Compare to the department's stated policies, practices, or procedures.
- Determine the status and reasonableness of old memorandum account items.

Quality of Risk Management

Conclusion: The quality of risk management is (strong, satisfactory, weak)

Policy

Conclusion: The board (has/has not) established appropriate policies for consigned items and other customer services.

Objective: Determine if the bank has formal/informal policies adequate to control the risks from consigned items and other customer services.

1. Review the bank's policies for consigned items and other customer services. Determine if the policies:
 - Have been adopted by the board of directors.
 - Outline adequate controls.
 - Address compliance with applicable regulations.

Processes

Conclusion: The board (has/has not) implemented effective processes to manage consigned items and other customer services.

Objective: Determine the adequacy of processes in place to manage consigned items and other customer services.

1. Review consigned items and other customer services operating policies or practices, paying particular attention to any changes since the previous examination.
2. For each consigned item and customer service offered, determine the adequacy of internal controls. The following are items to consider, as appropriate, in reviewing each area. Because the nature and scope of these services differ among banks, the absence of an item does not necessarily indicate a weakness in the bank's internal controls.

Safe Deposit Boxes

- A lease contract, reviewed and approved by bank counsel, covering the rental, use, and termination of safe deposit boxes is used.
- A signed lease contract is on file for each safe deposit box in use.
- A standard fee schedule for this service has been adopted.
- Receipts for keys to the safe deposit box are obtained.
- Officers or employees of the bank are prohibited from having access to safe deposit boxes except their own or one rented in the name of a member of their family.
- The guard key to safe deposit boxes is maintained under absolute bank control.
- The bank refuses to hold any safe deposit box keys for customers renting such boxes.
- Each admittance slip is signed in the presence of the safe deposit clerk and the time and date of entry noted.
- Admittance slips are filed numerically.
- Vault records are noted for joint tenancies and co-rental contracts requiring the presence of two or more persons at each access.
- Safe deposit boxes are locked, the renter's key removed and returned to the customer, and the guard

key removed while permitting access to the contents.

- The safe deposit clerk is prohibited from assisting the customer in looking through the contents of a box.
- The safe deposit clerk participates in the relocating of the box to make sure the number of the box corresponds to that of the one that was opened.
- An attendant examines all coupon booths after being used, but before being assigned to another renter, to be sure the previous person did not leave behind anything of value.
- All collections of rental income are recorded when received.
- All safe deposit boxes in which the lessee is delinquent in rent are flagged or otherwise marked so that access will be withheld until the rent is paid.
- A file is maintained of all attachments, notices of bankruptcy, letters of guardianship, and letters testamentary (court-issued authority empowering a person named an executor in a will to act in that capacity) served on the bank. Affected safe deposit boxes are flagged.
- An acknowledgment of receipt of all property and a release of liability is signed upon termination of occupancy.
- Locks are changed when boxes are surrendered, whether or not keys are lost.
- Drilling of boxes is witnessed by two individuals.
- The contents of drilled boxes are inventoried, packaged, and placed under dual control.
- All extra locks and keys are maintained under dual control.

Items in Safekeeping

- A written contract, reviewed and approved by bank counsel, is used.
- Contracts are on hand for each item that clearly define the functions to be performed by the bank.
- Set fees are charged for this service.
- Items are segregated from bank-owned assets and maintained under dual control.
- Duplicate receipts are issued to customers for items deposited in safekeeping.
- Blank, pre-numbered, multicopy receipts are kept under dual control and periodically audited.
- A safekeeping register is maintained to show details of all items for each customer.
- A record is maintained of all entries to custodial boxes or vaults.
- Sealed packages are not accepted unless the contents are known.
- Receipts are obtained from the customer when safekeeping items are released.

Custody Accounts

(Omit this section if the bank's trust department handles such accounts.)

- A written contract, reviewed and approved by bank counsel, is used.
- Contracts are on hand for each account that clearly define the functions to be performed by the bank.
- Standard fees are charged for this service.
- Duplicate receipts are issued to customers with detailed descriptions, including dates of coupons attached, if applicable, for all items accepted.
- Blank, pre-numbered, multicopy receipts are kept under dual control and periodically audited.
- All negotiable items handled in this area are maintained under dual control.
- For coupon securities held by the bank:
 - A tickler file or other similar system is used to ensure prompt coupon redemption on accounts for which the bank has been authorized to perform that service.
 - Coupons are not clipped unless the bank is authorized to do so.
 - Customers receive prompt credit when coupon proceeds or other payments are received.
- Withdrawals and transmittals of items to customers are done in accordance with procedures.
- All withdrawals are reviewed and approved by an officer prior to the transaction.

Collection Items

- Access to the collection area is controlled.
- Set fees are charged for this service.
- A permanent record is maintained for registered mail.
- Permanent registers are kept for incoming/outgoing collection items.
- All collections are indexed in the collection register.
- Registers furnish a complete history of the origin and final disposition of each collection item.
- Receipts are issued to customers for all items received for collection.
- Serial numbers or pre-numbered forms are assigned to each collection item and all related papers.
- All incoming tracers and inquiries are handled by an officer or employee not connected with the processing of collection items.
- A record is kept to show the various collection items which have been paid and credited as a part of the day's business.
- An itemized daily summary is made of all collection fees, showing collection numbers and amounts.
- Employees handling collection items are rotated periodically, without advance notification, to other banking duties.
- Settlement is made with the customer on the same business day that payment of the item is received.
- The customer does not receive credit until final payment is received.
- An officer supervises tracers and inquiries on unpaid collection items in the hands of correspondents.
- Customers are promptly notified and the item returned when a collection is not paid.
- The files of notes entered for collection are clearly and distinctly segregated from bank-owned loans and discounts.
- The collection notes described above are maintained under memorandum control, and the control is balanced regularly.
- Collection files are locked when the employee handling such items is absent.
- Vault storage facilities are provided for collection items carried over to the next day's business.
- The collection teller turns over all cash to the paying teller at the close of business each day, and starts each day with a standard change fund.

Consigned Items

- The reserve stock of consigned items is maintained under dual control.
- Prudent inventory dollar limits are assigned.
- Working supplies are kept to a reasonable minimum; e.g., two or three days' supply, and adequately protected during banking hours.
- A memorandum control is maintained of consigned items.
- Separate accounts with the consignor are maintained at each issuing location (branch), if applicable.
- The working supply is put in the vault at night and over weekends or holidays, or otherwise protected.
- Remittances for sales are made on a regularly scheduled basis.

3. Determine whether bank officers and employees are operating in conformance with established policies or practices.

Personnel

Conclusion: Bank personnel (do/do not) possess an understanding of the risks and risk management regarding consigned items and other customer services.

Objective: Determine if bank personnel possess the knowledge and skills needed to understand and manage the risks in the

consigned items and other customer services areas.

1. Discuss with appropriate bank personnel their roles and responsibilities regarding consigned items and other customer services.
2. Discuss with appropriate bank personnel their education, training and experience in the area of consigned items and other customer services.

Controls

Conclusion: Management has (effective/ineffective) control systems for consigned items and other customer services.

Objective: Determine that appropriate controls exist for consigned items and each customer service the bank provides.

1. Review the latest audit reports, management's response to those audits and any additional reports to assess the scope and adequacy of the audit.
2. Review deficiencies noted during internal/external audit and other bank reviews and determine if management attention is appropriate and timely.

Conclusion

Objective: To prepare written conclusion comments and communicate findings to management. Review findings with the EIC prior to discussion with management.

1. Provide EIC with a brief conclusion regarding:
 - The adequacy of the bank's policies, procedures, and internal controls.
 - Violations of laws, rulings, and regulations.
 - Recommended corrective action when policies or practices are deficient.
 - The quantity of risk and the quality of risk management in all areas reviewed.

2. Determine the impact on the aggregate and direction of risk assessments for any applicable risks identified by performing the above procedures. Examiners should refer to guidance provided under the OCC's large and community bank risk assessment programs.
 - Risk Categories: Transaction, Compliance, Reputation
 - Risk Conclusions: High, Moderate, or Low
 - Risk Direction: Increasing, Stable, or Decreasing

3. Discuss findings with management including:
 - The adequacy of the bank's policies, procedures, and internal controls.
 - Violations of laws, rulings, and regulations.
 - Recommended corrective action when policies or practices are deficient.
 - The quantity of risk and the quality of risk management in all areas reviewed.
 - The impact on the aggregate and direction of risk assessments for applicable risks.

4. As appropriate, prepare a brief consigned items and other customer services comment for inclusion in the report of examination.

5. Prepare a memorandum or update the work program with any information that will facilitate future examinations.

6. Update the OCC database.

7. Organize and reference working papers in accordance with OCC guidance.

Consigned Items and Other Customer Services

References

Custodial Holdings of Government Securities

Regulations 12 CFR 9
 17 CFR 450

General Power

Laws 12 USC 24(7)

Penalty Provisions

Laws 12 USC 25a
 18 USC 1306

Prohibited Activities

Laws 12 USC 25a
 31 USC 5118