RESCINDED

AL 98-14
Subject: Fiduciary Services and Year 2000 Readiness
Date: September 3, 1998

TO: Chief Executive Officers of National Banks, Department

Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

This advisory is to alert you to the recent release of an FFIEC interagency statement on the Year 2000 problem. "Guidance Concerning Fiduciary Services and Year 2000 Readiness," a supplement to previous FFIEC interagency statements, guides banks in overseeing and managing the risks posed by the Year 2000 problem to fiduciary services. The guidance describes the responsibilities of senior management and the board of directors in this area, and outlines the controls and actions banks should use to manage the risks to their fiduciary activities. Such controls and actions will be determined by the types of fiduciary services a bank offers and the nature of the assets it manages. The guidance also describes such specific areas of potential concern as account and asset administration, third-party risk, counterparty risk, transfer agent services, and client disclosures. Financial institutions should work to prevent Year 2000 problems that could affect their fiduciary clients. Beneficiaries and other interested parties may interpret a financial institution's lack of response as a failure to fulfill its fiduciary duties. For further information on fiduciary services and Year 2000 readiness please contact the Asset Management Division at (202) 874-4447.

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Bank Supervision Policy

Attachment

Federal Financial Institutions Examination Council

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Press Release

For Immediate Release **September 2, 1998**

FFIEC Issues Year 2000 Guidance on Fiduciary Services

The Federal Financial Institutions Examination Council (FFIEC) issued guidance today that addresses the Year 2000 risks associated with fiduciary services. Today's guidance stresses fiduciaries' obligations to protect the assets of all account beneficiaries and manage all client assets solely in those beneficiaries' best interest. The guidance emphasizes particular areas that may affect fiduciary services.

FFIEC member agencies expect that financial institutions will act to mitigate and manage Year 2000 exposures by reviewing their fiduciary services and fiduciary account assets. Directors and senior management are expected to take an active role in this process.

The action a financial institution takes to manage fiduciary risks depends on the types of fiduciary services it offers and the types of assets it manages for account beneficiaries. Areas of potential concern include account and asset administration, third-party risk, counterparty risk, transfer agent services, and client disclosures. The guidance addresses each of these areas.

A financial institution's lack of response to fiduciary Year 2000 issues may be interpreted by beneficiaries and other interested parties as a failure to fulfill its fiduciary duties and to observe the standards of prudence set by the Employee Retirement Income Security Act of 1974 (ERISA) and other applicable laws and regulations.

The FFIEC agencies expect each financial institution to address Year 2000 problems it identifies in fiduciary relationships in order to protect account beneficiaries and limit potential risks to the institution.

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Federal Financial Institutions **Examination Council**

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September 2, 1998

Guidance Concerning Fiduciary Services and Year 2000 Readiness

To: The board of directors and chief executive officers of all federally supervised financial institutions and examining personnel and senior management of each FFIEC agency.

Background

Financial institution fiduciaries manage a variety of tangible and financial assets for beneficiaries. As fiduciaries, they are obligated to protect the assets of all account beneficiaries, and manage all client assets solely in those beneficiaries' best interests. If a fiduciary exercises investment discretion over its accounts, the standard of care is higher for investing and managing client assets. Year 2000 problems affecting fiduciary services may expose financial institutions to increased risks.

Financial institutions need to consider potential Year 2000 problems that could affect their fiduciary clients. A financial institution's lack of response to fiduciary Year 2000 issues may be interpreted by beneficiaries and other interested parties as a failure to fulfill its fiduciary duties and to observe the standards of prudence set by the Employee Retirement Income Security Act of 1974 (ERISA) and other applicable laws and regulations.

Purpose

The purpose of this guidance is to remind financial institutions of the potential for increased risk of Year 2000 problems associated with fiduciary services. The guidance describes controls and actions that institutions should use to manage these risks.

The Federal Financial Institutions Examination Council (FFIEC) has issued guidelines on many Year 2000 topics. The existing FFIEC Year 2000 guidance applies to all services, including fiduciary services offered by financial institutions regulated by the FFIEC member agencies. The FFIEC agencies expect directors and senior management to review the existing FFIEC statements when deciding how to remedy the Year 2000 problems of fiduciary accounting and operating systems, including all add-on or feeder systems. These statements can be found on the FFIEC's Internet site at http://www.FFIEC.GOV.

Areas of Potential Risk

To avoid an increase in an institution's operational, reputation, legal, compliance and financial risks, the FFIEC agencies advise each financial institution to address Year 2000 problems that they identify in fiduciary relationships. Some specific areas of concern include:

- Account and Asset Administration
- Third-Party Risk
- Counterparty Risk
- Transfer Agent Services
- Client Disclosures

We discuss each below.

<u>Account and Asset Administration</u>

As previously noted, a fiduciary is obligated to manage fiduciary assets and relationships in the best interest of account beneficiaries. A fiduciary must take the necessary steps to ensure that internal accounting systems are Year 2000 ready and that assets held for beneficiaries do not expose the fiduciary to unnecessary risks.

The FFIEC agencies expect financial institutions to:

- Develop a process to evaluate potential Year 2000 risks associated with managing clients' assets.

- Conduct a thorough review of significant fiduciary account assets to determine potential liability or exposure attributable to issuers of securities with Year 2000 problems. Certain types of assets, such as closely-held companies, partnership interests, and income producing real estate, may also be the source of potential Year 2000 exposure. Financial institutions can conduct this review as part of ongoing account reviews.

<u>Third Party Risk</u>

Financial institution fiduciaries may use a variety of third party service providers to help them in meeting their fiduciary responsibilities.[1] Some common types of services obtained through third

[1]For additional information concerning third-parties, please review the FFIEC Interagency Statement Guidance Concerning Institution Due Diligence in Connection with Service Provider and Software Vendor Year 2000 Readiness, dated March 17, 1998.

parties are: depositories, investment advisory, custodial, transfer, fiscal and paying agencies. A financial institution that relies on third-parties to meet its fiduciary obligations should be aware that it could experience increased risk because of the third party's Year 2000 problems. The FFIEC agencies expect financial institutions to:

- Evaluate the Year 2000 readiness of third parties that the financial institution uses to meet its fiduciary responsibilities.

- Include alternatives to significant third parties in their contingency planning to reduce risk to account beneficiaries from a third party's failure to meet its contractual obligations.

Counterparty Risk

Counterparties are entities engaged in a financial transaction in which each party fulfills a role in the execution of the transaction.[2] A fiduciary's services may be adversely affected if counterparties are unable to meet their legal or contractual obligations because of Year 2000 problems. For example, if a counterparty is unable to settle a securities transaction, the account beneficiary may suffer harm. A financial institution may be exposed to counterparty risk in a variety of fiduciary activities including custodial services, retirement services, and trustee relationships.

The FFIEC agencies expect financial institutions to:

- Evaluate the Year 2000 readiness of each significant counterparty with which they routinely conduct fiduciary business.

- Include alternatives to fiduciary counterparties in the institution's Year 2000 contingency plans to reduce risk to account beneficiaries from counterparty failure.

Transfer Agent Services

Some financial institutions offer transfer agent services to clients. Financial institutions that offer these services should ensure that they address any Year 2000 problems, particularly those associated with use of automated transfer agent systems. Some potential Year 2000 concerns with a transfer agent's computer programs include the failure of a system to accept securities transfers and difficulties calculating dividend payment dates for equity securities and maturity dates for debt securities.

Client Disclosures

[2] For additional information concerning counterparties, please review the FFIEC Interagency Statement Guidance Concerning the Year 2000 Impact on Customers, dated March 17, 1998.

Legal documents establishing fiduciary relationships require a fiduciary or trustee to render specific fiduciary services. A financial institution may reduce its risks of litigation if it discloses to beneficiaries information addressing the Year 2000 date change.[3]

The FFIEC agencies expect financial institutions to consult legal counsel to determine whether they are responsible for disclosing to account beneficiaries:

- The extent of their Year 2000 preparation.
- Significant Year 2000 issues with specific asset holdings in customer accounts.
- Significant Year 2000 issues with third parties and counterparties.

Conclusion

The FFIEC agencies expect financial institutions offering fiduciary services to review their fiduciary services and fiduciary account assets to identify potential liabilities or exposures from the Year 2000 date change. In addition, FFIEC member agencies expect that financial institutions will act to mitigate and manage Year 2000 exposures resulting from their fiduciary services. The action a particular financial institution takes to manage these risks depends on the types of fiduciary services offered by the institution and the types of assets managed for account beneficiaries.

[3]For additional information concerning customer disclosures, please review the FFIEC Interagency Statement Guidance Concerning Year 2000 Customer Awareness Programs, dated May 13, 1998.