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Introductory Comment: It has been quite some time since we presented information specific to BSA/AML. In this edition I present recent guidance issued by FinCEN, as well as the Interagency Statement on Enforcement of BSA/AML. Also, I have included information on the OCC's capital and liquidity requirements for National Trust Banks; the SEC's extension of bank's from the definition of "broker"; and EBSA's guidance on tax-sheltered annuity programs for 403(b) plans.

FinCEN: Guidance 2007-G002 - Requests by Law Enforcement for Financial Institutions to Maintain Accounts

Background
The Financial Crimes Enforcement Network (FinCEN) has issued guidance to financial institutions to address law enforcement agency requests to keep open particular accounts. The salient points of the guidance are outlined below.

- On June 13, 2007, the Financial Crimes Enforcement Network (FinCEN) issued guidance for financial institutions with regard to requests by a law enforcement agency to keep particular accounts open.
- The decision to maintain or close an account t should be made by a financial institution in accordance with its own standards and guidelines
- In the even of a request, the financial institution should ask for a written request that states the purpose of the request and the duration, which should not exceed six months.
- If the financial institution chooses to maintain the account, it is required to comply with all applicable Bank Secrecy Act recordkeeping and reporting requirements, including the requirement to file Suspicious Activity Reports, regardless of the status of the investigation.

Information
The Financial Crimes Enforcement Network (FinCEN) is issuing the following guidance for financial institutions with account relationships that law enforcement may have an interest in ensuring remain open notwithstanding suspicious or potential criminal activity in connection with the account. Ultimately, the decision to maintain or close an account should be made by a financial institution in accordance with its own standards and guidelines. Although there is no requirement that a financial institution maintain a particular account relationship, financial institutions should be mindful that complying with such a request may further law enforcement efforts to combat money laundering, terrorist financing, and other crimes.

If a law enforcement agency requests that a financial institution maintain a particular account, the financial institution should ask for a written request. A written request from a federal law enforcement agency should be issued by a supervisory agent or by an attorney within a United States Attorney's Office or another office of the Department of Justice. If a state or local law enforcement agency requests that an account be maintained, then the financial institution should obtain a written request from a supervisor of the state or local law enforcement agency or from an attorney within a state or local prosecutor's office. The written request should indicate that the agency has requested that the financial institution maintain the account and the purpose of the request. For example, if a state or local law enforcement agency is requesting that the financial institution maintain the account for purposes of monitoring, the written request should include a statement to that effect. The request should also indicate the duration for the request, not to exceed six months. Law enforcement may issue subsequent requests for account maintenance after the expiration of the initial request. Although there is no recordkeeping requirement under the Bank

Secrecy Act for this type of correspondence, FinCEN recommends that financial institutions maintain documentation of such requests for at least five years after the request has expired. If a financial institution is aware – through a subpoena, 314(a) request, National Security Letter, or similar communication – that an account is under investigation, FinCEN recommends that the financial institution notify law enforcement before making any decision regarding the status of the account.

Financial institutions are reminded that, as part of their Bank Secrecy Act/Anti-Money Laundering compliance program requirement, they are required to have written policies, procedures, and processes that, among other things, address the identification and reporting of suspicious activity. If the financial institution chooses to maintain the account, it is required to comply with all applicable Bank Secrecy Act recordkeeping and reporting requirements, including the requirement to file Suspicious Activity Reports, even if the bank is keeping an account open or maintaining a customer relationship at the request of law enforcement.

FinCEN: Guidance 2007-G003 – Suspicious Activity Report Supporting Documentation

Background
The Financial Crimes Enforcement Network (FinCEN) has issued guidance reminding financial institutions to provide all documentation supporting the filing of a Suspicious Activity Report (SAR) upon request by FinCEN, appropriate law enforcement or a supervisory agency. Highlights of the guidance are:

- On June 13, 2007, FinCEN issued guidance clarifying the Bank Secrecy Act (BSA) requirement to provide supporting documentation to law enforcement or supervisory agencies, the description of supporting documentation, and the legal process for the disclosure of supporting documentation.
- Financial institutions should take special care to verify that a requestor of information is, in fact, a representative of FinCEN, appropriate law enforcement or a supervisory agency.
- Supporting documentation includes all documents or records that a financial institution used in making the determination that certain activity required a SAR filing.
- The manner in which a financial institution maintains supporting documentation can be defined by the institution and should be incorporated into its BSA/AML Compliance Program written procedures.
- The Right to Financial Privacy Act generally prohibits financial institutions from disclosing a customer's financial records to a government agency without service of legal process, notice to the customer and an opportunity to challenge the disclosure. However, no such requirement applies when the financial institution provides the financial records or information to FinCEN or a supervisory agency in the exercise of its "supervisory, regulatory or monetary functions."

Information
The Financial Crimes Enforcement Network (FinCEN) is issuing this guidance to clarify:
(1) The Bank Secrecy Act (BSA) requirement that financial institutions provide Suspicious Activity Report (SAR) supporting documentation in response to requests by FinCEN and appropriate law enforcement or supervisory agencies; (2) What constitutes "supporting documentation" under SAR regulations; and (3) When legal process is required for disclosure of supporting documentation.

<u>Disclosure of Supporting Documentation to FinCEN and Appropriate Law Enforcement or Supervisory Agencies</u>
When a financial institution files a SAR, it is required to maintain a copy of the SAR and the original or business record equivalent of any supporting documentation for a period of five years from the date of filing the SAR. Financial institutions must provide all documentation supporting the filing of a SAR upon request by FinCEN or an appropriate law enforcement or supervisory agency.

When requested to provide supporting documentation, financial institutions should take special care to verify that a requestor of information is, in fact, a representative of FinCEN or an appropriate law enforcement or supervisory agency. A financial institution should incorporate procedures for such verification into its BSA compliance or anti-money laundering program. These procedures may include, for example, independent employment verification with the requestor's field office or face-to-face review of the requestor's credentials.

Disclosure of SARs to appropriate law enforcement and supervisory agencies is protected by the safe harbor provisions applicable to both voluntary and mandatory suspicious activity reporting by financial institutions.

<u>What Constitutes Supporting Documentation</u>
"Supporting documentation" refers to all documents or records that assisted a financial institution in making the determination that certain activity required a SAR filing. A financial institution must identify supporting documentation at the time the SAR is filed, and this documentation must be maintained by the institution as such. The manner in which a financial institution maintains supporting documentation may vary from institution to institution, but each institution should prescribe its own method in its anti-money laundering program written procedures. For instance, a financial institution's procedures may require that all supporting documentation for a particular SAR be segregated in a single file folder or scanned and maintained in a data file.

What qualifies as supporting documentation depends on the facts and circumstances of each filing. As indicated in each of the SAR forms, financial institutions should identify in the SAR narrative the supporting documentation, which may include, for example, transaction records, new account information, tape recordings, e-mail messages, and correspondence. While items identified in the narrative of the SAR generally constitute supporting documentation, a document or record may qualify as supporting documentation even if not identified in the narrative.

<u>No Legal Process is Required for Disclosure of Supporting Documentation</u>
The Right to Financial Privacy Act (RFPA) generally prohibits financial institutions from disclosing a customer's financial records to a Government agency without service of legal process, notice to the customer and an opportunity to challenge the disclosure. However, no such requirement applies when the financial institution provides the financial records or information to FinCEN or a supervisory agency in the exercise of its "supervisory, regulatory or monetary functions." In addition, no such requirement applies when FinCEN or an appropriate law enforcement or supervisory agency requests either a copy of a SAR or supporting documentation underlying the SAR.

With respect to supporting documentation, rules under the BSA state explicitly that financial institutions must retain copies of supporting documentation, that supporting documentation is "deemed to have been filed with" the SAR, and that financial institutions must provide supporting documentation upon request. FinCEN has interpreted these regulations under the BSA as requiring a financial institution to provide supporting documentation even in the absence of legal process. FinCEN understands that this is in accord with the RFPA, which states that nothing in the act "authorize(s) the withholding of financial records or information required to be reported in accordance with any Federal statute or rule promulgated thereunder."

FDIC: Interagency Statement on Enforcement of Bank Secrecy Act/ Anti-Money Laundering Requirements

Background
On July 19, 2007, the federal financial regulatory agencies issued a statement setting forth the agencies' policy for enforcing specific anti-money laundering requirements of the Bank Secrecy Act (BSA). The purpose of the Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements is to provide greater consistency among the agencies in enforcement decisions in BSA matters and to offer insight into the considerations that form the basis of those decisions. This interagency statement, jointly issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the

Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration, sets forth the Agencies' policy on the circumstances in which an Agency will issue a cease and desist order to address noncompliance with certain Bank Secrecy Act/Anti-Money Laundering ("BSA/AML") requirements, particularly in light of the specific BSA/AML compliance provisions in section 8(s) of the Federal Deposit Insurance Act ("FDIA") and section 206(q) of the Federal Credit Union Act ("FCUA").

Information

BSA/AML Compliance Program Requirement. Under section 8(s) of the FDIA and section 206(q) of the FCUA, each of the Agencies is directed to prescribe regulations requiring each insured depository institution to establish and maintain procedures reasonably designed to assure and monitor the institution's compliance with the requirements of the Bank Secrecy Act ("BSA Compliance Program"). Sections 8(s) and 206(q) also require that each Agency's examinations of an insured depository institution review the BSA Compliance Program and that its reports of examination describe any problem with the BSA Compliance Program. Finally, sections 8(s) and 206(q) state that if an insured depository institution has failed to establish and maintain a BSA Compliance Program or has failed to correct any problem with the BSA Compliance Program previously reported to the institution by the appropriate Agency, the appropriate Agency shall issue a cease and desist order against the institution. As required by sections 8(s) and 206(q), each of the Agencies has issued regulations that require any institution it supervises or insures to establish and maintain a BSA Compliance Program. Each of these regulations imposes substantially the same requirements. Specifically, under each Agency's regulations, a BSA Compliance Program must have, at a minimum, the following elements:

- a system of internal controls to assure ongoing compliance with the BSA;
- independent testing for BSA/AML compliance;
- a designated individual or individuals responsible for coordinating and monitoring BSA/AML compliance; and
- training for appropriate personnel.

In addition, a BSA Compliance Program must include a Customer Identification Program with risk-based procedures that enable the institution to form a reasonable belief that it knows the true identity of its customers.

Communication of Supervisory Concerns about BSA Compliance Programs. When an Agency identifies supervisory concerns relating to a banking organization's or credit union's BSA Compliance Program in the course of an examination or otherwise, the Agency may communicate those concerns by various means. The particular method of communication used typically depends on the seriousness of the concerns. These methods include:

- informal discussions by examiners with an institution's management during the examination process;
- formal discussions by examiners with the board of directors as part of or following the examination process;
- supervisory letters and other written communications from examiners or the agency to an institution's management;
- a finding contained in the report of examination or in other formal communications from an Agency to an institution's board of directors indicating deficiencies or weaknesses in the BSA Compliance Program; or
- a finding contained in the report of examination or in other formal communications from the Agency to an institution's board of directors of a violation of the regulatory requirement to implement and maintain a reasonably designed BSA Compliance Program.

As explained below, in order to be a "problem" with the BSA Compliance Program that will result in a cease and desist order under sections 8(s) or 206(q) if not corrected by the institution, deficiencies in the Program must be identified in a report of examination or other written document as requiring communication to an institution's board of directors or senior management as matters that must be corrected. However, other issues or suggestions for improvement may be communicated through other means.

Enforcement Actions for BSA Compliance Program Failures. In accordance with sections 8(s)(3) and 206(q)(3), the appropriate Agency will issue a cease and desist order against a banking organization or a credit union for noncompliance with BSA Compliance Program requirements in the following circumstances, based on a careful review of all the relevant facts and circumstances.

Failure to establish and maintain a reasonably designed BSA Compliance Program. The appropriate Agency will issue a cease and desist order based on a violation of the requirement in sections 8(s) and 206(q) to establish and maintain a reasonably designed BSA Program where the institution:

- Fails to have a written BSA Compliance Program, including a customer identification program, that adequately covers the required program elements (i.e., internal controls, independent testing, designated compliance personnel, and training); or
- Fails to implement a BSA Compliance Program that adequately covers the required Program elements (institution-issued policy statements alone are not sufficient; the program as implemented must be consistent with the banking organization's written policies, procedures, and processes); or
- Has defects in its BSA Compliance Program in one or more program elements that indicate that either the written Compliance Program or its implementation is not effective, for example, where the deficiencies are coupled with other aggravating factors, such as (i) highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing, (ii) patterns of structuring to evade reporting requirements, (iii) significant insider complicity, or (iv) systemic failures to file Currency Transaction Reports, Suspicious Activity Reports, or other required BSA reports.

For example, an institution that has procedures to provide BSA/AML training to appropriate personnel, independent testing, and a designated BSA/AML compliance officer, would nonetheless be subject to a cease and desist order if its system of internal controls (such as customer due diligence, procedures for monitoring suspicious activity, or an appropriate risk assessment) fails with respect to a high risk area or to multiple lines of business that significantly impact the institution's overall BSA compliance. Similarly, a cease and desist order would be warranted if, for example, an institution has deficiencies in the required independent testing element of the Program and those deficiencies are coupled with evidence of highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing in the institution. However, other types of deficiencies in an institution's BSA Compliance Program or in implementation of one or more of the required Program elements will not necessarily result in the issuance of a cease and desist order, unless the deficiencies are so severe as to render the Program ineffective when viewed as a whole. For example, an institution that has deficiencies in its procedures for providing BSA/AML training to appropriate personnel, but has effective controls, independent testing, and a designated BSA/AML compliance officer, may ordinarily be subject to examiner criticism and/or supervisory action other than the issuance of a cease and desist order, unless the training program deficiencies, viewed in light of all relevant circumstances, are so severe as to result in a finding that the organization's Program, taken as a whole, is not effective.

In determining whether an organization has failed to implement a BSA Compliance Program, an Agency will also consider the application of the organization's Program across its business lines and activities. In the case of institutions with multiple lines of business, deficiencies affecting only some lines of business or activities would need to be evaluated to determine if the deficiencies are so severe or significant in scope as to result in a conclusion that the institution has not implemented an effective overall program.

Failure to correct a previously reported problem with the BSA Compliance Program. A history of deficiencies in an institution's BSA Compliance Program in a variety of different areas, or in the same general areas, may result in a cease and desist order on that basis. An Agency will, in accordance with sections 8(s) and 206(q), and based on a careful review of the relevant facts and circumstances, issue a cease and desist order whenever an institution fails to correct a problem with BSA/AML compliance identified during the supervisory process. In order to be considered a "problem" within the meaning of sections 8(s)(3)(B) and 206(q)(3)(B), however, a deficiency reported to the institution ordinarily would involve a serious defect in one or more of the required components of the institution's BSA Compliance Program or implementation thereof that a report of examination or other written supervisory communication identifies as requiring communication to the institution's board of directors or senior management as a matter that must be corrected. For example, failure to take any action in response to an express criticism in an examination report regarding a failure to appoint a qualified compliance officer could be viewed as an uncorrected problem that would result in a cease and desist order.

An Agency will ordinarily not issue a cease and desist order under sections 8(s) or 206(q) for failure to correct a BSA Compliance Program problem unless the deficiencies subsequently found by the Agency are substantially the same as those previously reported to the institution. For example, if an Agency notes in one examination report that an institution's training program was inadequate because it was out of date (for instance if it did not reflect changes in the law), and at the next examination the training program is adequately updated, but flaws are discovered in the internal controls for the BSA/AML Program, the Agency may determine not to issue a cease and desist order under sections 8(s) or 206(q) for failure to correct previously reported problems and will consider the full range of potential supervisory responses. Similarly, if an institution is cited in an examination report described above for failure to designate a qualified BSA compliance officer, and the institution by the next examination has appointed an otherwise qualified person to assume that responsibility, but the examiners recommend additional training for the person, an Agency may determine not to issue a cease and desist order under sections 8(s) or 206(q) based solely on that deficiency. Statements in a written examination report or other supervisory communication identifying less serious issues or suggesting areas for improvement that the examination report does not identify as requiring communication to the board of directors or senior management as matters that must be corrected would not be considered problems" for purposes of sections 8(s) and
206(q).

The Agencies recognize that certain types of problems with an institution's BSA Compliance Program may not be fully correctable before the next examination, for example, remedial action involving adoption or conversion of computer systems. In these types of situations, a cease and desist order is not required provided the Agency determines that the institution has made acceptable substantial progress toward correcting the problem at the time of the examination immediately following the examination where the problem was first identified and reported to the institution.

<u>Other Enforcement Actions for BSA Compliance Program Deficiencies.</u> As noted above, in addition to the situations described in this Statement where an Agency will issue a cease and desist order for a violation of the BSA Compliance Program regulation or for failure to correct a previously reported Program "problem," an Agency may also issue a cease and desist order or enter into a formal written agreement, or take informal enforcement action against an institution for other types of BSA/AML Program concerns. In these situations, depending upon the particular facts involved, an Agency may pursue enforcement actions based on unsafe and unsound practices or violations of law, including the BSA. The form of the enforcement action in a particular case will depend on the severity of the noncompliance, weaknesses, or deficiencies, the capability and cooperation of the institution's management, and the Agency's confidence that the institution will take appropriate and timely corrective action.

<u>BSA Reporting and Recordkeeping Requirements:</u> Suspicious Activity Reporting Requirements. Under regulations of the Agencies and the Treasury Department, organizations subject to the Agencies' supervision are required to file a suspicious activity report ("SAR") when they detect certain known or suspected criminal violations or suspicious transactions. Suspicious activity reporting forms the cornerstone of the BSA reporting system, and is critical to the United States' ability to utilize financial information to combat money laundering, terrorist financing, and other financial crimes. The regulations require banking organizations and credit unions to file SARs with respect to the following general types of activity:

- known or suspected criminal violations involving insider activity in any amount;
- known or suspected criminal violations aggregating $5,000 or more when a suspect can be identified;
- known or suspected criminal violations aggregating $25,000 or more regardless of potential suspects; or

- suspicious transactions of $5,000 or more that involve potential money laundering or BSA violations.

The SAR must be filed within 30 days of detecting facts that may constitute a basis for filing a SAR (or within 60 days if there is no subject).

The Agencies will cite a violation of the SAR regulations, and will take appropriate supervisory action, if the organization's failure to file a SAR (or SARs) evidences a systemic breakdown in its policies, procedures, or processes to identify and research suspicious activity, involves a pattern or practice of noncompliance with the filing requirement, or represents a significant or egregious situation.

Other BSA Reporting and Recordkeeping Requirements. Banking organizations and credit unions also are subject to other BSA reporting and recordkeeping requirements set forth in regulations issued by the Treasury Department. These requirements are reviewed in detail in the *FFIEC BSA/AML Examination Manual*; they include, inter alia, requirements applicable to cash and monetary instrument transactions and funds transfers, Currency Transaction Report ("CTR") filing and exemption rules, and due diligence, certification, and other requirements for foreign correspondent and private banking accounts.

Enforcement Actions for Non-Program BSA/AML Requirements. In appropriate circumstances, an Agency may take formal or informal enforcement actions to address violations of BSA/AML requirements other than the BSA Compliance Program requirements. These other requirements include, for example, the SAR and CTR regulatory obligations described above.

OCC – Guidance for Capital and Liquidity for National Trust Banks

Background

On June 26, 2007 the Office of the Comptroller of the Currency issued guidance for capital and liquidity of National Trust Banks. This guidance rescinds OCC Bulletin 2000-26, "Supervision of National Trust Banks: Capital and Liquidity." The bulletin was originally issued to highlight the critical need for national trust banks (NTBs) to maintain adequate liquidity and capital and for examiners to assess these matters through the supervisory process. In light of recent examination findings and to clarify certain aspects of the previously issued bulletin the OCC is issuing this revised guidance. Specifically, the revised guidance:

- Reiterates the OCC's expectation that it is the responsibility of a NTB's management and board to implement a system to analyze and maintain adequate liquidity and capital.
- Clarifies the OCC's expectation that capital and liquidity in all NTBs will increase beyond the initial minimum requirements as the size, complexity, and corresponding risks of the activities of the NTB evolve.
- Clarifies the concept that capital and liquidity should be evaluated separately. In addition, clarifies that balance-sheet assets that are pledged or encumbered, such as those that are committed to meet the NTB's minimum capital requirement or to meet state pledging requirements, should not be viewed as an available source of primary liquidity.
- Discusses the importance that NTBs develop and maintain forward-looking liquidity risk management processes and develop contingency funding plans to address potential shortfalls.

Information

A NTB is a national bank whose business primarily consists of fiduciary and related products and services. Traditional fiduciary services offered by NTBs include personal trust and estate administration, retirement plan services, investment management and advisory activities, and corporate trust administration. Related services include custody and safekeeping, security-holder services, financial planning, and cash management. Most NTBs do not offer loans or accept deposits and do not have FDIC insurance.

Pursuant to the authority granted in 12 USC 92a, and the licensing requirements of 12 CFR 5.26, a NTB must receive OCC approval to exercise fiduciary powers. Some NTBs are independent, stand-alone entities, while others are subsidiaries of, or are affiliated with, commercial banks, bank holding companies, financial service providers, or other business enterprises.

NTBs are subject to the minimum leverage and risk-based capital ratios defined in 12 CFR 3. However, these ratios generally are not optimal measures of capital adequacy for NTBs, as the risks posed by off-balance sheet asset management activities are not captured in capital ratio calculations. In addition, NTBs are required by 12 USC 92a(i) to have initial capital and surplus not less than the capital and surplus required of state banks offering similar services in the state where the trust bank is located.

Experience indicates that the initial minimum capital levels required by many states often may not be sufficient to cover the risks and expenses of operating a NTB. Therefore, NTBs, generally, are chartered with a condition specifying a minimum dollar amount of capital and, in some cases, a minimum amount of liquidity that must be initially maintained. This amount is based on an analysis of quantitative and qualitative factors including, but not limited to, financial projections, fixed and variable expenses, the nature of fiduciary products and services being proposed, and discussions with organizers. For a more complete discussion of chartering considerations for NTBs, please refer to the "Charters" booklet of the *Comptroller's Licensing Manual*.

Management of Capital and Liquidity

It is the responsibility of the board of directors and management of a NTB to ensure that capital and liquidity levels are adequate and that appropriate capital and liquidity planning processes are in place. This includes ensuring compliance with the conditions set forth in the initial approval letter or subsequent licensing decisions as well as considering ongoing capital and liquidity needs. Failure to maintain adequate capital or liquidity is an unsafe and unsound banking practice.

Board-approved capital and liquidity policies should outline the board's philosophy and articulate responsibilities and expectations for the management of capital and liquidity. Policies should also define acceptable levels of capital and liquidity, establish a regular monitoring program, and include contingency funding plans that identify alternatives for meeting unanticipated needs.

The board should regularly assess management's adherence to established policies and evaluate capital adequacy and overall levels and trends in liquidity. The OCC expects NTBs to assess the appropriateness of their level of liquidity on, at least, a quarterly basis. Additionally, the OCC expects NTBs to assess the appropriateness of their level of capital at least annually. A more frequent analysis of capital and/or liquidity is warranted for a NTB that:

- Has not achieved stable profitability;
- Is experiencing rapid growth, offering new products or entering new business lines;
- Offers fiduciary services that are concentrated by revenue source or account officer; or
- Has other conditions that increase the NTB's risk profile.

Capital Management

Bank capital is generally used to support the bank's risk profile, business strategies, and future growth prospects and to provide a cushion against unexpected losses. The OCC expects that capital in all NTBs will increase beyond the initial minimum capital requirement as the size, complexity, and corresponding risks of the business offered by the NTB evolve. When determining capital needs beyond the initial level, management should assess the quantity of risk associated with the NTB's fiduciary and related activities and the quality of the bank's risk management systems in place.

The OCC recognizes that complex analytical processes and tools may not be practical for all NTBs. The analytical processes at a large and sophisticated NTB may include formal, company-wide risk management processes and systems including model-driven risk analysis capabilities and tools used to stress-test the NTB's sensitivity of earnings and capital. For small, less complex NTBs, a less complicated analytical process may include a capital floor based on a percentage of fiduciary and related assets, supplemented by an analysis of the following factors:

- *The composition, stability, and direction of revenue.* Compare actual revenue against projected revenue. Evaluate revenue by business line. Consider growth expectations along with customer concentrations. Assess fee structure and pricing policies including negotiated concessions. Also, consider earnings sensitivity to market risk factors (*e.g.,* exposure to changes in interest rates, foreign exchange rates, commodity prices, and equity prices).
- *The level and composition of expenses in relation to the bank's operations.* Consider fixed versus variable expenses, the level of cash expenditures for existing or planned contract agreements (employment, equipment, fixtures, premises, etc.), and the adequacy of the cash budgeting and planning process.
- *The level of retained earnings.* Evaluate the relationship between retained earnings and realized and anticipated growth. Consider shareholder/parent company expectations for dividends along with their commitment and ability to augment capital, if needed. Also, consider the volume of intangible assets and their affect on capital levels and regulatory capital requirements.
- *The quantity and direction of strategic and reputation risk.* Evaluate the volume, type, and growth in managed and nonmanaged assets. Consider the risks associated with the various product types, business lines, concentrations, investment strategies, and outsourcing arrangements. Evaluate the impact of customer complaints, pending lawsuits, and regulatory actions. Consider the likelihood and magnitude of a loss event along with the opportunity cost of lost business.
- *The quality of risk management processes, including the adequacy of internal and external audit, internal controls, and the compliance management system.* Consider the volume and significance of noncompliance with policies and procedures, laws, regulations, prescribed practices, and ethical standards.
- *The quantity of transaction risk from the bank's delivery and administration of asset management products and services.* Consider the condition, security, capacity, and recoverability of systems. Also consider plans for conversions, integrations, and system upgrades.
- *The impact of external factors, including economic conditions, competition, evolving technology, legislative changes, and precedent-setting court decisions.*

This list is intended to represent factors common to many NTBs. Some factors may not be relevant for each NTB, and additional factors not described here may be appropriate, based on the circumstances of the individual NTB.

Liquidity Management

A NTB must ensure that sufficient liquidity is available at a reasonable cost to meet the bank's obligations when they come due. Liquidity sources for NTBs differ from those available to their commercial bank counterparts. Most NTBs do not take deposits; therefore, this primary funding source used by commercial banks, generally, is not accessible to a NTB. Instead, most NTBs are dependent on fee income as their primary source of liquidity. This fee income tends to fluctuate with the value of assets the NTB manages for its clients. As a result, in periods of volatile or declining financial markets, a NTB may face a decline in revenues and an increase in short-term liquidity needs.

Many NTBs rely on balance-sheet assets, typically in the form of short-term investment securities for secondary liquidity purposes. However, balance-sheet assets that are pledged or encumbered, such as those that are committed to meet the NTB's minimum capital requirement or to meet state pledging requirements, are not an available liquidity source.

All NTBs should develop a comprehensive liquidity risk management program to maintain adequate liquidity at a reasonable cost. The specific analysis and tools that bank management uses to assess liquidity will depend on the complexity of the NTB. At a minimum, a NTB's liquidity program should include a process to analyze current and projected sources and uses of funds. In addition, each NTB should establish limits that quantify the nature and amount of liquidity risk the bank is willing to assume. For instance, a NTB may establish a minimum number of months of current and/or projected operating expenses that must be covered by primary liquidity. Limit exceptions can be early indicators of excessive risk or inadequate liquidity risk management.

Current guidance on sound liquidity risk management requires all banks, including NTBs, to develop and maintain a contingency funding plan (CFP). A CFP is a cash flow projection and comprehensive funding plan that forecasts funding needs and funding sources under adverse scenarios. Potential scenarios that may affect the bank's liquidity position include a decline in revenue due to such factors as a prolonged period in which investment prices fall, the loss of a key trust officer, or the loss of a significant account relationship. Litigation, fraud, and other potential impairments can also have material impact on a NTB's liquidity needs.

A NTB's CFP should detail contingent sources of liquidity available to meet or exceed funding requirements under adverse conditions. These sources could include: (1) unencumbered on-balance-sheet cash, cash equivalents, or other short-term investments; (2) an irrevocable letter of credit from a third party; or (3) financial support from a parent company, as required by a legally enforceable agreement, such as a Capital Assurance and Liquidity Maintenance Agreement (CALMA). A NTB that is relying upon its owner, an affiliate, or a third party for contingent financial support is expected to review and assess, periodically, the financial capacity of that entity in order to confirm that it has the financial wherewithal to support the NTB.

For more information and guidance on liquidity risk management and the development and maintenance of contingency funding plans, see the Comptroller's Liquidity Handbook.

Supervisory Considerations: The OCC expects capital and liquidity at NTBs to be maintained at levels sufficient to support safe and sound operations. During the normal course of the supervisory process, examiners will evaluate the adequacy of capital and liquidity at NTBs, including the development of, and adherence to, a sound capital and liquidity management process. Examiners will seek corrective action for significant weaknesses or unwarranted risks.

SEC - Order Extending Temporary Exemption of Banks From the Definition of ''Broker'' Under Section 3(a)(4) of the Securities Exchange Act of 1934

Background

On June 29, the Securities and Exchange Commission ("Commission") issued an order extending the temporary exemption of banks from the definition of "broker". The Gramm-Leach-Bliley Act (''GLBA'') repealed the blanket exception of banks from the definitions of ''broker'' and ''dealer'' under the Securities Exchange Act of 1934 (''Exchange Act'') and replaced it with functional exceptions incorporated in amended definitions of ''broker'' and ''dealer.'' Under the GLBA, banks that engage in securities activities either must conduct those activities through a registered broker-dealer or ensure that their securities activities fit within the terms of a functional exception to the amended definition of ''broker.'' The GLBA provided that the amended definitions of ''broker'' and ''dealer'' were to become effective May 12, 2001. Starting on May 11, 2001, in connection with various rulemaking proposals, the Commission extended, most recently until July 2, 2007, a temporary exemption that gave banks time to come into full compliance with the more narrowly-tailored exceptions from broker-dealer registration under the GLBA.

On October 13, 2006, President Bush signed into law the Financial Services Regulatory Relief Act of 2006 (''Regulatory Relief Act'') Among other things, the Regulatory Relief Act requires the Commission and the Board of Governors of the Federal Reserve (''Board'') jointly to adopt final rules implementing the bank broker exceptions in Section 3(a)(4) of the Exchange Act. It also requires the Commission and the Board jointly to issue proposed rules within 180 days of passage of the Regulatory Relief Act. Consistent with the Regulatory Relief Act, on December 18, 2006, the Commission and the Board jointly proposed implementing rules, which were designated as Regulation R. At that time, the Commission also granted banks an exemption from compliance with the definition of broker until July 2, 2007 in order to permit the Commission and the Board time to receive and evaluate comments and to take final action on the implementing rules.

To date, the Commission and the Board have received over 70 comments on proposed Regulation R. The Commission and the Board are carefully considering the comments, in consultation with the other Federal banking agencies, and expect to take final action on proposed Regulation R shortly.

Information - Extension of Temporary Exemption From Definition of ''Broker''
In light of the need to carefully consider, together with the Board and the other Federal banking agencies, the comments on proposed Regulation R, the Commission finds that extending the temporary exemption for banks from the definition of ''broker'' until September 28, 2007 is necessary and appropriate in the public interest, and is consistent with the protection of investors. The extension of this temporary exemption will prevent banks from incurring interim business disruption, as well as interim implementation and compliance costs before the Commission and the Board jointly adopt final implementing rules. It will also provide the Commission and the Board time fully to consider the comments, consult with and seek the concurrence of the other Federal banking regulators, and take final action on the proposal.

Conclusion
Accordingly, pursuant to Section 36 of the Exchange Act,9 *it is hereby ordered* that banks are exempt from the definition of the term ''broker'' under the Exchange Act until September 28, 2007.

EBSA: Field Assistance Bulletin No. 2007-07 - ERISA Coverage Of IRC § 403(b) Tax-Sheltered Annuity Programs

Background
On July 24, 2007 the Employee Benefits Security Administration issued Field Assistance Bulletin No. 2007-02. The Bulletin provides guidance on how the Department of the Treasury and the Internal Revenue Code 403(b) tax-sheltered annuity programs affect the status of such programs under the DOL's safe harbor regulation at 29 C.F.R. § 2510.3-2(f). A tax-sheltered annuity (TSA) program under section 403(b) of the Internal Revenue Code (Code), also known as a "403(b) plan," is a retirement plan for employees of public schools, employees of certain tax-exempt organizations, and certain ministers. Under a 403(b) plan, employers may purchase for their eligible employees annuity contracts or establish custodial accounts invested only in mutual funds for the purpose of providing retirement income. Annuity contracts must be purchased from a state licensed insurance company, and the custodial accounts must be held by a custodian bank or IRS approved non-bank trustee/custodian. The annuity contracts and custodial accounts may be funded by employee salary deferrals, employer contributions, or both. Although not subject to the qualification requirements of section 401 of the Code, some of the requirements that apply to qualified plans also apply, with modifications, to 403(b) plans.

These TSA programs, if established or maintained by an employer engaged in commerce or in any industry or activity affecting commerce, generally are "pension plans" within the meaning of section 3(2) of ERISA and covered by Title I pursuant to section 4(a) of ERISA. The terms "establish" or "maintain" are not defined in ERISA, and uncertainty as to the application of ERISA to TSA programs funded entirely with employee contributions prompted the Department of Labor in 1979 to issue a "safe harbor" regulation at 29 C.F.R. § 2510.3-2(f).

The safe harbor at § 2510.3-2(f) states that a program for the purchase of annuity contracts or custodial accounts in accordance with provisions set forth in section 403(b) of the Code and funded solely through salary reduction agreements or agreements to forego an increase in salary, are not "established or maintained" by an employer under section 3(2) of the Act, and, therefore, are not employee pension benefit plans subject to Title I, provided that certain factors are present. These factors are: (1) that participation of employees is completely voluntary, (2) that all rights under the annuity contract or custodial account are enforceable solely by the employee or beneficiary of such employee, or by an authorized representative of such employee or beneficiary, (3) that the involvement of the employer is limited to certain optional specified activities, and (4) that the employer receive no direct or indirect consideration or compensation in cash or otherwise other than reasonable reimbursement to cover expenses properly and actually incurred in performing the employer's duties pursuant to the salary reduction agreements. In this latter regard, if an employer, or a person acting in the interest of an employer, receives, for example, other consideration from an annuity contractor, the employer could be deemed to have "established or maintained" a plan.

The safe harbor allows the employer to engage in a range of activities to facilitate the operation of the program. The employer may permit annuity contractors—including agents or brokers who offer annuity contracts or make available custodial accounts—to publicize their products, may request information concerning proposed funding media, products, or annuity contractors, and may compile such information to facilitate review and analysis by the employees. The employer may enter into salary reduction agreements and collect annuity or custodial account considerations required by the agreements, remit them to annuity contractors, and maintain records of such collections. The employer may hold one or more group annuity contracts in the employer's name covering its employees and exercise rights as representative of its employees under the contract, at least with respect to amendments of the contract. The employer may also limit funding media or products available to employees, or annuity contractors who may approach the employees, to a number and selection designed to afford employees a reasonable choice in light of all relevant circumstances.

The Department of the Treasury/Internal Revenue Service has issued final regulations at 26 C.F.R. 1.403(b)-0 et seq. (July 2007) reflecting legislative changes made to § 403(b) since the existing regulations were adopted in 1964. The § 403(b) regulations also incorporate interpretive positions that the Department of the Treasury/Internal Revenue Service have taken in other guidance on § 403(b). This Bulletin is intended to provide guidance to EBSA's national and regional offices concerning the extent to which compliance with the updated regulations would cause employers to exceed the limitations on employer involvement permitted under the Department of Labor's safe harbor for tax-sheltered annuity programs at 29 C.F.R. § 2510.3-2(f).

Information

The new § 403(b) regulations have not led the Department of Labor to change its view on the principles that apply in determining whether any given TSA program is covered by Title I of ERISA. Even though the differences between the tax rules for TSA programs and those governing other ERISA-covered pension plans may have diminished, the Department's safe harbor regulation at 29 C.F.R. § 2510.3-2(f) remains operative. The new § 403(b) regulations allow significant flexibility regarding the employer's functions in the structure and operation of the arrangement. Thus, compliance with the new § 403(b) regulations will not necessarily cause a TSA program to become covered by Title I of ERISA.

The Department has acknowledged that employers have an interest separate from acting as their employees' authorized representatives in ensuring that the annuity contracts and custodial accounts in TSA programs are tax compliant. The Code's qualification requirements impose obligations directly on employers in connection with the employees' annuity contracts and custodial accounts. If individual contracts or accounts fail to satisfy the tax qualification requirements, even if due to actions or errors of an employee or annuity contractor, the employer can be liable to the IRS for potentially substantial penalty taxes, correction fees, and employment taxes on employee salary deferrals. Accordingly, in the Department's view, the safe harbor at section 2510.3-2(f) subsumes certain employer activities designed to ensure that a TSA program continues to be tax compliant under section 403(b) of the Code.

The Department of Labor has issued advisory opinions and other guidance on whether specific employer functions are compatible with the safe harbor. The Department believes that the safe harbor allows an employer to conduct administrative reviews of the program structure and operation for tax compliance defects. Such reviews may include discrimination testing and compliance with maximum contribution limitations under the Treasury regulations. As noted in previous guidance issued by the Department, the employer may also fashion and propose corrections; develop improvements to the plan's administrative processes that will obviate the recurrence of tax defects; obtain the cooperation of independent entities involved in the program needed to correct tax defects; and keep records of its activities.

A program could fit within the section 2510.3-2(f) safe harbor and include terms that require employers to certify to an annuity provider a state of facts within the employer's knowledge as employer, such as employee addresses, attendance records or compensation levels. The employer may also transmit to the annuity provider another party's certification as to other facts, such as a doctor's certification of the employee's physical condition. The employer could not, however, consistent with the safe harbor, have responsibility for, or make, discretionary determinations in administering the program. Examples of such discretionary determinations are authorizing plan-to-plan transfers, processing distributions, satisfying applicable qualified joint and survivor annuity requirements, and making determinations regarding hardship distributions, qualified domestic relations orders (QDROs), and eligibility for or enforcement of loans.

An important requirement in the Treasury regulations is that a TSA program must be maintained pursuant to a "written defined contribution plan" that satisfies the Code's regulatory requirements and contains all the material terms and conditions for benefits under the plan. An employer, by adopting such a written plan, does not automatically establish a Title I plan. Compiling the benefit terms of the contracts and the responsibilities of the employer, annuity providers and participants is a function similar to the information collection and compilation activities expressly permitted under the Department's TSA safe harbor. Indeed, the preamble to the final Treasury regulations makes clear that the "plan" required to satisfy the Code does not have to be a single document, but may incorporate by reference other documents, including insurance policies and custodial account agreements and other documents governing the contracts and accounts prepared by the annuity providers. 26 C.F.R. § 1.403(b)-3(b)(3).

The Department of Labor expects that the written plan for a TSA program that complies with the safe harbor would consist largely of the separate contracts and related documents supplied by the annuity providers and account trustees or custodians. An employer's development and adoption of a single document to coordinate administration among different issuers, and to address tax matters that apply, such as the universal availability requirement in Code section 403(b)(12)(A)(ii), without reference to a particular contract or account, would not put the TSA program out of compliance with the safe harbor.

Because the Treasury regulations allow a plan to allocate responsibility for performing administrative functions to persons other than the employer, the relevant documents should identify the parties that are responsible for administrative functions, including those related to tax compliance. The documents should correctly describe the employer's limited role and allocate discretionary determinations to the annuity provider or participant or other third party selected by the provider or participant.

In addition, an employer seeking to take advantage of the safe harbor may periodically review the documents making up the plan for conflicting provisions and for compliance with the Code and the Treasury regulations. Negotiating with annuity providers or account custodians to change the terms of their products for other purposes, such as setting conditions for hardship withdrawals, would be a form of employer involvement outside the safe harbor.

A tax-sheltered annuity program will not, in the Department's view, become covered by Title I of ERISA merely because the written plan conforms to the new § 403(b) regulations by limiting employees to exchanges of contract funds only among providers who have adopted the written plan, or transfers from the program of a former employer to that of the current employer. Under the safe harbor, the employer may limit funding media or products available to employees, or annuity providers who may approach the employee, to a number designed to afford employees a reasonable choice in light of all relevant circumstances. The Code-mandated restrictions on transfers of funds may, however, require the employer to allow providers to offer a wider variety of products in order to afford employees a reasonable choice in light of all relevant circumstances for purposes of the safe harbor. Alternately, an employer may limit the number of providers to which it will forward salary reduction contributions as long as employees may transfer all or a part of their funds to any provider whose annuity contract or custodial account complies with the Code requirements and who agrees to the plan's division of tax compliance responsibilities among the employer, provider and participant.

Finally, in the event an employer decides that it does not want to continue to perform the ministerial and administrative functions required under the § 403(b) regulations, the Department does not believe that the employer's determination to terminate a TSA program in compliance with the Treasury regulations will cause a program not otherwise covered by Title I of ERISA to become covered.

Conclusion

The Department is of the view that tax-exempt employers will be able to comply with the requirements in the new § 403(b) regulations and remain within the Department's safe harbor for TSA programs funded solely by salary deferrals. The Bulletin does note, however, that the new § 403(b) regulations offer employers considerable flexibility in shaping the extent and nature of their involvement under a tax-sheltered annuity program. The question of whether any particular employer, in complying with the § 403(b) regulations, has established or maintained a plan covered under Title I of ERISA must be analyzed on a case-by-case basis applying the criteria set forth in 29 C.F.R. § 2510.3-2(f) and section 3(2) of ERISA.