



BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

MEMORANDUM NO. M-2013-025

**To : ALL BANKS AND OTHER FINANCIAL INTERMEDIARIES
PERFORMING TRUST, OTHER FIDUCIARY BUSINESS AND
INVESTMENT MANAGEMENT ACTIVITIES**

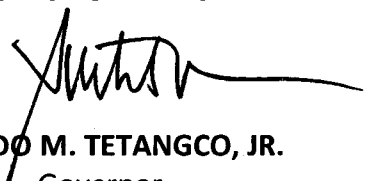
Subject : Revised Trust Rating System

The Monetary Board, in its Resolution No. 852 dated 23 May 2013, approved the adoption of the attached revised Trust Rating System (TRS). The TRS is intended to complement the risk-focused supervision of the BSP and to comprehensively and uniformly evaluate the administration of fiduciary activities of all trust entities.

The revised TRS shall be effective for examinations that will start 1 July 2013 onwards.

For information and guidance.

FOR THE MONETARY BOARD:


AMANDO M. TETANGCO, JR.
Governor

13 June 2013

Att.: a/s

THE TRUST RATING SYSTEM

The supervisory process of the Bangko Sentral ng Pilipinas (BSP) has geared towards risk-focused supervision to be more effective and responsive to the growth of the trust industry and attuned to international standards on regulatory supervision. It is in this context that the Trust Rating System is being used to promote and complement efficient and effective examination processes.

The Trust Rating System (TRS) takes into consideration key factors that are essential in the operations of a Trust Entity¹ (TE) (managerial capability, operational capacity, compliance function, asset management practices, and earnings performance). Moreover, it evaluates TE's risk management practices and capability to handle relevant exposures in its fiduciary dealings. Under this rating system, the BSP endeavors to ensure that all TEs are evaluated in a comprehensive and consistent manner, and that proper supervisory attention is focused on TEs engaging in fiduciary business that are not consistent with sound fiduciary principles.

OVERVIEW

Under the TRS, the fiduciary activities of TEs are assigned a composite rating based on the evaluation and assessment of five essential components of an institution's fiduciary activities. These components cover the following:

1. Capability of board of directors, trust committee and senior management responsible in the administration of fiduciary business;
2. Soundness of operations, controls and audits;
3. Adequacy of compliance with governing instruments, applicable laws, rules and regulations, and sound fiduciary principles;
4. Prudent management of fiduciary assets; and
5. Earnings performance.

Composite and component ratings are assigned based on a 1 to 4 numerical scale. 4, the highest rating, indicates the strongest performance and risk management practices, and the least degree of supervisory concern. On the other hand, 1, the lowest rating, indicates weakest performance and risk management practices and, therefore, warrants the highest degree of supervisory attention.

The composite and component numerical rating largely reflect the Management's ability to implement the basic standards and risk management guidelines for trust, other fiduciary and investment management accounts under existing regulations. Risks affecting the component ratings are assessed through an assignment of an aggregate risk rating which considers quantitative and qualitative factors as well as the direction of such risks. It is recognized, however, that appropriate management practices may vary considerably among financial institutions, hence, the

¹ A bank or a non-bank financial institution, through its specifically designated business unit, to perform trust functions authorized by the BSP to engage in trust and other fiduciary business under Section 79 of R. A. No. 8791 (the General Banking Law of 2000) or to perform investment management services under Section 53 of R. A. No. 8791

evaluation of the composite and component ratings considers the size, complexity and risk profiles of TEs fiduciary activities . For instance, TEs that engage in large, complex operations are expected to adopt formal and relatively sophisticated risk management methodologies.

COMPOSITE RATINGS

Composite ratings are based on a careful evaluation of how an institution conducts and administers its fiduciary activities. The review encompasses the capability of management, the soundness of policies and practices, the quality of service rendered to the public, and the effect of fiduciary activities upon the soundness of the TE. The composite ratings are defined and described as follows:

Composite Rating	Definition	Description of Rating
4	Highly satisfactory	Discharge of fiduciary duties is highly satisfactory in all material respect. Risk management practices are strong relative to the size, complexity, and risk profile of the TE. Observance of the basic standards in the administration of trust, other fiduciary and investment management accounts is highly satisfactory. The TE is in general compliance with fiduciary principles, laws and regulations, and risks are assessed as low. Any weaknesses are minor in nature and can be handled immediately in the regular course of business by management. No cause for supervisory concern. Generally, components are all rated 4 or mostly 4, with no component rating less than 3.
3	Satisfactory	Discharge of fiduciary duties and risk management practices relative to the TE's size, complexity, and risk profile are satisfactory. Observance of the basic standards in the administration of trust, other fiduciary and investment management accounts is likewise satisfactory. The TE is in substantial adherence with fiduciary principles, laws and regulations, and risks are assessed as low to moderate. While low to moderate weaknesses are present, these are well within management's capabilities and willingness to correct. There are no material supervisory concerns and, as a result, the supervisory response is limited and may include corrective actions to improve or strengthen the trust function. Generally, components are all rated 3 or mostly 3, with no component rating less than 2.
2	Less than satisfactory	Discharge of fiduciary duties and risk management practices relative to the TE's size, complexity, and risk profile are less than satisfactory. Observance of the basic standards in the administration of trust, other fiduciary and investment management accounts is likewise less than satisfactory. The TE does not substantially adhere with fiduciary principles, laws and regulations, and risks are assessed as moderate to high. A combination of weaknesses exists that may range from moderate to severe. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Problems of relative significance may exist, and may pose a threat to the clients and/or beneficiaries or to the soundness of the institution in the future. The TE's fiduciary activities require more than normal supervision and may include enforcement actions. Generally, components are all rated 2 or mostly 2.

Composite Rating	Definition	Description of Rating
1	Deficient	Discharge of fiduciary duties and risk management practices relative to the TE's size, complexity, and risk profile are deficient. Observance of the basic standards in the administration of trust, other fiduciary and investment management accounts is likewise deficient. There is substantial non-adherence with fiduciary principles, laws and regulations, and risks are assessed as high. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors/TC and management. These problems pose a threat to the account of clients and/or beneficiaries generally and, if left unchecked, could evolve into conditions that could cause significant losses to the institution and ultimately undermine public confidence in the institution. The TE's fiduciary activities exhibit serious supervisory concern/s that requires close supervisory attention and enforcement action /s. Generally, all or mostly all components are rated 1.

It must be noted, however, that the following could warrant a rating of "1":

1. A TE with unsafe and unsound practice/s or condition/s as determined by the appropriate supervising department/unit of the BSP; or
2. A TE that was rated 2 in the previous examination and failed to satisfactorily address/resolve major issues noted in the previous examination.

The composite rating generally bears a close relationship to the component ratings assigned and the overall quality of risk management system. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a *qualitative analysis* of the factors comprising that component and its interrelationship with the other components. Assigned composite and component ratings as well as the risk assessments are disclosed to the institution's board of directors, trust committee, and senior management in the Report of Examination.

The capability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions or initiation of new fiduciary activities/products, or willingness and promptness to correct/address findings noted are important factors in evaluating an institution's overall fiduciary risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating which shall not be more than the management component rating.

Detailed guidelines for the evaluation of the component (numerical) ratings and risk assessment are discussed in Appendices A and B, respectively. A sample summary risk assessment matrix is shown as Appendix C.

ENFORCEMENT ACTION/S

Enforcement action/s to be imposed on the institution as mentioned above shall be those provided under existing regulations. Enforcement actions shall be directed to address underlying causes of weaknesses/deficiencies and violations of BSP rules and regulations.

TRUST RATING SYSTEM COMPONENT RATINGS

The component ratings cover the following:

1. Capability of board of directors, trust committee and senior management responsible in the administration of fiduciary business;
2. Soundness of operations, controls and audits;
3. Compliance with governing instruments, applicable laws, rules and regulations, and sound fiduciary principles;
4. Prudent management of fiduciary assets; and
5. Earnings performance.

Each of the component rating descriptions is divided into three sections:

- a. Narrative description of the component;
- b. List of factors considered in the evaluation of the component; and
- c. Definition and description of each numerical rating for that component.

I. Capability of Management¹

This rating reflects the capability of the board of directors (or its functional oversight equivalent which may include the country head in the case of foreign banks/TEs), trust committee (TC), and senior management, in their respective roles, to discharge the prescribed responsibilities under existing BSP guidelines. These include, among others, the Management's ability to identify, measure, monitor and control the relevant risks² of a TE's fiduciary activities; ensure that the TE's fiduciary activities are conducted in a safe and sound manner, and in compliance with applicable laws, rules and regulations, and fiduciary principles.

A TE's performance with respect to the four other components – Operations, Controls and Audits; Compliance; Asset Management; and Earnings; is, to a large extent, a result of decisions made by the board of directors, TC and trust officer. Accordingly, findings and conclusions on the four other components are often major determinants of the management rating.

The assessment of the capability and performance of management shall be based on the evaluation of, but not limited to, the following factors:

- a. Level and quality of oversight and support of fiduciary activities, including committee structure and adequate documentation of committee actions;

¹ "Management" in this context pertains to the overall governance structure of the TE that encompasses an evaluation of the role of board of directors, trust committee and senior management responsible in the administration of fiduciary business

² As defined in the Risk Management Guidelines for Trust and Other Fiduciary Business and Investment Management Activities.

- b. Ability of the board of directors and TC, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the introduction of new activities or products;
- c. Independence of the trust operations as expressed in its governance structure;
- d. Attitude of the management as demonstrated by its appetite for risk and adequacy of risk management framework adopted to monitor, manage and control risks;
- e. Ability to ensure effective risk management practices which may be characterized, among others, by the adequacy and competence of risk personnel; access to information technology systems; systems development resources and support; and access to internal information;
- f. Capacity to implement sound and effective self assessment functions such as internal audit, compliance, risk management and accounts review;
- g. Conformance with laws, regulations and sound fiduciary principles, as well as adequacy and implementation of internal policies, practices and controls addressing the operations and risks of significant fiduciary activities;
- h. Accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the TE's size, complexity, and fiduciary risk profile;
- i. Responsiveness to recommendations from auditors and regulatory authorities;
- j. Extent of strategic planning for fiduciary products and services including its outcome/performance in terms of earnings;
- k. Level of experience and competence of fiduciary management and staff, including issues relating to turnover and succession planning;
- l. Availability of competent legal counsel;
- m. Extent and nature of pending litigation associated with fiduciary activities, and its potential impact on earnings, capital, and the TE's reputation; and
- n. Process for identifying and responding to fiduciary customer complaints.

Below is the rating scale for the component *Capability of Management*:

Rating	Definition	Description of Rating
4	Highly satisfactory	Indicates strong oversight by the board of directors and TC, and capability of senior management. Risk management practices are likewise strong relative to the size, complexity and risk profile of the TE's fiduciary activities. Governance structure and practices are sound and self-

Rating	Definition	Description of Rating
		assessment functions are highly effective. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Board and Management are proactive, and have demonstrated the ability to promptly and effectively address existing and potential problems and risks.
3	Satisfactory	Indicates satisfactory oversight by the board of directors and TC, and capability of senior management. Risk management practices are likewise satisfactory relative to the size, complexity and risk profile of the TE's fiduciary activities. Governance structure and practices are satisfactory and self-assessment functions are effective. Low to moderate weaknesses may exist, but are not material to the sound administration of fiduciary activities, and are being addressed. In general, significant risks and problems are substantially identified, measured, monitored, and controlled.
2	Less than satisfactory	Indicates less than satisfactory oversight by the board of directors and TC, and capability of senior management. Risk management practices are likewise less than satisfactory relative to the size, complexity and risk profile of the TE's fiduciary activities. Governance structure and practices exhibits moderate weaknesses and self-assessment functions are not fully effective. Problems and significant risks are inadequately identified, measured, monitored, or controlled.
1	Deficient	Indicates deficient oversight by the board of directors and TC, and capability of senior management. Risk management practices are likewise deficient relative to the size, complexity and risk profile of the TE's fiduciary activities. Self-assessment functions are ineffective and governance structure and practices are poor. Problems and significant risks are not identified, measured, monitored, or controlled. Requires immediate action by the board and senior management to protect the assets of account clients and/or beneficiaries, and to prevent erosion of public confidence in the TE.

II. Operations, Controls and Audits

This rating reflects the adequacy of the TE's fiduciary operating systems and internal controls in relation to the volume and nature of business conducted, as well as the strict observance of the BSP-prescribed basic standards in the administration of fiduciary business. Audit functions must assure the integrity of the financial records, the sufficiency of internal controls, and the adequacy of the compliance process.

The operations, internal controls and audit rating is based upon, but not limited to, an assessment of the following evaluation factors:

1. Operations and Internal Controls:

- a. Review and testing by an independent party on the effectiveness of the internal control system³;
- b. Internal control measures prescribed in Subsection X185/4185Q of the MORB/MORNBFi;
- c. Adequacy of staffing and continuous training provided;
- d. Sufficiency of space, equipments and facilities;
- e. Adequacy, appropriateness and proper implementation of internal policies, practices and controls;
- f. Adequacy of operating systems;
- g. Proper maintenance of records to reflect all fiduciary activities;
- h. Accuracy of financial information reflected in the books and reported to clients and/or regulators including adherence to accounting and regulatory principles and standards;
- i. Proper documentation of trading, marketing and asset/fund administration functions, and securities lending activities, if applicable;
- j. Sufficiency of account documentation including KYC and client profiling documentation;
- k. Disaster and/or business recovery programs; and
- l. Investigation and proper escheatment of funds of dormant accounts/clients (*Compliance with Unclaimed Balances Act*).

2. Audits:

- a. On the internal audit -
 - Effectiveness, independence, frequency, quality and scope relative to the volume, character and risk profile of the TE's fiduciary activities;
 - Audit rating and reports;
 - Experience and competence of the internal audit staff (*sufficiency in number, training and competence of audit personnel*);
 - Monitoring of audit exceptions and effectiveness of follow-through mechanism;

³ Refer to Risk Management Guidelines for Trust and Other Fiduciary Business and Investment Management Activities for the expectations on internal control systems.

- Reporting system, including a system that allows sensitive findings to be reported directly to the BOD;
- b. On the external audit –
 - Effectiveness and quality;
 - Opinion in the audited financial statements for trust and UITFs; and
- 3. Controls on key processes as articulated in the basic standards for trust, other fiduciary and investment management accounts covering:
 - a. Pre-acceptance account review;
 - b. Establishment and post acceptance review (account opening and documentation)
 - Periodic review of existing accounts
 - Credit process
 - Investment process;
 - c. Account termination.

Below is the rating scale for the component *Operations, Controls and Audits*:

Rating	Definition	Description of Rating
4	Highly satisfactory	Indicates that operational capability, internal controls, and audit functions are strong in relation to the volume and nature of the TE's fiduciary activities. All significant risks are effectively identified, measured, monitored, and controlled.
3	Satisfactory	Indicates that operational capability, internal controls and audit function are satisfactory in relation to the volume and nature of the TE's fiduciary activities. Moderate weaknesses may exist, but are not material. Significant risks, in general, are substantially identified, measured, monitored, and controlled.
2	Less than satisfactory	Indicates that operational capability, internal controls or audit functions are less than satisfactory in relation to the volume and nature of the TE's fiduciary activities. Problems and significant risks are inadequately identified, measured, monitored, and controlled.
1	Deficient	Indicates deficient operational capability, internal controls or audit functions. One or more of these areas are inadequate or the level of problems and risk exposure is excessive in relation to the volume and nature of the TE's fiduciary activities. Problems and significant risks are not identified, measured, monitored, and controlled and thus threaten the ability of the TE to continue engaging in fiduciary activities.

III. Compliance

This rating reflects the TE's overall compliance with: (a) applicable BSP regulations, (b) fiduciary principles and accepted standards of fiduciary conduct, (c) banking and other laws governing or relevant to fiduciary activities and account instruments, i.e., agreements, contracts, and court order, d) duties associated with account administration, and (e) internally established policies and procedures. In addition, assessment is made on the performance of the TE's compliance function and effectiveness of the compliance program.

The compliance rating is based upon, but not limited to, an assessment of the following factors:

- a. Compliance with applicable banking, securities and other laws as well as regulations issued by the Bangko Sentral ng Pilipinas;
- b. Compliance with the terms of governing instruments;
- c. Adequacy of overall policies, practices, and procedures governing compliance, considering the size, complexity, and risk profile of the TE's fiduciary activities;
- d. Adequacy of policies and procedures addressing account administration,
- e. Independence and effectiveness of the compliance function; and
- f. Effectiveness of the compliance program.

Below is the rating scale for the component *Compliance*:

Rating	Definition	Description of Rating
4	Highly satisfactory	Indicates a highly effective compliance program and strong compliance function relative to the size, complexity and risk profile of the TE's fiduciary activities. Accounts are generally administered in accordance with applicable laws and regulations, sound fiduciary principles, governing instruments, and internal policies and procedures. Any violations are isolated and easily correctable. All significant risks are effectively identified, measured, monitored and controlled.
3	Satisfactory	Indicates an effective compliance program and satisfactory compliance function relative to the size, complexity and risk profile of the TE's fiduciary activities. While account administration may exhibit low to moderate weaknesses in policies, procedures or practices, these are within management's capabilities and willingness to correct. Fiduciary activities are conducted in substantial compliance with applicable laws and regulations, sound fiduciary principles and governing instruments. Management institutes appropriate actions in a timely manner to address deficiencies. Significant risks are substantially identified, measured, monitored, and controlled.
2	Less Than Satisfactory	Indicates that the compliance program is not fully effective and compliance function is less than satisfactory relative to the size, complexity and risk profile of the TE's fiduciary activities. Policies, procedures and controls have not proven effective and require strengthening. Fiduciary activities may be in substantial noncompliance with applicable laws and regulations, sound fiduciary principles or governing instruments. While management may have the ability to achieve compliance, the number of violations that exist, or the failure to correct prior violations, are indications that management has not devoted sufficient time and attention to its compliance responsibilities. Risks are inadequately identified, measured, monitored and controlled.

Rating	Definition	Description of Rating
1	Deficient	Indicates an ineffective compliance program and deficient compliance function relative to the size, complexity and risk profile of the TE's fiduciary activities. Account administration is notably deficient or incompetent and there could be a flagrant disregard for the terms of the governing instruments and interests of account beneficiaries. Numerous significant non-adherences to applicable laws and regulations, sound fiduciary principles, governing instruments, and internal policies and procedures, and many may remain uncorrected from previous examinations. Management has not exerted sufficient effort to effect compliance and may lack the ability to effectively administer fiduciary activities. The level of compliance problems is significant and, if left unchecked, may subject the TE to monetary losses or reputation risk. Risks are not identified, measured, monitored and controlled, and now threaten the ability of management to continue engaging in fiduciary activities.

IV. Asset Management

This rating reflects the risks associated with managing the assets of clients under a trusteeship, other fiduciary or agency agreement. Prudent portfolio management is based on an assessment of the needs and objectives of each account or portfolio. An evaluation of asset management should consider the adequacy of processes related to the investment of all accounts and portfolios, and the observance of fiduciary principles and best practices, in its credit and investment processes regardless of the discretion granted by the client. Emphasis is also given on the role of accounts review, which encompasses administrative and investment review, in ensuring that the terms and conditions of the agreement are adhered to and that investment performance are able to meet the client's objectives for the assets under management.

The asset management rating is based upon, but not limited to, an assessment of the following factors:

- a. Adequacy of overall policies, practices and procedures governing asset management, considering the size, complexity and risk profile of the TE's fiduciary activities;
- b. Decision-making processes used for selection, retention and preservation of assets including adequacy of documentation, committee review and approval, and a system to review and approve exceptions;
- c. Observance of fiduciary principles and best practices such as best execution, Chinese Wall, personnel investment policies, confidentiality and materiality of information, fair dealing, diligence and reasonable basis, in-house or related party transaction handling, and valuation;
- d. Risk management practices pertaining to the portfolios including the use of quantitative tools to measure the various financial risks in investment accounts and portfolios;

- e. Existence of policies and procedures addressing the use of derivatives or other complex investment products, as applicable;
- f. Extent, independence, comprehensiveness, effectiveness and adequacy of periodic accounts review, covering both the administrative and investment performance, taking into consideration the needs and objectives of each account or portfolio;
- g. Monitoring of changes in the composition of fiduciary assets for trends and related risk exposure;
- h. Quality of investment research used in the decision-making process and documentation of the research;
- i. Due diligence processes for –
 - Evaluating investment advice received from brokers (including approved list of securities);
 - Evaluating investment instructions from the clients, whether it will be for the best interest of the client's funds;
 - Reviewing and approving brokers and/or counter parties used by the TE;
- j. Quality and quantity of earnings of the managed funds; and
- k. Suitability of investment activities with the parameters set by the clients and/or defined risk appetite.

Below is the rating scale for the component *Asset Management*:

Rating	Definition	Description of Rating
4	Highly satisfactory	Indicates strong asset and risk management practices in relation to the size and complexity of the assets managed. Accounts review process is highly effective. Identified weaknesses are minor in nature. All significant risks are consistently and effectively identified, measured, monitored, and controlled.
3	Satisfactory	Indicates satisfactory asset and risk management practices in relation to the size and complexity of the assets managed. Accounts review process is generally effective. Low to moderate weaknesses are present but are well within management's ability and willingness to correct. In general, significant risks and problems are substantially identified, measured, monitored, and controlled.
2	Less Than Satisfactory	Indicates less than satisfactory asset and risk management practices in relation to the size and complexity of the assets managed. Accounts review process is not effective. Weaknesses may range from moderate to severe and may not be within the Management's ability to address. Problems and significant risks are inadequately identified, measured, monitored, or controlled.
1	Deficient	Indicates deficient asset and risk management practices in relation to the size and complexity of the assets managed, and a flagrant disregard of

Rating	Definition	Description of Rating
		fiduciary duties. Accounts review process is deficient. The levels of risk are significant and inadequately controlled. The problems and significant risks are not identified, measured, monitored, or controlled, thus, pose a threat to account beneficiaries, and if left unchecked, may subject the TE to losses and could undermine the reputation of the TE.

V. Earnings

This rating reflects the profitability of the TE's fiduciary activities and its effect on the financial condition of the TE. The use and adequacy of budgets and earnings projections by functions, product lines and clients are reviewed and evaluated. Controls are in place to ensure the integrity of reported results of operations.

The evaluation of earnings is based upon, but not limited to, an assessment of the following factors:

- a. Quality and sustainability of earnings from fiduciary activities as demonstrated by the diversified sources of income and activities;
- b. Effectiveness of the TE's procedures in monitoring income and expense relative to the size and scope of these activities;
- c. Level and consistency of profitability, or the lack thereof, generated by the TE's fiduciary activities in relation to the volume and nature of the TE's business and market condition;
- d. The overall importance to the TE of offering fiduciary services to its customers and local community;
- e. Dependence upon fees and commissions that are sourced from non-core fiduciary business;
- f. Adoption of fee structures including deviation thereof;
- g. Ability of earnings to support the necessary overhead expenses;
- h. Ability to forecast or control operating expenses;
- i. Ability to properly classify the operating expenses according to regulatory requirements;
- j. Accounting practices (e.g., unusual methods⁷ of allocating [1] direct and indirect expenses and overhead or [2] fiduciary income and expense) where two or more

⁷ Include selective method of allocating administrative and other overhead expenses to a few selected managed trust and other fiduciary accounts.

fiduciary TEs within the same holding company share fiduciary services and/or processing functions;

- k. Extent and effectiveness of management's use of budgets, projections and other cost analysis procedures and the methods used for directors' approval of financial budgets and/or projections;
- l. Management's attitude towards growth; and
- m. New business development efforts, including types of business solicited, market potential, advertising, competition, relationships with local organizations, and an evaluation by management of risk potential inherent in new business areas (*marketing plans for business development efforts*).

Below is the rating scale for the component Earnings:

Rating	Definition	Description of Rating
4	Highly satisfactory	Indicates that earnings are highly satisfactory. Earnings are more than sufficient to support operations and growth. The institution consistently earns a rate of return on its fiduciary activities that is commensurate with the risk of those activities. This rating would normally be supported by a history of consistent profitability over time and a judgment that future earnings prospects are favorable. All the operational expenses are properly classified and valued. Management techniques for evaluating and monitoring earnings performance and expenses are fully adequate and there is appropriate oversight by the TE's board of directors or a committee thereof. Management makes effective use of budgets and cost analysis procedures.
3	Satisfactory	Indicates that earnings are satisfactory. Earnings are sufficient to support operations and growth. Although there are instances of misalignment between risk and earnings, management is aware of such and/or these are maintained at a minimum level. Moreover, earnings performance does not pose a risk to the trust entity's ability to meet its fiduciary obligations. Generally, fiduciary earnings meet management targets and appear to be sustainable. Management processes for evaluating and monitoring earnings and expenses are generally sufficient in relationship to the size and risk of fiduciary activities that exist, and any deficiencies can be addressed in the normal course of business. Management makes use of budgets and cost analysis procedures.
2	Less than satisfactory	Indicates that earnings are less than satisfactory. Earnings may not fully support operations and growth. Earnings and expenses are not commensurate with the risk associated with the fiduciary activities undertaken. Earnings may be erratic or exhibit downward trends and future prospects are unfavorable. Management processes for evaluating and monitoring earnings and expenses exhibit serious deficiencies, although such deficiencies do not pose an immediate danger to either the overall financial condition of the institution (in the case of a trust department) or the TE's ability to meet its fiduciary obligations. Management may not have used budgets and cost analysis procedures or the procedures are ineffective.

Rating	Definition	Description of Rating
1	Deficient	Indicates that earnings are insufficient to support operations. There are indicators that management is engaging in activities with which it is not familiar or where there are inordinately high levels of risk present that have not been adequately evaluated. The institution is characterized by fiduciary earnings performance that is poor historically, or faces the prospect of significant losses in the future. Management processes for monitoring and evaluating earnings and expenses may be poor. The board of directors has not adopted appropriate measures to address significant deficiencies. Management has not adopted the use of budgets and cost analysis procedures.

TRUST RATING SYSTEM RISK ASSESSMENT

A formal risk management program should be established to effectively manage risks associated with the fiduciary activities. The elements of an effective risk management program include: (a) active and appropriate board of directors, TC and senior management oversight; (b) adequate risk management processes, policies, and procedures; (c) appropriate risk measurement system, prudent risk limits, monitoring, and management information systems; and (d) comprehensive and effective internal controls, audit, and compliance program. The risk management framework and relevant program should be subject to continuous review and update to ensure it remains responsive of current and anticipated business risks.

Risks Associated with Fiduciary Activities

Depending on the nature and scope of a TE's fiduciary activities, management practices may need to address some or all of the following risks:¹

1. Credit/counterparty risk is the current and prospective risk to client's earnings or principal contribution arising from an obligor's failure to meet the terms of any contract with the TE or otherwise perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance. It arises anytime fiduciary funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, and reflected in the client's financial statements. Credit/counterparty risk exists in the loan portfolio and other forms of credit accommodations
2. Market risk is the current and prospective risk to client's earnings or principal contribution arising from changes in the value of the TE's holdings of investment portfolios. Market risk arises from dealing and position-taking activities in interest rate, foreign exchange and equity markets.
3. Liquidity risk is the current and prospective risk to client's earnings or principal contribution arising from a TE's inability to recognize or address unplanned changes in client's and/or beneficiary's needs thereby affecting the ability to liquidate assets quickly with minimal loss in value. The TE shall determine and maintain adequate level of liquidity in each accounts based on client-defined constraints/circumstances or product specifications.
4. Operational risk is the current and prospective risk to the TE's/non-TE financial institution's earnings or capital arising from fraud or error, and the inability of the TE to deliver products or services, maintain a competitive position and manage information. Operational risk is evident in each fiduciary product and service offered. As the fiduciary products and services become sophisticated or volume of activities expands, so does the level of operational risk. This risk encompasses

¹ Refer to the Risk Management Guidelines for Trust and Other Fiduciary Business and Investment Management Activities.

product development and delivery, operational processing, systems development, and the internal control environment. Operational risk is present in the day-to-day operations of TEs and in all aspects of fiduciary activities.

A part of Operational risk is Legal risk which arises from non-adherence with the terms of the fiduciary agreement and the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations of a TE.

5. Compliance risk is the current and prospective risk to the TE's/non-TE financial institution's earnings or capital arising from violation of laws, rules and regulations of regulatory authorities, prescribed practices or sound fiduciary principles, internal policies and procedures, and prudent ethical standards. Compliance risk also arises in situations where the laws or rules governing certain fiduciary products or activities of the TE may be ambiguous or untested. This risk exposes the TE to fines, payment of damages, and the voiding of contracts. Compliance risk can lead to limited business opportunities, reduced expansionary potential, unenforceability of contract or even adversely affect TE's reputation.
6. Strategic risk is the current and prospective risk to the TE's/non-TE financial institution's earnings and capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. Strategic risk is a function of the compatibility of a financial institution's strategic goals, the business strategies developed to achieve those goals, the resources deployed in support of these goals, and the quality of implementation. The TE's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes. Financial success requires a sound strategic planning process embraced by the board and senior management.
7. Reputation risk is the current and prospective risk to the TE's/non-TE financial institution's earnings and capital arising from negative publicity regarding the financial institution's fiduciary business practices. The negative public opinion can cause (a) clients to question or doubt the TE's integrity to engage in fiduciary activities which can result in the termination of fiduciary relationships, (b) litigation costs to increase, or (c) revenues to decline. Reputation risk affects the TE's ability to establish new fiduciary relationships or services, or continue servicing existing relationships. Since public's perception is critical in the fiduciary business, TEs should exercise an abundance of caution in dealing with clients and the public in general.

Assignment of Aggregate Risk Rating and Direction of Risk

Aggregate risk is the summary judgment that incorporates the ratings on the quantity of risk and the quality of risk management, and is characterized as LOW, MODERATE or HIGH. The following matrix provides guidance on assessing aggregate risk by balancing the observed quantity and degree of risk with the assessed overall strength of the risk management system. The ratings provided at the intersections are

simply examples. The examiner should feel free to consider factors that are significantly material in the evaluation process but are not depicted in the matrix.

Quality of Risk Management	Quantity of Risk		
	Low	Moderate	High
	AGGREGATE RISK ASSESSMENT		
Weak	LOW OR MODERATE	MODERATE OR HIGH	HIGH
Acceptable	LOW	MODERATE	HIGH
Strong	LOW	LOW OR MODERATE	MODERATE

High Risk - risk management system does not significantly mitigate the high inherent risk of the activity. Thus, the activity could potentially result in a financial loss that would have a significant negative impact on the organization's overall condition or client's financial position, even in some cases where the systems are considered acceptable. For an activity with moderate inherent risk, a risk management system that has significant weaknesses could result in a high composite risk assessment because management appears to have an insufficient understanding of the risk and uncertain capacity to anticipate and respond to changing conditions.

Moderate Risk - risk management systems appropriately mitigate moderate inherent risk. For an activity with low inherent risk, significant weaknesses in risk management system may result in a moderate risk assessment. On the other hand, a strong risk management system may reduce the risks of an inherently high risk activity so that any potential financial loss from the activity would have only a moderate negative impact on the financial condition of the organization or client's financial position.

Low Risk - generally assigned to an activity that has low inherent risks. An activity with moderate inherent risk may be assessed a low composite risk where internal controls and risk management systems are strong and effectively mitigate much of the risk.

Consequently, in analyzing the direction of risk, consideration should be made on the circumstances affecting the TE's operations including, but not limited to, the complexity of the TE's activities and products, strategic plans, business decisions and investment objectives as well as gravity of findings and the TE's ability to address finding noted in the examination. For instance, the following scenarios may warrant an increasing direction of risk in their respective risk areas: plans to expand business, or findings noted in the examination needing some time to correct.

Strategic Risk

Strategic Risk	Quantity of Strategic Risk		
	Low	Moderate	High
The TE's business model is considered conservative and stable. The plan calls for a well diversified business model. Revenue is derived from a variety of sources.	The TE's business model is not overly aggressive as risk exposures are manageable. The business model is fairly well diversified but may exhibit some concentrations with regard to revenue sources.	The TE's business model is considered aggressive, and is not well suited to the TE's competitive position. Products and services contemplated are not well supported by staff expertise. The plan lacks diversification or may call for rapid growth and/or expansion into areas in which the TE has little experience.	The TE's business model is considered aggressive, and is not well suited to the TE's competitive position. Products and services contemplated are not well supported by staff expertise. The plan lacks diversification or may call for rapid growth and/or expansion into areas in which the TE has little experience.
The specific goals and targets contained in the strategy and business plan are realistic and achievable.	The specific goals and targets contained in the strategy and business plan are achievable but may appear optimistic or are less than fully supported.	Goals and targets are not clearly defined and/or are considered unrealistic or unachievable.	Goals and targets are not clearly defined and/or are considered unrealistic or unachievable.
The business model calls for an emphasis on products/activities that are unique and/or are not being pursued by a significant number of competitors.	The business model calls for an emphasis on products/activities that are found in a number of competitors.	The business model calls for an emphasis on products/activities that are highly concentrated on products/activities being pursued by a number of other competitors.	The business model calls for an emphasis on products/activities that are highly concentrated on products/activities being pursued by a number of other competitors.
Direct competition is limited or low such that the TE does not experience significant pressure on fees and/or experience heightened customer attrition.	Direct competition is moderate such that the TE experiences select pressure on fees and/or experiences a moderate level of customer attrition.	Direct competition is significant such that the TE is experiencing significant pressure on fees and/or heightened customer attrition.	Direct competition is significant such that the TE is experiencing significant pressure on fees and/or heightened customer attrition.
The Board and senior management have demonstrated a capacity to execute strategies and business plans.	The Board and senior management have demonstrated a capacity to execute strategies and business plans but modest exceptions have been noted.	The Board and senior management have not demonstrated a capacity to achieve strategic targets and/or budget goals. Frequent revisions to budget are necessary.	The Board and senior management have not demonstrated a capacity to achieve strategic targets and/or budget goals. Frequent revisions to budget are necessary.
The Board and senior management have demonstrated a pro-active capacity to identify emerging threats and opportunities and have proven adept at re-positioning the TE to benefit from these assessments.	The Board and senior management generally are pro-active in identifying emerging threats and opportunities. While the Board has been successful in positioning the TE to benefit from these assessments, the effort is time consuming	The Board and senior management have not demonstrated a pro-active capacity to identify emerging threats and opportunities. The TE tends to get caught out of position as economic and competitive factors change.	The Board and senior management have not demonstrated a pro-active capacity to identify emerging threats and opportunities. The TE tends to get caught out of position as economic and competitive factors change.

Appendix B

Quantity of Strategic Risk		
Low	Moderate	High
Current and prospective economic factors support and are aligned with the TE's strategic and business plan.	and not fully effective. Current and prospective economic factors generally support and are aligned with the TE's strategic and business plan. Some weakening support for select business lines may be noted but is offset by economic support for others.	Economic factors or prospective economic factors do not support the TE's current or proposed strategic and business plan. The economy may be declining generally, or negative economic factors may have a magnified effect given the TE's concentrated risk exposures.
The TE's supporting infrastructure, including MIS and risk management, as well as its personnel and skill sets are adequate to support execution of the strategic and business plan.	The TE's supporting infrastructure, including MIS and risk management, as well as its personnel and skill sets are generally adequate to support execution of the strategic and business plan. Some gaps are noted but are not sufficient to threaten the overall viability of the plan.	The TE's supporting infrastructure, including MIS and risk management, and its personnel and skill sets are not adequate to support execution of the strategic and business plan.

Quality of Strategic Risk Management		
Strong	Acceptable	Weak
Corporate planning systems are formal and strong, and include all major functional areas of the TE including information systems (IT). Strengths and weaknesses assessments are ongoing and the Board has developed an effective feedback and evaluation mechanism to ensure the TE's business model remains appropriate.	Corporate planning systems are satisfactory, and include most major functional areas of the TE including IT. Strengths and weaknesses assessments are performed periodically and the Board periodically evaluates propriety of business model.	Corporate planning systems are informal or non-existent. Planning systems, if any, do not cover all significant functional areas of the TE. Strengths and weaknesses assessments are not performed or are unsatisfactory. Feedback and evaluation mechanism to ensure propriety of the TE's business model has not been developed or is ineffective.
Board participation is sufficient to ensure strong oversight. Reporting is sound and covers both internal and external developments. Deviations from plan and budget are pro-actively identified, discussed and addressed.	Board participation is sufficient to ensure adequate oversight. Reporting covers both internal and external developments but exhibits some deficiencies and modest weaknesses. Deviations from plan and budget are identified but may not be addressed in a timely manner.	Board participation is not sufficient to ensure strong oversight. Reporting is deficient. Deviations from plan and budget are not pro-actively identified.
Strategic initiatives and budget goals are clearly disseminated throughout the organization. Tracking mechanisms have been deployed and pro-actively identify deviations from plan and budget.	Strategic initiatives and budget goals are disseminated throughout the organization. Tracking mechanisms have been deployed and identify significant deviations from plan and budget.	Strategic initiatives and budget goals are not clearly disseminated throughout the organization. Tracking mechanisms have not been established, are not reliable or do not pro-actively identify deviations from plan and budget.
The budgeting process is tied into the strategic planning function such that budget goals are reasonable and expenditures, including IT are sufficient to support the achievement of the plan.	The budgeting process is tied into the strategic planning function but there may be some moderate disconnect between the budget and goals and expenditures, including IT. The goals themselves may seem moderately optimistic.	The budgeting process is not tied into the strategic planning function. Budget goals may be unreasonable and expenditures, including IT are not sufficient to support the achievement of the plan.

Reputation Risk

Quantity of Reputation Risk		
Low	Moderate	High
Franchise value is minimally exposed to reputation risk. Exposure from reputation risk is expected to remain low in the foreseeable future.	Franchise value may be exposed to reputation risk. Exposure is expected to remain relatively low in the foreseeable future.	Franchise value is substantially exposed to reputation risk as shown in significant litigation, large losses, or a high volume of customer complaints. The potential exposure is increased by the number of accounts, the volume of assets under management, or the number of affected transactions.
Conflicts of interest are effectively managed and internal control environment is generally sound. Losses from fiduciary activities are low relative to the number of accounts, the volume of assets under management, and the number of affected transactions. The TE does not regularly experience litigation/customer complaints.	Conflicts of interest are inconsistently managed. The level of litigation, losses, and customer complaints are moderate relative to the number of accounts, the volume of assets under management, and the number of affected transactions.	Poor administration and other legal or control breaches are evident. Conflicts of interest are ineffectively managed that compromise TE's discharge of fiduciary duties. Customer complaints are high or of significant nature.
The TE is engaged only in non-complex products and does not offer significant amounts of non-deposit investment products to retail clients.	The TE is engaged primarily in non-complex products and non-deposit investment products are sold to retail clients in modest volumes. The TE provides retail customers limited access to sophisticated, complex investments.	The TE provides retail customers access to significant volumes of non-deposit investment products and/or sophisticated, complex investment products.
The TE is not subject to any supervisory action and is in sound financial and operating condition.	The TE is not subject to a formal supervisory action but is experiencing deteriorating trends and/or has experienced a significant operational lapse which has become public.	The TE is subject to a supervisory action, such as Prompt Corrective Action, has announced a significant deterioration in earnings or capital or has been involved in a public scandal.
The TE has not been subject to negative press coverage.	Negative press coverage is noted but is limited in nature and has not adversely affected the TE's reputation.	The TE has been subject to significant negative press coverage due to financial condition, operating errors and/or violations of law.

Quality of Reputation Risk		
Strong	Acceptable	Weak
Management fosters a sound ethical culture that is well communicated and supported throughout the organization and has proven very effective over time.	Administration procedures and processes are satisfactory. An ethics policy is in place but has not been fully communicated or enforced. Management has a good record of correcting problems. Any deficiencies in management information systems are minor.	The TE has not adopted an ethics policy, or does not enforce ethical behavior. Weaknesses may be observed in one or more critical operational, administrative, or investment activities. Management information at various levels exhibits significant weaknesses.
Management anticipates and responds well to market or regulatory changes that impact TE's reputation.	Management adequately responds to market or regulatory changes that impact the TE's reputation.	Management does not anticipate or take timely or appropriate actions in response to market or regulatory changes.
Internal controls and audit are fully effective and the TE is effectively "self-policing" risks.	Internal controls and audit are generally effective and the TE is generally "self-policing" risks.	Internal controls or audit are not effective in mitigating exposures. Management has either not initiated, or has a poor record of corrective action to address problems. The TE's performance in "self-policing" risk is wanting.
The TE employs strong client suitability testing and/or frequent review and assessments of its client's investment and trust accounts.	Client suitability testing is employed but exhibits a number of minor deficiencies. Trust and investment management accounts likewise are subject to frequent reviews and assessments but exhibit modest lapses.	The TE does not employ adequate client suitability testing. Trust and investment management accounts are not subject to frequent reviews and assessments.

Operational Risk

Quantity of Operational Risk		
Low	Moderate	High
Operations/products are relatively non-complex. A majority of revenue is derived from traditional trust products.	Operations/products are moderately complex. A moderate level of revenue is derived from activities that carry higher levels of inherent operational risk.	Operations/products are considered highly complex. A high level of revenue is derived from activities that carry higher levels of inherent operational risk.
The organizational structure of the TE is non-complex. Inter-company transactions and operating arrangements are minimal.	The organizational structure of the TE is moderately complex. Inter-company transactions and operating arrangements exist but are of a limited nature.	The organizational structure of the TE is complex, necessitating numerous inter-company transactions and operating relationships.
The TE is not known as a product innovator.	The TE launches innovative new products but at a reasonable pace. New products are generally pre-authorized through a formal new product approval process.	The TE is aggressive in launching innovative new products. However, many of the products launched by the organization have not been subjected to an adequate new product approval process.
Planning and due diligence are performed adequately.	Planning and due diligence are performed although minor weaknesses exist.	Planning or due diligence may be inadequate, exposing the TE to risk from the introduction of new products and services or acquisitions.
Infrastructure spending is adequate to support the business plan and growth. Staff possesses appropriate technical skills, the training program is appropriate and succession planning is evident.	Infrastructure spending is generally adequate to support the business plan and growth. Staff generally possesses appropriate technical skills, but some skill gaps exist in non-critical areas. The training program is not fully matched with the needs of the TE and/or succession planning exhibits modest deficiencies.	Infrastructure spending is not adequate to support the business plan and growth. Staff does not possess appropriate technical skills, and/or the training program is inappropriate. Succession planning is not evident.
Staff is tenured and turn-over is low.	Staff is somewhat inexperienced and turn-over levels are moderate.	Staff is inexperienced and turn-over levels are high.
Operations are well supported by systems development.	Operations are adequately supported by systems development.	Operations processing and systems development are inconsistent and reflect weaknesses.
Management information is complete and	Minor deficiencies may exist in management	Management information related to operational

Appendix B

Quantity of Operational Risk		
Low	Moderate	High
allows for effective operation and information processing activities.	information that relate to operation and information processing activities.	activity exhibits significant weaknesses.
Compensation plans tie operational integrity to performance evaluations and salary. Disciplinary systems address follow-up and correction of operational lapses.	Compensation plans address operational integrity but performance evaluations and salary are not directly affected by performance. Disciplinary systems address follow-up and correction of operational lapses but are not consistently applied.	Compensation plans do not address operational integrity. Salary and bonuses are tied to growth and/or profitability without regard to operational integrity. Disciplinary systems do not address follow-up and correction of operational lapses.
The TE is not reliant on regulatory agencies/external auditors to identify deficiencies and weaknesses in internal operations.	The TE self-identifies most major deficiencies and weaknesses in internal operations. External audit/regulatory agency examinations do not typically disclose exceptions which management is not already aware of.	The TE is fully reliant on the external auditor/regulatory agencies to identify deficiencies and weaknesses in internal operations. External audit/regulatory agency examinations typically disclose significant exceptions which management is not aware of.

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Quality of Operational Risk Management		
Strong	Acceptable	Weak
Management fully understands all aspects of operational risk and has established a methodology to identify new and increasing risks.	Management reasonably understands the key aspects of operational risk and adequately monitors its environment to identify new and increasing risks.	Management does not understand or has chosen to ignore, key aspects of operational risk.
Management anticipates and responds well to market and technological changes.	Management adequately responds to market or technological changes.	Management does not adequately respond to market or technological changes.
The Board has implemented a formal operations risk management framework. The framework is commensurate to the nature and complexity of the TE's operations. Systems and tracking mechanisms are formal, comprehensive, independent and adequately staffed.	The Board has implemented a formal operations risk management framework although the framework may have low to moderate weaknesses that are within management's capability to correct. Alternatively, the framework maybe informal but policies and processes are working effectively to minimize operational risk.	The Board has not implemented a formal operations risk management framework. A formal or informal framework may have been in place but is not commensurate to the nature and complexity of the TE's operations.
The Board has established a formal, new product approval process. This process is applied pro-actively before product launch and incorporates the input of all major affected departments including compliance and internal audit. Board review of, and prior approval of proposed significant new products is required.	The Board has established an informal new product approval process. However, the process may not be applied pro-actively, or may suffer from technical defects. Some key units, such as compliance may have been excluded from the process. Board review of, and prior approval of proposed significant new products is not consistently required.	The Board has not established a new product approval process. Alternatively, the process suffers from systemic defects, such as the omission of key units such as accounting, legal compliance and/or internal audit. Board review of, and prior approval of proposed significant new products is not required.
A strong control culture has resulted in sound systems. Segregation of duties, independent balancing and a hierarchical approval structure has been adopted and are consistently followed. Controls on key processes such as account opening, client suitability, periodic review of existing accounts, credit and investment process	Operating and information processing systems are adequate. Segregation of duties, independent balancing and a hierarchical approval structure has been adopted but exhibit minor to moderate flaws or may not be followed. Deficiencies, while noted, are not considered systemic. Controls on key processes such as	Serious weaknesses exist in operating and information systems and/or internal controls. Controls on key processes such as account opening, client suitability, periodic review of existing accounts, credit and investment process and account termination, are poor.

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Quality of Operational Risk Management		
Strong	Acceptable	Weak
and account termination, are strong.	account opening, client suitability, periodic review of existing accounts, credit and investment process and account termination, are adequate.	
Contingency and disaster recovery plans have been tested and are reliable.	Contingency and disaster recovery plans are evident but exhibit some minor weaknesses.	Serious weaknesses exist in the contingency/disaster recovery plans.
Internal audit is considered independent, and fully effective.	Internal audit is considered independent. Deficiencies may be noted in the scope, audit procedures, or follow-up procedures but such do not compromise the effectiveness of the function.	Internal audit is not independent and is ineffective.

Legal Risk

Quantity of Legal Risk		
Low	Moderate	High
The TE has limited, if any, history of legal problems.	The TE has a moderate history of legal problems that would be expected in the normal course of business for a TE of its size.	The TE is frequently in litigation with other TEs, former clients, or third parties.
The TE's current and prospective exposure to judgments in which the TE is a defendant is considered low relative to capital and earnings.	The TE's current and prospective exposure to judgments in which the TE is a defendant is considered moderate relative to capital and earnings.	The TE's current and prospective exposure to judgments in which the TE is a defendant is considered large and significant relative to capital and earnings.
All new products, markets and outsourcing options are fully evaluated for legal risks prior to initiation of the respective option.	All new products, markets, and outsourcing options are generally evaluated for legal risks prior to initiation of the respective option.	The TE's initiation of new product lines, markets, or outsourcing options are done with little or no consideration of the legal risks associated with this entry.
Thorough and active due diligence program for reviewing potential acquisitions that identifies all potential legal risks associated with the acquisition.	Generally adequate due diligence program for reviewing the legal risks associated with the potential acquisitions.	Inadequate due diligence for reviewing the legal risks associated with the potential acquisitions.
Legal counsel has a proven track record of protecting the TE's interest when necessary. The TE's image in the community is of a company willing to aggressively protect its interests.	Legal counsel is adequate, with more wins than losses. The TE is perceived as a consistent, yet not highly aggressive, defender of its interests.	Legal counsel is not serving the TE well in litigation/negotiations. The TE is perceived as an easy target for cash settlements.

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Quality of Legal Risk		
Strong	Acceptable	Weak
The Board and senior management are highly proactive in ascertaining that the TE's culture ensures that all potential legal risks are minimized. Legal counsel is actively involved in drafting the TE's policies and contracts for adherence with statutes and ensuring that the TE is not exposed to undue risk. The policies are sound and effectively practiced.	The Board and senior management works to ensure that the TE's culture generates an overall awareness of compliance and legal risks, without unduly limiting prudent risk-taking by the TE. Management drafts the policies with the legal counsel reviewing the policy or contract prior to adoption. The policies are generally satisfactory and are generally practiced by management.	The Board and senior management is indifferent toward the need for compliance and legal risk monitoring. Management and the board tolerate ethical lapses or repeated "mistakes" by staff members in critical positions. Legal counsel is not involved with the drafting, reviewing, or the adoption of TE policies and contracts. The policies are less than satisfactory and are not practiced/implemented.

Compliance Risk

Quantity of Compliance Risk		
Low	Moderate	High
The TE has limited, if any, history of non-adherence to applicable laws and regulations, sound fiduciary principles, governing instruments, and internal policies and procedures.	The TE has a moderate history of non-adherence to applicable laws and regulations, sound fiduciary principles, governing instruments, and internal policies and procedures.	The TE is frequently not adhering to applicable laws and regulations, sound fiduciary principles, governing instruments, and internal policies and procedures.
The TE's current and prospective exposure to regulatory sanctions is considered small relative to capital and earnings.	The TE's current and prospective exposure to regulatory sanctions is considered moderate relative to capital and earnings.	The TE's current and prospective exposure to regulatory sanctions is considered large and significant relative to capital and earnings.
All new products, markets and outsourcing options are fully evaluated for compliance risk prior to initiation of the respective option.	All new products, markets, and outsourcing options are generally evaluated for compliance risk prior to initiation of the respective option.	The TE's initiation of new product lines, markets, or outsourcing options are done with little or no consideration of the compliance risk associated with this entry.
Thorough and active due diligence program for reviewing potential acquisitions that identifies all potential compliance risk associated with the acquisition.	Generally adequate due diligence program for reviewing the compliance risk associated with the potential acquisitions.	Inadequate due diligence for reviewing the compliance risk associated with the potential acquisitions.

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Quality of Compliance Risk		
Strong	Acceptable	Weak
The Board and senior management are highly proactive in ensuring that the TE's culture ensures that all potential compliance risks are minimized.	The Board and senior management works to ensure that the TE's culture generates an overall awareness of compliance risk, without unduly limiting prudent risk-taking by the TE.	The Board and senior management is indifferent toward the need for compliance risk monitoring. Management and the board tolerate ethical lapses or repeated "mistakes" by staff members in critical positions.
Board and senior management support continuing education to changing laws/regulations, implementing changes in a timely manner.	Board and senior management generally support continuing education to changed laws/regulations, implementing changes in a timely manner.	Board and senior management is not aware of changing laws/regulations or is slow to implement changes in practices to reflect these regulatory challenges.
Comprehensive compliance program is developed and effectively implemented. Compliance management system is sound and minimizes the likelihood of excessive or serious future violations or non-compliance. Control systems are appropriately implemented.	Generally comprehensive compliance program is developed and satisfactorily implemented. Compliance management system is adequate to avoid significant or frequent violations or noncompliance. Controls are satisfactorily implemented and probability of serious future violations or noncompliance is within acceptable tolerance.	Compliance program is not effective. Compliance management system is critically deficient and reflects an inadequate commitment to risk management. Likelihood of continued violations/noncompliance is high because of absence of corrective action program or extended time is needed to implement such program.
Management promptly implements meaningful corrective action to identified weaknesses/deficiencies.	Management is responsive when deficiencies are identified and problems can be corrected in the normal course of business without a significant investment of money or management attention.	Deficiencies are often not detected internally, corrective action is often ineffective, or management is unresponsive.

Credit/Counterparty Risk

Quantity of Credit/Counterparty Risk		
Low	Moderate	High
Lending and investment activities are characterized by traditional secured lending and reasonable yields on loans and securities. Investments consist of plain vanilla, highly rated traditional securities.	Lending and investment activities are characterized by elements of higher risk such as clean loans. The investment portfolio exhibits some elements of structured or higher risk (counterparty and/or tenor) components. Yields are high but exhibit a reasonable trade-off between risk and profitability.	Lending and investment activities are characterized by concentrations in specialized or higher risk lending. Investments exhibit a high concentration in emerging markets or in structured, or other exotic securities. Yields are high and exceed the comparable peer and industry.
Lending activities are conservative. New extensions of credit are conservative in structure, terms, growth, or settlement practices.	Lending activities shows moderate growth. New extensions are prudent in structure, terms, growth, or settlement practices.	Lending activities shows aggressive growth. New extensions are aggressive in structure, terms, growth, or settlement practices.
The loan and/or investment portfolios are highly diversified, with little correlation risk.	The loan and/or investment portfolios exhibit moderate concentrations to single counterparty, repayment source, instrument, or geographic dispersion. Moderate levels of correlation risk are noted.	The loan and/or investment portfolios exhibit high levels of, or significantly large concentration to a single counterparty, repayment source, instrument or geographic dispersion. High levels of correlation risk are noted.
The volume of non-performing and/or problem assets is low and can be worked through in the normal course of business.	The volume of problem assets is moderate and has affected client's earnings. Nevertheless, asset quality problems can be worked through within a reasonable time frame.	The volume of problem assets is high and has adversely affected client's earnings or even principal. Resolution will require an extended time.
Economic factors are positive and supportive of the overall credit/investment exposure.	Economic factors are supportive but portions of the credit/investment exposures may be experiencing deterioration in operation conditions.	Economic factors are negative and at odds with the credit/investment profile.

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Quality of Credit/Counterparty Risk Management		
Strong	Acceptable	Weak
The board and management fully understand all aspects of credit/counterparty risk and anticipate and respond appropriately to changes in market conditions.	The board and management understand key aspects of credit/counterparty risk and adequately respond to changes in market conditions.	The board and management do not understand, or ignore, key aspects of credit/counterparty risk. They do not anticipate, or take timely and appropriate actions in response to changes in market conditions.
Policies (loans, investments and derivatives) are fully comprehensive and appropriate to the TE's strategic and business plan. Feedback mechanisms have been established and the Board ensures policy parameters are updated to reflect changing circumstances.	Policies (loans, investments and derivatives) are substantially complete and appropriate for the key parts of the TE's operations. Some disconnect is noted between policies and the business plan but the resulting deviations are not expected to have a material adverse effect on operations. Policy updates may be infrequent and there may be some limited discrepancies between policy guidelines and actual operations.	Policies (loans, investments and derivatives) have significant omissions and/or other weaknesses. Key products or business lines are not adequately supported by policy parameters and/or a large volume of significant policy exceptions have been discovered. Policies are not updated in a timely manner and there is a substantial difference between policy and practice.
Relevant credit/counterparty risk limits are comprehensive, well structured and consistently followed. Limits address consolidated exposures and are adequately monitored.	Relevant credit/counterparty risk limits are comprehensive, but may exhibit modest gaps in coverage leading to isolated limit breaches. Limits address consolidated exposures but system limitations render timely monitoring problematic.	Relevant credit/counterparty risk limits are not comprehensive, or well structured. Frequent breaches are noted. Limits do not address consolidated exposures across and/or are not adequately monitored.
Credit/Investment and counterparty accreditation analysis is comprehensive and promotes early identification of emerging risk. Written analyses are current, thorough and of high quality.	Credit/Investment and counterparty accreditation analysis is satisfactory, but may be less formal. Available information on file, combined with interviews with concerned officers indicates an acceptable understanding of credit/counterparty risk exposures.	Credit/Investment and counterparty accreditation analysis is deficient. Financial and other relevant information on file, and/or concerned officer's comprehension thereof, is deficient.

Market Risk

Quantity of Market Risk		
Low	Moderate	High
Activities reflect low foreign exchange (FX) and interest rate risk, and volatility in equity prices relative to the number and level of managed accounts.	Activities reflect FX and interest rate risk, and volatility in equity prices at moderate levels relative to the number and level of managed accounts.	Exposure reflects significant repricing risk, high levels of basis risk, FX risk, or undue yield-curve risk relative to the number and level of managed accounts.
Sources of market risk is limited to FX, interest rate risk or volatility in equity prices.	Sources of market risk include a combination of the following: FX, interest rate risk and/or volatility in equity prices.	Sources of market risk include FX, interest rate risk and volatility in equity prices.
Exposures reflect limited un-hedged positions.	Exposures reflect moderate un-hedged exposures or with minimal increases in un-hedged positions.	TE lacks capability to hedge or does not have ready access to hedging tools.
Fund earnings exhibit only nominal volatility from movements in interest rates or asset prices.	Fund earnings exhibit moderate volatility from movements in interest rates or asset prices.	Fund earnings exhibit significant volatility from movements in interest rates or asset prices.

Quality of Market Risk Management		
Strong	Acceptable	Weak
The Board and senior management have a thorough understanding of all aspects of market risk and the products/services offered are anticipatory and offer generally appropriate responses to changes in economic conditions. Policies are comprehensive, appropriate, and are adequate relative to the risk profile. Policies are sound and effectively communicate guidelines for management of market risk, functional responsibilities, and tolerances for risk.	The Board and senior management have an adequate understanding of key aspects of risk and the products/services offered are not fully anticipatory but offer generally appropriate response to changes in economic conditions. Policies are substantially complete and adequate relative to the risk profile. Policies adequately communicate guidelines for management of market risk, functional responsibilities, and risk tolerances. Minor to moderate weaknesses may be evident but do not compromise the overall effectiveness of market risk management system.	The Board and senior management do not exhibit an adequate understanding of market risk and the business' products and services are not anticipatory and do not offer appropriate responses to changes in economic conditions. Policies have significant deficiencies and are inadequate relative to the risk profile. Policies do not effectively communicate guidelines for management of market risk, functional responsibilities and risk tolerance.
Limit structure is comprehensive and provides clear parameters for risk under a variety of defined and reasonable scenarios. Limits are low relative to total exposure.	Limit structures are generally comprehensive although some gaps are noted. Limits are adequate to control risk under a limited number of defined and reasonable scenarios. Limits are moderate relative to total exposure.	Limit structures are not comprehensive and/or reasonable. Limits are high relative to total exposure.
Measurement tools and methods enhance decision-making by providing meaningful and timely information under a variety of defined and reasonable rate scenarios. Measurement of risk exposures and monitoring compliance with risk limits is fully independent from the risk-taking function.	Measurement tools and methods have minor weaknesses, but are appropriate given the size and complexity of the TE's exposures. Monitoring of compliance with risk limits is generally independent from the risk-taking function.	The measurement process is overly simplistic in light of the relative size and complexity of the TE's exposures. Measurement of risk exposures and monitoring of compliance with risk limits is not independent from risk-taking function.
The data input process is effective and ensures the accuracy and integrity of management information. Assumptions are reasonable and well documented.	The data input process is adequate and generally ensures the accuracy of management information. Assumptions are reasonable.	The quality of the data input process exhibits material weaknesses. Assumptions are not realistic or well supported.

Liquidity Risk

Quantity of Liquidity Risk		
Low	Moderate	High
Liquidity position (all currencies) is favorable. Market sources exceed demand for liquidity and there is negligible exposure to client's earnings. Given the strategic or business plan, or expected economic factors, adverse changes in liquidity profile are considered unlikely.	Can meet liquidity demand in all currencies. There is no excessive vulnerability to funding difficulties should an adverse change in market perception occur. Client's earnings exposure is manageable. Given the strategic or business plan or expected economic factors, expected changes in liquidity profile are manageable.	There is excessive vulnerability to funding difficulties in any currency. Sources of funding alternatives are limited and/or declining. Meeting liquidity needs may expose client's earnings to significant risk. TE is susceptible to an adverse change in market perception and/or expected changes in liquidity profile are unmanageable.
Liquidity contingency plans are well-developed, effective and reliable. The plan incorporates reasonable assumptions, scenarios and crisis management planning, and is tailored to the needs of the TE. All currency books are covered.	Liquidity contingency plans adequately and reasonably address most relevant issues. The plans contain adequate level of detail, including multiple scenario analysis. However, the plan may require minor refinements. Significant currency books are covered.	No liquidity contingency plan. Alternatively, the plan is not realistic, or is not properly implemented. The plan requires major changes. Significant currency books are not covered.

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Quality of Liquidity Risk Management		
Strong	Acceptable	Weak
The Board and senior management fully understand all key aspects of liquidity risks; anticipate and responds well to changes in market conditions.	The Board and senior management generally understand most key aspects of liquidity risk; generally anticipates and takes timely and appropriate actions in response to changes in market conditions.	The Board and senior management does not understand or chooses to ignore key aspects of liquidity risks; does not anticipate or take timely and appropriate actions in response to changes in market conditions.
Risk management process for identifying, measuring, monitoring and controlling liquidity risk is effective and reflects a sound culture that has proven effective over time.	Risk management process for identifying, measuring, monitoring and controlling liquidity risk is satisfactory. There may be minor weaknesses given the complexity of the risks undertaken, but these are easily corrected and do not compromise the process.	Risk management process for identifying, measuring, monitoring and controlling liquidity risk is ineffective and deficient in one or more material aspects given the complexity of the risks undertaken.
Management information system focuses on significant issues and produce timely, accurate, complete and meaningful information to support effective management of liquidity. No significant errors are noted.	Management information system captures concentrations and rollover risks and are, for the most part, timely and accurate. Recommendations are minor and do not impact effectiveness. Errors, while noted, are not material to compromise the reports.	Management information system is deficient. Material information may be lacking or inaccurate, and reports are not meaningful.

TRUST RATING SYSTEM
SAMPLE SUMMARY ASSESSMENT MATRIX

Component/Risk Area	Assessment	Rating
Capability of Management	Satisfactory	3
Strategic Risk	Moderate and Increasing	
Reputation Risk	Low and Stable	
Operations, Controls and Audit	Satisfactory	3
Operational Risk	Moderate and Increasing	
Legal Risk	Low and Stable	
Compliance	Less than Satisfactory	2
Compliance Risk	Moderate and Increasing	
Asset Management	Less than Satisfactory	2
Credit/Counterparty Risk	Moderate and Increasing	
Market Risk	Moderate and Increasing	
Liquidity Risk	Low and Increasing	
Earnings	Highly Satisfactory	4
Composite Rating	Satisfactory	3