Idaho Department of Finance
Guidance Statement
2020-03-FIB

MINIMUM CAPITAL REQUIREMENTS AND PERMISSIBLE INVESTMENTS FOR TRUST COMPANIES

Issue Date: July 1, 2020 (Replaces Interpretive Statement 2017-02)

I. Background

The purposes of this Guidance Statement are to provide clarification on the statutory minimum capital requirements for trust companies to engage in trust business in Idaho, and to provide supervisory guidance of the Idaho Department of Finance ("Department") on permissible investments and capital management for state trust companies chartered under the Idaho Trust Institutions Act ("Act"), chapters 32 through 36, title 26, Idaho Code.

The Act permits state trust companies to engage in trust business in this state, and permits out-of-state trust companies to engage in trust business in this state upon compliance with all applicable laws of this state, to the extent consistent with standards for safety and soundness and the protection of consumers, clients and other customers of such trust institutions.

II. Statutory Minimum Capital

The Act requires that a state trust company comply with the minimum capital requirement set forth in the Act of paid-in capital of not less than one million five hundred thousand dollars ($1,500,000). Idaho Code § 26-3504(1). In addition, the Act requires a state trust company to maintain, at all times, capital of not less than one million five hundred thousand dollars ($1,500,000). Idaho Code § 26-3504(3).

The Act allows an out-of-state trust institution to establish an office in this state, provided the out-of-state trust institution confirms in writing to the Director that it will comply with all applicable laws of this state for as long as it maintains a trust office in this state. Idaho Code § 26-3504. Furthermore, Article 6 of the Nationwide Cooperative Agreement for Supervision and Examination of Multi-State Trust Institutions states that host state laws shall apply generally to the operations in a host state of a multi-state trust institution, including, without limitation, trust, estate and probate law, consumer protection laws, and licensing, registration or other nondiscriminatory filing requirements. Therefore, an out-of-state trust company must comply with the minimum capital requirements set forth in the Act for a state trust company.

The Director may not issue a charter to a state trust company, approve the notice filed by out-of-state trust company, or license the trust office of an out-of-state trust company until the state trust company or out-of-state trust company has received cash or marketable securities in at least the full amount of required capital from subscriptions for the issuance of shares or participation shares. Paid-in capital is the amount of cash or other assets that owners put into a trust company in exchange for stock or share ownership in the company. In order to qualify as paid-in capital, marketable securities or other assets received in exchange for stock or share ownership of a trust company must qualify as a permissible investment for a state trust company to hold or maintain for its own account.

III. Permissible Investments

A state trust company may purchase, hold, and convey real estate, including facilities, for the purpose of conducting trust business, including meeting the reasonable needs and convenience of the state trust company's customers, computer operations, document and other item processing, maintenance and record retention and storage. Without the prior written approval of the Director, a state trust company may not directly or indirectly invest an amount in excess of its capital in state trust company facilities, furniture, fixtures, and equipment.

A state trust company may invest its corporate funds in any type or character of equity or investment securities permissible for a state bank. While the Idaho Bank Act is silent on permissible investments for state banks, Part 362 of the FDIC Rules and Regulations, implementing provisions of Section 24 of the Federal Deposit Insurance Act, prohibits an insured state bank from engaging in activities or holding investments that are not permissible for a national bank, subject to certain exceptions which are specified in the regulation.

A state trust company may purchase and sell for its own account, without limitation and subject only to the exercise of prudent judgment:

Type I Securities

(1) Obligations of the United States;

(2) Obligations issued, insured, or guaranteed by a department or an agency of the United States Government, if the obligation, insurance, or guarantee commits the full faith and credit of the United States for the repayment of the obligation;

(3) Obligations issued by a department or agency of the United States, or an agency or political subdivision of a State of the United States, that represent an interest in a loan or a pool of loans made to third parties, if the full faith and credit of the United States has been validly pledged for the full and timely payment of interest on, and principal of, the loans in event of non-payment by the third-party obligor(s);

(4) General obligations of a State of the United States or any political subdivision;

(5) Obligations authorized under 12 U.S.C. 24 (Seventh) as permissible for a national bank to deal in, underwrite, purchase, and sell for the bank's own account, including qualified Canadian government obligations; and

(6) Other securities the OCC determines to be eligible as Type I securities under 12 U.S.C. 24 (Seventh).

A state trust company may purchase and sell Type II securities for its own account, provided the aggregate par value of Type II securities issued by any one obligor held by the state trust company does not exceed 10 percent of capital and surplus.

Type II Securities

(1) Obligations issued by a State, or a political subdivision or agency of a State, for housing, university, or dormitory purposes that would not satisfy the definition of Type I securities;

(2) Obligations of international and multilateral development banks and organizations listed in 12 U.S.C. 24 (Seventh);

(3) Other obligations listed in 12 U.S.C. 24 (Seventh) as permissible for a bank to deal in, underwrite, purchase, and sell for the bank's own account subject to a limitation per obligor of 10 percent of the bank's capital and surplus; and

(4) Other securities the OCC determines to be eligible as Type II securities under 12 U.S.C. 24 (Seventh).

A state trust company may purchase and sell Type III securities for its own account, provided the aggregate par value of Type III securities issued by any one obligor held by the state trust company does not exceed 10 percent of capital and surplus.

Type III Securities

(1) An investment security that does not qualify as a Type I, II, IV, or V security, such as corporate bonds and municipal revenue bonds. This category includes most trust preferred securities. (OCC Interpretive Letter #777)

A state trust company may purchase and sell Type IV securities for its own account. The amount of the Type IV securities that a state trust company may purchase and sell is not limited to a specified percentage of capital and surplus.

Type IV Securities

(1) A small business-related security as defined in Section 3(a)(53)(A) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(53)(A), that is rated investment grade or is the credit equivalent thereof, that is fully secured by interests in a pool of loans to numerous obligors;

(2) A commercial mortgage-related security that is offered or sold pursuant to Section 4(5) of the Securities Act of 1933, 15 U.S.C. 77d(5), that is rated investment grade or is the credit equivalent thereof, or a commercial mortgage-related security as described in Section 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78 c(a)(41), that is rated investment grade in one of the two highest investment grade rating categories, and that represents ownership of a promissory

note or certificate of interest or participation that is directly secured by a first lien on one or more parcels of real estate upon which one or more commercial structures are located and that is fully secured by interests in a pool of loans to numerous obligors; and

(3) A residential mortgage-related security that is offered and sold pursuant to Section 4(5) of the Securities Act of 1933, 15 U.S.C. 77d(5), that is rated investment grade or is the credit equivalent thereof, or a residential mortgage-related security as described in Section 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(41), that is rated investment grade in one of the two highest investment grade rating categories, and that does not otherwise qualify as a Type I security.

A state trust company may purchase and sell Type V securities for its own account provided that the aggregate par value of Type V securities issued by any one issuer held by the state trust company does not exceed 25 percent of the bank's capital and surplus.

Type V Securities

An investment grade, marketable security that is not a Type IV security and is fully secured by interests in a pool of loans to numerous obligors and in which a state trust company could invest directly.

A state trust company may invest for its own account in equity securities of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.) and the Securities Act of 1933 (15 U.S.C. Sec. 77a et seq.) if the portfolio of the investment company consists wholly of investments in which the state trust company could invest directly for its own account.

IV. Responsibilities of the Board of Directors

It is the responsibility of the board of directors and management of a state trust company to ensure that capital levels are adequate and that appropriate capital 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 needs. Failure to maintain adequate capital is an unsafe and unsound banking practice.

Board-approved capital policies should outline the board's philosophy and articulate responsibilities and expectations for the management of capital. Policies should also define acceptable levels of capital, 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. The Department expects a state trust company to assess the appropriateness of its level of capital at least annually. A more frequent analysis of capital is warranted for a state trust company 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 state trust company's risk profile.

V. Capital Management

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

The Department recognizes that complex analytical processes and tools may not be practical for all trust companies. The analytical processes at a large and complex trust company may include formal, company-wide risk management processes and systems including model-driven risk analysis capabilities and tools used to stress test the trust company's sensitivity of earnings and capital. For small, less complex trust companies, 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 trust company'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 expectations for dividends along with their commitment and ability to augment capital, if needed. Also, consider the volume of intangible assets and their effect on capital levels and statutory 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 trust company's delivery and administration of asset management products and services. Consider the condition, security, capacity, and recoverability of systems as well as 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 trust companies. Some factors may not be relevant for each trust company, and additional factors not described here may be appropriate, based on the circumstances of the individual trust company.

VI. Summary - Supervisory Considerations

The Department expects capital at state trust companies to be maintained at levels sufficient to support safe and sound operations. During the normal course of the supervisory process, the Department will evaluate the adequacy of capital at state trust companies, including the development of, and adherence to, a sound capital management process. The Department will seek corrective action for significant weaknesses or unwarranted risks.

Contact - You may direct comments or requests for additional information regarding this Guidance Statement to:

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