

Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

## Introduction to Private Banking

Many savings associations offer “private banking” services with oversight provided by the trust department. These services may also be known as “wealth accumulation,” “wealth management,” “family wealth” or “private financial services.” For the purpose of this discussion, the term “private banking” will be used.

Private banking offers convenient, responsive and personalized service along with a special package of financial services designed to meet the credit and investment needs of individuals. In the past, private banking was exclusively for the very wealthy or for those seeking a safe haven offshore for their capital. It is now undergoing a massive change from a once quiet and discrete service to a highly dynamic and competitive business. Today’s private bankers are dealing with very active money, as shown by an increased movement of money from onshore to offshore.

There is no typical private banking client but generally they can be divided between the old-line, wealthy families (the traditional private banking customers) and the “nouveau riche,” that is, self-made millionaires who have profited from mergers and acquisitions, the dot.com revolution, lotteries or the real estate boom. After a decade of unprecedented economic growth, this second group is larger and more attractive as potential customers. The business of handling and managing personal wealth is growing between 15 to 20 percent each year.<sup>1</sup>

The relative stability of client revenues and the lower level of credit risk is elevating private banking to the top of the financial industry’s list of target markets. The offering of these services is no longer the exclusive domain of large commercial banks. Competitors now include investment banks, thrifts, insurance companies, lawyers and accountants. Not only is it easier to make a profit on the large sums of money involved but private banking customers tend to remain loyal to trusted advisers.

Private bankers are starting to prepare for and cater to, a new generation of private investors who want to participate in the management of their money and receive high returns from diversified investments. The transformation of the client base is forcing private bankers to offer new investment packages and services. Clients want brokerage services, advisory services on investments, stock options, taxes, margin loans and off shore havens. They want quick and easy ways to obtain credit, advice on how to transfer money to family or nonprofit groups, checking accounts and other typical banking services, along with estate planning and trust services. These clients also increasingly want all these services in one place. Private banking has become a place where the wealthy have access to expertise on all lines of financial services as well as an elevated level of personal service. The goal of the private banker is to satisfy the needs and objectives of each client in the context of their life. The private banker not only offers advice on how to create and grow wealth, but also on how to protect, preserve and distribute wealth.

Private banking clients look for advice from people who deal with other wealthy individuals. Rather than having multiple bank representatives deal with a customer, a single private banking representative, commonly referred to as a relationship manager (RM), delivers most, if not all, of the private banking services to the client. The RM is the client’s primary contact and provides a high level of support and service to the client. The RM is generally charged with understanding and anticipating the needs of the client and recommending services and products. The RM strives to provide a high degree of confidentiality, support, service and investment opportunities while maintaining long lasting, strong relationships that provide a stable

<sup>1</sup> The Washington Post, November 26, 2000, H01, “The Private Banking Boom”

stream of fee income to the private banking institution in good times and bad. Because of this close relationship, clients often delegate a great deal of authority and discretion to the RM.

A major concern to the private banking operation is that RMs may take accounts with them if they change employment. Another is the shortage of knowledgeable individuals whose education, sophistication and personality make them successful private bankers. Adapting to the clients' changing expectations and tastes is also a major concern. The new breed of client not only wants expert advice and service but also wants to retain a tight grip. They want to be more directly involved and not just write a check. These clients need legal and financial advisers to not only assist with traditional tax problems, but to advise on nontraditional situations such as whether to take stock or cash during a buyout or whether to use derivatives to hedge against a fall in a stock value.

Traditionally, clients learned of private banking services by word of mouth. As competition for these clients has increased however, financial institutions are using very specific marketing strategies such as seminars, advertising on web sites and in trade magazines and even direct mailings to reach the market. Forming alliances with attorneys and CPA's is proving fruitful as are referral programs with affiliates and retail bankers.

### Overview of Private Banking Products and Services

Private banking accounts may be opened in the name of an individual, a commercial business, a law firm, an investment advisor, a trust or a private investment company (PIC), among others.

Private banking products and services typically combine a wide array of commercial/retail banking services with services offered by the trust department. Some private banking products and services are described below.

#### Deposit Taking Activities

The private banking client's deposit account typically serves as the foundation of the relationship. It usually serves as the conduit for the client's money flow. The client's deposit account minimums and the fees assessed for retail banking services are generally much higher than those for a typical retail/commercial customer, as the private banking client will be provided a higher level of customer service.

Private banking often provides a broad range of deposit services that include check writing, deposit taking, withdrawals and wire transfers. A private banking customer may also need multi-currency deposit accounts if engaged in foreign securities and derivative trading activities involving foreign currency exchanges.

#### Credit Facilities/Activities

Private banking clients frequently request secured or unsecured credit to finance personal and business activities. Credit vehicles may include mortgages, lines of credit, letters-of-credit, bills-of-lading and credit cards.

### Margin Loans

These types of loans are prominent in private banking operations. Margin loans are loans secured by margin stock. Margin stock encompasses equity securities, convertible debt or mutual funds that are registered or have unlisted trading privileges on a national securities exchange, or any OTC security designated as qualified for trading in the National Market System.

OTS chartered banks involved in margin lending are subject to registration and reporting requirements with the Federal Reserve. There may be certain lending restrictions. The Federal Reserve has opined that Regulation U applies to the activities of a bank or thrift when it is acting in its capacity as a trustee. If a savings association extends either \$200,000 in margin loans in any calendar quarter or maintains credit outstanding in any calendar quarter totaling \$500,000 or more, it must file Form FR G-1 with the Federal Reserve. For each credit secured by margin securities, the lender and the borrower must fill out Federal Reserve Form G-3 and the lender must maintain a collateral list for three years after the credit is paid off. The bank must file Federal Reserve Form FR G-4 at the end of each calendar year.

### Funds Transfer

This service involves the transfer of funds from the private banking client to third parties, typically as part of bill-paying or investment services. Transfers are executed on the basis of client instructions.

### Hold Mail

Private banking clients who elect to have financial statements and other documents maintained at the savings association rather than mailed to their personal residence may utilize the private bank's "Hold-Mail" or "No-Mail" services. These services should only be provided when an agreement is in place between the institution and the client that indicates the exact nature of the service and when the client will pick up the mail (at least annually). The "Hold-Mail"/"No-Mail" services may also include the delivery of the client's mail to some prearranged location.

### Investment Management

Private banking typically provides both discretionary and nondiscretionary investment management services. In a discretionary situation, the RM, a portfolio manager from an affiliate or an investment officer of the savings association is assigned the task of managing the private banking client's portfolio. The RM, portfolio manager or trust investment officer buys and sells securities for the client based on established investment objectives that the client has established. For nondiscretionary accounts, the RM, portfolio manager or trust investment officer may render advice to the client or simply act in accordance with instructions received from the client or the client's third-party asset manager. At no time does he have discretionary authority over the client's investments.

### Personal Trust and Estate Services

Trust and estate services may be an integral part of the private banking relationship. The savings association may serve as the executor or administrator of the client's estate or may be appointed by the client to act as trustee under a trust agreement or will for individual or charitable purposes. These relationships are often complex in nature and require special expertise to administer.

### Custody Services

The saving association will also offer custodial services to private banking clients. These services may include securities safekeeping, as well as recordkeeping and accounting for the receipt and disbursement of dividends and interest. In a custodial relationship the client instructs the institution with respect to the assets held and the custodian follows those instructions. The actual ownership of the assets remains with the client.

### Stock Options

Often the private banker is involved with tax planning with regards to the client's current compensation. This is especially true when the client has received large bonuses, awards or golden parachute payments as compensation. The private banker may be asked to lend advice or assistance regarding the tax treatment surrounding the exercise of stock options.

### Web Sites

Savings associations are finding they have to invest heavily in technology to improve their administrative efficiency and provide private banking clients with new ways of receiving information. The client wants information quickly and accurately coupled with good strong advice. A large segment of private banking clients want to use the internet to communicate with their bankers. Managing the blend of technology and old-fashioned personal service is probably one of the most important challenges private bankers face. The level of spending on information delivery through Internet services is not likely to decrease in the near term. Customers will start to shop around if private bankers do not provide the services they demand.

### Payable Through Accounts

The payable through account, commonly referred to as "PTA," is a deposit account through which U.S. banking entities (payable-through banks) extend check-writing services to clients of a foreign bank. The foreign bank, the master account holder, opens a master checking account with a U.S. bank and uses this account to provide customer access to the U.S. banking system. The master account, maintained at the foreign bank, is divided into "subaccounts," each in the name of one of the foreign bank's customers, who may or may not be known to the U.S. bank. Consequently, the U.S. bank may have customers who have not been subject to the same account-opening requirements imposed on its U.S. account holders. These subaccount customers are able to write checks on, and make deposits at the U.S. banking entity. The number of subaccounts permitted under this arrangement is virtually unlimited.

### Private Investment Companies (PIC) and Offshore Trusts

Private investment companies (PIC) and offshore trusts are often used by private banking to serve a client's global needs. These may be "shell" companies or trusts that are established in offshore jurisdictions such as the Cayman Islands, Channel Islands, Bahamas, British Virgin Islands and Netherlands Antilles. They are used to hold the client's assets and to provide confidentiality.

Private banking most often includes the above described services but may include additional services not listed here. All services offered should be governed by written policies and procedures and a strong system of internal controls.

Private bankers must use sound judgment and prudent banking practices, especially when they are assisting clients in establishing offshore vehicles. Establishing and following comprehensive policies and procedures are essential to minimizing the risks inherent in private banking. For example, the institution should

document that it has appropriate know-your-customer policies and procedures. Private banking departments should obtain information on each client and emphasis should be placed on verifying the source of the client's wealth. Policies should indicate the types of clients that the institution will accept and establish the level of authority needed to accept clients.

Client demands are forcing institutions to recognize that they cannot provide the best possible service if they try to do everything themselves. An increasing number are entrusting selected services such as account administration, investment management, custody and transaction processing to outside service providers. This has been one of the most significant developments in the private banking business in recent years. The increasing investment sophistication and the cost of transaction processing and back-office systems can pose an enormous constraint on private banking activities, particularly at smaller institutions. Private bankers are becoming aware that they have to offer the best available products and services even though they may not be from in-house resources. Outsourcing enables them to offer a wider array of products and services without investing vast amounts of capital. Most institutions are finding that costs are increasingly coming under the microscope of top management.

### Management's Responsibilities / Oversight

Senior management of the private banking operation must establish a sound risk management and control environment and establish goals and objectives. They must also provide active oversight and create an appropriate corporate culture. Risk assessments should be an ongoing process and a separate compliance function should be established.

The savings association's board of directors should review the policies and procedures established for private banking on a regular basis. These policies and procedures, at a minimum, should address: know your customer concerns; offering of credit; documentation and due diligence; diversification and concentration accounts; trust and estate administration (including estate and financial planning if those services are being extended); and monitoring and reporting suspicious-activity.

The savings association must also provide for adequate risk management and monitoring systems. Sound private banking operations emphasize information relating to the clients and due diligence where needed to verify information provided by the client or the client's representative. Systems should provide management with timely information necessary to analyze and effectively manage the private banking business, monitor accounts for suspicious-activity and report such activity to authorities as required.

Sound risk management processes and strong internal controls are critical to private banking activities. Management's involvement in ensuring the integrity of these processes has become increasingly important as new products and activities are introduced. The quality of risk-management practices and internal controls should be given significant weight in the evaluation of management and the overall condition of private banking operations. An institution's failure to establish and maintain a risk management framework that identifies and controls the risks associated with private banking should be strongly criticized, especially if the private banking operations are extensive.

The private banking function is exposed to a number of risks, including reputational, fiduciary, credit, legal, operational and market risks. Although effective management of all risks is crucial, reputational risk may have the most profound effect on the bank and its private banking operations. There is a potential that negative publicity concerning the bank's business practices and clients could cause a runoff in the customer base or costly litigation resulting in a large revenue reduction.

An effective compliance program should be developed for ensuring compliance with laws and regulations. Some institutions may have a distinct compliance department for ensuring compliance institution-wide while others may have a separate compliance function within each business line, including private banking.

**RESCINDED**

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# Private Banking Examination Program

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## Examination Objectives

To determine the adequacy and/or effectiveness of the trust department's private banking activities. Consider whether:

- an effective system of policies, procedures and internal controls has been implemented;
- personnel are qualified to effectively administer private banking accounts;
- effective risk management, compliance and audit functions have been implemented; and
- management identifies deficiencies and promptly initiates corrective action.

## Examination Procedures

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### Level I

Level I procedures first focus on a review of the examination scoping materials. The next step consists of interviews with trust department personnel to confirm their qualifications and levels of expertise; to determine if the trust department's practices conform to written guidelines; to establish whether any significant changes in personnel, operations or business practices have occurred; or whether new products or services have been introduced. If items of concern are uncovered during Level I procedures or if problems are identified during the preexamination monitoring and scoping, the examiner may need to perform certain Level II procedures.

1. Review examination scoping materials related to private banking activities. Scoping material should include:
  - Risk profile
  - Relevant PERK documents
  - Previous trust and asset management examination report
  - Workpapers from the previous examination
  - Previous safety and soundness examination report
  - Most recent ADV filed and any amendments

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- Board of director and other committee minutes
  - Examination reports of subordinate, functionally regulated entities
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2. Assess the adequacy of policies and procedures, taking into consideration the range of services being offered to private banking clients and the method of aggregating client holdings and activities across business lines.
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3. Ensure that the trust department has implemented appropriate “know your customer” policies and procedures. Do the policies and procedures consider:
- the purpose and reasons for opening the account;
  - anticipated account activity;
  - source of wealth;
  - estimated net worth;
  - source of funds (description of the origin and the means of transfer for monies that are accepted for the account opening); and
  - references or other sources to corroborate reputation information where available.
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4. Determine whether any new private banking products or services have been introduced. If so, were appropriate policies and procedures implemented?
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5. Are any of these products or services outsourced to third parties or affiliates? If so, are there written outsourcing agreements?
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6. Evaluate how management monitors private banking activities. Assess the reports management regularly receives and determine if they are sufficient based on the level of complexity of these activities.
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7. Evaluate whether management has the knowledge and expertise to manage its private banking activities. Note any significant personnel and/or organizational changes and discuss with management.
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8. Are individuals with expertise managing the relationships, administering the private banking accounts and providing the appropriate products and services?
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9. Review management practices regarding risk assessment, compliance and audit reviews of private banking products and services. Consider whether procedures are in place to cover all activities, products and services, including:
- Depository activities
  - Credit related activities
  - Cash management/wire transfer activities
  - Hold mail services
  - Payable through account services
  - Investment management services

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- Estate, tax or financial planning services
- Custodial services
- Trust and fiduciary services
- Insurance products
- Electronic commerce

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10. Is there a requirement that all new clients and accounts are approved by at least one person other than the private banker?

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11. Are there policies and procedures for updating the client file on a regular basis or when there are major changes?

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12. Are there policies and procedures regarding the privacy of client information in accordance with OTS regulations, including the use of disclosures, where appropriate?

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13. Consider whether the following risk contributors, if applicable, have been addressed:

- Does management fully understand all aspects of risk with respect to private banking?
  - Are the monitoring systems sufficient to handle this line of business?
  - Does the board provide effective oversight?
  - Are outsourcing agreements comprehensive?
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**The completion of the Level I procedures may provide sufficient information to make a determination that no further examination procedures are necessary. If no determination can be made, proceed to Level II.**

### Level II

Level II procedures focus on an analysis of trust department documents, such as reports and outsourcing contracts. The examiner should complete the appropriate Level II procedures when the completion of Level I procedures does not reveal adequate information on which to base a conclusion that the trust department meets the examination objectives. Neither the Level I nor the Level II procedures include any significant verification.

1. Review the results of internal risk assessment, compliance and audit reports and assess compliance with policies and procedures. Discuss any unresolved issues or exceptions with management.  

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2. Do the number of clients or accounts assigned to relationship managers appear reasonable?  

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3. Does the fee structure reflect the services provided for private banking accounts? Are the fees reasonable compared with services offered?  

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4. If offered, does the savings association have adequate policies and procedures for tracking margin loans? Has someone been authorized to ensure Regulation U filings are current?  

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5. Does someone have responsibility for ensuring proper collateral is maintained on margin loans and for contacting the client when additional collateral is required?  

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6. Are proper procedures in place to ensure that all discretionary trust and asset management accounts receive proper investment reviews?

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7. Does the private banker hold regular meetings with the client(s)? Is someone representing the various areas of expertise present at the meetings (i.e. banking, investments, trust, generational planning, insurance, etc.)?

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8. If a company is a client, such as a private investment company, does the private banker understand the structure of the company sufficiently to determine the initial capitalization of the funds received, the principal owner(s) of shares or who has control over the funds?

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9. If the private banker accepts walk-in clients or electronic banking relationships, determine if policies and procedures require a higher degree of due diligence prior to account acceptance.

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10. Is management aware of the risks involved from accepting accounts from high-risk countries, offshore jurisdictions, clients whose wealth emanates from high risk activities, or from individuals who have or have had positions of public trust (i.e. politicians, government officials, important political party officials, etc.).

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11. Is management aware of the legal environment as it pertains to private banking? Has management considered:

- Graham-Leach-Bliley Act
- State Principal and Income Act
- 12 C.F.R. §§563.41 & 42

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- Appropriate SEC & NASD Laws and Regulations
- The Economic Growth and Tax Relief Reconciliation Act of 2001
- State law version of the Uniform Trust Act

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12. Is management sensitive to personnel issues such as commission based versus fee based compensation, licensing, product knowledge training, sales skills and employee supervision?

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13. Are the savings association's accounting and tickler systems adequate to provide management with timely information regarding all areas of expertise necessary to effectively run a private banking division?

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14. Are there written policies and procedures for identifying unusual or suspicious activities? Ensure that the policies include:

- the definition of unusual or suspicious activities;
  - how to identify unusual or suspicious activities;
  - monitoring;
  - reporting;
  - follow-up, analysis and decision making concerning the activity;
  - record retention; and
  - education and training programs.
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15. Are there referral fees and/or revenue sharing arrangements? If so, does management regularly review these arrangements and is applicable law followed in regards to disclosure or other requirements?

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16. Has management ensured that the role of audit and compliance is proactive versus reactive?

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17. Has management entertained offering aggregation for its clients? If so, are the necessary risk and key controls (i.e. security, compliance, vendor management, data gathering and use, contracting, etc.) in place?

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18. If necessary to validate an assertion, finding or concern arising from the completion of the Level I and II procedures, judgmentally select a limited number of accounts for review considering the degree of risk to the institution. Not all types of accounts need to be reviewed to arrive at a well-founded conclusion.

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### Level III

Level III procedures include verification procedures that auditors usually perform. Although certain situations may require that Level III procedures be completed, it is not the standard practice of the Office of Thrift Supervision (OTS) examination staff to duplicate or substitute for the testing performed by auditors.

1. Select a sample of relationships for review. Assess whether adequate documentation exists to establish the identity of clients and beneficial owners.

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2. Perform a detailed file review of depository activities. Consider whether:

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- sufficient identification of clients is required;
- adequate due diligence is performed prior to acceptance of the relationship;
- adequate documentation exists on the establishment of accounts and their continued activities;
- account activities are monitored for potential illegal activities, such as money laundering; and
- appropriate investigation and reporting procedures are in place for suspicious activities.

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3. Perform a review of credit activities. Consider whether:

- applications, disclosure, underwriting and other necessary documentation are maintained;
- underwriting supports the credit decision;
- collateral requirements are met for secured loans;
- appropriate controls are in place and repayment capacity is supported for unsecured loans;
- appropriate loan review and approval process is in place;
- for margin loans, appropriate collateral is obtained and regulatory compliance documented;
- appropriate collection procedures are in place; and
- appropriate loan loss reserves have been established.

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4. Review fund transfer activities. Consider whether:

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- proper authorization and approval documentation exists;
- the recipient has authorization to receive the funds;
- fund transfer activities are monitored to detect unauthorized or illegal activities; and
- appropriate reporting procedures are in place to detect suspicious activities.

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5. Review hold mail activities. Consider whether:

- adequate contracts are established that specify the date the hold mail is to begin and end, the dates the hold mail is to be forwarded and the location for delivery;
- appropriate identification procedures are required for hold mail pickups; and
- items received are reviewed, itemized and held under dual control.

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6. Review payable through accounts. Consider whether:

- similar due diligence efforts are performed for both international and domestic clients;
- evidence exists that accounts are being continually monitored for money laundering and other illicit activities;
- adequate information is obtained and verified about the ultimate users of these accounts. If the information is not obtainable, is the account closed?
- sufficient records and transaction histories are maintained for omnibus or general clearing accounts.

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7. Review private investment companies, offshore and token name accounts. Consider whether:

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- management is familiar with these accounts and the account holders;
- adequate documentation exists with respect to related parties; and
- the accounts are monitored for suspicious activities.

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8. Review the suspicious activity reports (SARs) filed during the review period. If any involve private banking clients, discuss the resolution with management.

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## Examiner's UTRS Rating, Summary, Conclusions and Recommendations:

### References - 740P

#### Laws

Graham-Leach-Bliley Act  
SEC Rules  
State Insurance Laws

#### Code of Federal Regulations

12 CFR 550                      Trust Powers of Federal Associations (General)

#### Office of Thrift Supervision Publications

OTS Memorandum              Enhanced Scrutiny for Transactions That May Involve The Proceeds of Foreign Official Corruption, January 31, 2001  
OTS Thrift Bulletin TB11-1      Purchased Software Evaluation Guidelines, April 20, 1989  
FHLBB Resolution 86-277      Exercise of Trust Powers  
FFIEC Publication              Risk Management of Outsourced Technology Services, November 28, 2000  
Board of Governors, Federal Reserve System  
SR 97-19, Private Banking Activities, June 30, 1997  
Guidance on Sound Risk Management Practices Governing Private Banking Activities, July 1997  
FRB Rule 23 A & B  
FRB Reg U

#### Other

Wolfberg AML Principles,      Global Anti-Money-Laundering Guidelines for Private Banking, October 30, 2000  
OCC Bulletin 2001-12, Bank-Provided Account Aggregation Services, February 28, 2001

### Workpaper Attachments - 740P

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### **Optional Topic Questions**

The following list of questions is offered merely as a tool and reference for the examiner and is not a required part of the examination process. For additional guidance, the examiner should also reference the private banking examination program questions and all other pertinent optional topic questions contained within this handbook.

### ***Know Your Customer***

- Do the saving association's policies and procedures take into account the following components?
  - Obtaining identification and basic background information on the clients?
  - Describing the client's source of wealth and line of business?
  - Requesting references?
  - Handling referrals?
  - Identifying red-flags or suspicious transactions?
  - Corroborating the client's source of wealth?
  - The date of the information?
- Do the policies and procedures require that the type and volume of transactions expected to be passing through the account are compared with actual flows?

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