itm twentyfirst UNIVERSITY

keeping trusts on track

Pre-acceptance Process for Unique and Hard to Value Assets

A Session Specifically Designed for
The ITM TwentyFirst University

Wednesday, February 17, 2016

Presented By:

Richard Jacobs

President

W: pdscompanies.com

This course has been approved for 1 hour of Continuing Education for CTFA (Fiduciary) and CFP®

The Institute of Certified Bankers (ICB), a subsidiary of the American Bankers Association, is dedicated to promoting the highest standards of performance and ethics within the financial services industry. This statement should not be viewed as an endorsement of this program or its provider.

The Pre-acceptance Process for Unique and Hard to Value Assets - An Overview for Each Asset Class
A definition of "pre-acceptance" in the fiduciary context, a survey of the rationale behind the process, a summary of a standard approach and an overview of idiosyncrasies' for pre-acceptance for each asset class in the Unique and Hard to Value Asset category: real estate, loans and notes, mineral interests, and closely held businesses.

The Pre-acceptance Process for Unique and Hard to Value Assets - An Overview for Each Asset Class

- Definition(s)
  - Classic ("Old School")
    - A review of the assets and circumstances of an account to determine its acceptability. – The Author
    - Based on "Reg 9" (prior to the 1997 Revision – Oct 3, 1962, with transfer of authority over national banks to the OCC) and usually required an "asset by asset" and "account by account" review performed within 60 days of the acceptance of an account – Note: This sounds more like an "initial review"
    - Regulatory emphasis on conflict of interest
    - Internal pressure based upon competing agendas
    - Examples of historic audit criteria:
      "Reacceptance guidelines that address environmental and other risks associated with real estate interests"
      "The process and criteria, by which miscellaneous assets are accepted, selected and approved"
      "Documentation to support the acceptance, purchase, ongoing analysis and retention of miscellaneous assets considering the accounts' investment objective, risk tolerance, liquidity needs and tax implications;"
    - For Unique and Hard to Value assets – see "Real World" below
  - Pre-acceptance vs. Initial – Why and how we use these terms interchangeably and are they different?
    - HANDBOOK FOR THE FIDUCIARY ADVISING AND COUNSELING TRUSTEES MARY C. BURDETTE, Calloway, Norris, Burdette & Weber, 3811 Turtle Creek Blvd., Suite 400 Dallas, Texas 75219
      III EVALUATION OF TRUST ESTATE A. Initial Evaluation
      Upon accepting a trust, the trustee must promptly review all trust investments. Although it may take a trustee a significant period of time to fully evaluate all assets and to dispose of assets that are not appropriate for the trust estate to retain, the trustee should perform an immediate review of the trust assets to spot potential problems and to take steps to begin dealing with the problems. In the case of a corporate trustee, the Comptroller of the Currency Regulations require a national bank trust department to "review all trust investments promptly after accepting its appointment and, thereafter, at least once a year." Comptroller of the Currency Regulation 12 C.F.R. Section 9.7(a)(2).
    - FDIC Trust Examination Manual (05/10/05), Section 1 – Management, G.1. New Account Reviews
      The initial review of new accounts for which the bank has investment responsibility should be conducted promptly following acceptance. Industry

practice is to complete the review within 60-90 days of opening. The initial review should establish an investment program consistent with the needs and objectives of the account, and ensure that the synoptic record is complete and accurate

        - OCC UNIQUE AND HARD TO VALUE ASSETS HANDBOOK, 08/2012
          Initial post-acceptance review–12 CFR 9.6(b) and 12 CFR 150.210: Upon acceptance of a fiduciary account for which a bank has investment discretion, the bank shall conduct a prompt review (approximately 60 days after substantial funding of the account) to evaluate all assets of the account to ensure they are appropriate.
    - Legacy & After-discovered assets – More hair splitting (and procedural issues)
    - Discretionary vs. Directed – OCC PERSONAL FIDUCIARY ACTIVITIES HANDBOOK, 02/2015, Account Acceptance
      Pre-Acceptance Reviews
      "The pre-acceptance review is required for all accounts in which the bank acts in a fiduciary capacity regardless of how limited the bank's fiduciary role may be."
        - Legacy & After-discovered assets
        - The "Administrative Review"
    - The "Real World"
        - Common circumstances for U&HTV assets

- The Rationale
    - Regulatory Environment
        - OCC UNIQUE AND HARD TO VALUE ASSETS HANDBOOK, 08/2012, Risk Controls
          Pre-acceptance review–12 CFR 9.6(a) and 12 CFR 150.200: Before accepting a fiduciary account, a bank shall review the prospective account to determine whether the trust department has the resources and expertise to administer the account properly…… This preliminary review process may be used to screen out types of unique assets that the bank has determined it does not want—or does not have the resources—to manage or that pose heightened litigation or reputation risks exceeding the bank's risk appetite. A bank may also decide that certain asset types are too costly to manage and cannot be profitably held in a fiduciary account.
        - OCC PERSONAL FIDUCIARY ACTIVITIES HANDBOOK, 02/2015, Account Acceptance
          Pre-Acceptance Reviews
          12 CFR 9.6(a) requires national banks and 12 CFR 150.200 requires FSAs (Federal Savings Associations) to review prospective fiduciary accounts before accepting them. This review must document whether a bank can effectively administer the account. The bank must determine whether it has the expertise and systems to properly manage the account and whether the account meets the bank's risk and profitability standards. The pre-acceptance review is required for all accounts in which the bank acts in a fiduciary capacity regardless of how limited the bank's fiduciary role may be. A bank that accepts appointment as a directed trustee in which, for example, all investment responsibility is managed by a third party is still obligated to undertake a pre- acceptance review of the account to confirm that the bank has the staff and resources to administer the account. When a bank is only acting as trustee without investment management

responsibilities or discretion for an account, and the account is poorly managed, the bank may still face reputation risk based on its duties to properly administer the account.

Early identification of risk helps the bank control the amount of risk it accepts and enables the bank to price that risk properly. Bank policies and procedures should provide guidance on the types of fiduciary accounts that are desirable and should define specific conditions for accepting new accounts. A bank should adopt and implement procedures to ensure compliance with its account acceptance policies. These include procedures designed to identify potential Bank Secrecy Act of 1970 (BSA) and anti-money laundering (AML) issues. The Federal Financial Institutions Examination Council's *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual* provides a comprehensive overview of the BSA and AML areas, and a bank's pre-acceptance review process should include consideration of these risks. The bank should establish a due diligence process for reviewing each prospective account. The due diligence process should consider applicable risk management issues and ensure compliance with the bank's policies and procedures. The results of an account's due diligence review should be documented and recorded in the appropriate bank file.

Consistent with 12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs, the assets used to fund a personal fiduciary account must be reviewed by the bank as part of the pre- acceptance review process to determine whether it can properly administer the account. The bank must not accept an account that holds assets beyond the skill and expertise of the bank's staff to properly administer. The bank must acquire the appropriate expertise before accepting the account or it should decline the appointment. ***The bank should carefully review assets that are more likely to be illiquid, such as real estate, family businesses, oil and gas properties, foreign assets, and art (emphasis mine).*** Refer to the "Unique and Hard-to-Value Assets" booklet of the *Comptroller's Handbook* for additional information regarding pre-acceptance reviews of accounts holding illiquid or difficult-to-value assets.

- Why you should be doing it – 1. Risk Management
    - Horror stories
    - The opportunity to provide alternate solutions and add value for your client – segregation of assets, alternate packaging.
    - Who was your predecessor?
    - Beware the DE Trust – You still need a review
- Why you should be doing it – 2. Imposition of Corporate Vision and Policy
    - Start from the top and provide clear guidelines – emphasis on process
    - "This preliminary review process may be used to screen out types of unique assets that the bank has determined it does not want…." U&HTVA Handbook
    - Bending the rules
- Why you should be doing it - 3. Profitability – What they are saying by not saying it….
    - FDIC Trust Examination Manual (05/10/05), Section 1 – Management, C.1.a. Acceptance of New Accounts: "Management should delineate standards for the acceptance of new business to control potential risks. The standards should define criteria for accepting or declining new business, given management's

administrative capabilities. The ability of the trust institution's staff, systems, and facilities to handle the proposed duties must be considered, when accepting new accounts. Other areas for consideration include, but are not limited to: …

Profitability.

Examiners should note that the acceptance of an unprofitable account should not be necessarily viewed as unfavorable. Unprofitable accounts may be accepted for a number of reasons including, but not limited to: other related accounts which, when viewed as a whole, are profitable; major commercial bank relationships; pro-bono appointments for charitable or other worthy causes, etc. Fee concessions for director, officer, and employee accounts may be acceptable, if offered on a non- discriminatory basis and under well-defined policies."

  - Why you should be doing it – 4. Compatibility – The "Investment Policy" problem
    - Internal conflict
    - The "legacy asset" issue
- The Standard (Generic Approach)
  - Areas of concern
    - The OCC "Big 4" (excerpts from OCC PERSONAL FIDUCIARY ACTIVITIES HANDBOOK, 02/2015)
      Compliance Risk – "inherently high"
      Operational Risk – "…can be substantial"
      Reputation Risk - "…also high"
      Strategic Risk – if you try anything new "…can increase"
    - You can't leave U&HTV assets out - OCC BULLETIN 2008-10 Annual Reviews of Fiduciary Accounts Pursuant to 12 CFR 9.6 (c) 3/27/08
    - Asset Class Risk – RE vs. Oil and Gas vs. Loans , etc…
    - Evidence of Ownership
    - Value
  - Format
    - When U&HTV assets are included or excluded
    - "Check the Box" answers
    - Recommendations
- Mineral, Oil and Gas – Key Points & Idiosyncrasies
  - Evidence of Ownership
    - This is real property!
    - Deeds, Assignments and Probate
  - Valuation
    - Why you'll never have this…
    - The OCC and "Informal Opinion of Value" or the DYI method
  - Inspection
  - Risk Analysis
    - Working Interests
    - Royalty and Mineral Rights
  - Dormancy Statutes
- Closely Held Business - Key Points & Idiosyncrasies
  - Evidence of Ownership

        - Assignments / Operating and other Agreements
        - Tax documentation
    - Valuation
    - Risk Analysis
        - Business Type – Purpose
        - Jurisdiction of Formation & Current Standing
        - Control
    - Risk Analysis
        - Majority Ownership / Board of Directors
        - Minority
- Real Property - Key Points & Idiosyncrasies
    - Evidence of Ownership
        - Ownership and encumbrances
        - Deeds, Assignments and Probate
    - Valuation
        - Appraisers – who to trust and what certifications
        - Deeds, Assignments and Probate
        - Brokers Opinions, Tax Values and the internet
    - Inspection
        - The Drive-by
        - Interior
        - Farms and Ranches
        - Complex (commercial, multi family, retail, etc.)
        - Vacant land
    - Property Tax and Insurance
    - Risk Analysis
        - Environmental
        - Ag & Commercial/Retail
- Loans, Notes & Mortgages - Key Points & Idiosyncrasies
    - Evidence of Ownership
    - Valuation
    - Risk Analysis
        - Pay Status
        - Security / Foreclosure

About ITM TwentyFirst University

ITM TwentyFirst University was created to provide those individuals working with personal trusts and TOLI trusts a source of vital information to utilize in their practice. The course topics will include real life case studies that can be applied to day to day situations. Subject matter is designed to help Advisors provide better guidance and assistance to clients. Our faculty consists of sought after presenters who are experts in their related fields. The courses are offered for free and will carry Continuing Education (CE) credits. *See specific courses for CE listings.*

2016 Course Schedule - Free CFP® & CTFA CE Credits

Self-Directed IRAs: Proceed with Caution and Confidence

Jean Meyer, President, Mainstar Trust
– Formally: First Trust Company of Onaga (FTCO)
Tuesday, March 1, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

Self-directed IRA's have become one of the nation's retirement essentials. Understanding how to administer them is a hot topic among Advisor's and Trustee's. Managing and administering this asset can be tricky, but with the information in this session you will be able to move ahead with confidence. This is a session many have asked for and we are lucky to have an expert in Self-Directed IRA's leading it.

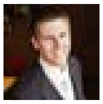
Buying and Selling Specialty Assets

John Rowland, Portfolio Manager, PDS Services
Wednesday, March 16, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

This webinar will explore when is the right time and method to sell a specialty asset and what types of special assets to buy to increase cash flow. It will also discuss how to prudently invest the trust property to make it productive for the beneficiaries and when an asset becomes a cash liability rather than a viable money making asset for the trust.

Developing a Compliant and Efficient Trust (ILIT) Administration Process



Jason Hassman, Client Relationship Manager, ITM Twenty First
Thursday, March 31, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

Putting an efficient and compliant process around the administration of personal trusts is no easy task. But with logical procedures to follow the task becomes much easier. This session will provide the Trustee or Advisor with the actual process developed and proven for personal trusts, with an emphasis on life insurance trusts, one of the more complex trusts to administer. The session, delivered by a specialist in personal trusts, will provide the framework for success for those professionals working in this market.

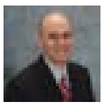
Pitfalls of Operations/Management of Specialty Asset

Kip West, Chief Operations Officer, Brenda Trevino, Operations Manager, Brett Helweg, Portfolio Manager, PDS Services
Wednesday, April 20, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

Unlike some asset classes, specialty assets can be a major headache for the operations and administrative staff of any fiduciary organization who does not have a separate special assets division or outside service provider. This webinar explores the pitfalls and handling of unique situations the assets create including revenue/expense processing, valuations, tracking timed events and ensuring all the boxes are checking according to your compliance requirements.

Beyond Ratings: An Alternative Approach to Analyzing Life Insurance Financial Strength

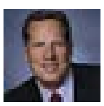


David Paul, Principal, ALIRT Insurance Research
Wednesday, May 4, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

Trustees and advisors need to better understand the financial strength of life insurance carriers in this low interest rate environment we are in. The market crash of 2007 and the quick credit worthiness drop of AIG pointed out this lesson to all. Past life insurance debacles, like Executive Life and the more current struggles of Phoenix Life and Conseco have shined a light on carrier financials strength as an area that Trustees and Advisor's should be aware of. This session will provide the professional with a much greater understanding of gauging carrier financial strength and provide an insight inside carrier financials that, to this point, probably was not seen or understood.

How to Make Sure Your TOLI Policies Are Competitive

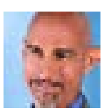


Michael Brohawn, CFP®, CLU®, Managing Partner, ITM TwentyFirst
Wednesday, May 18, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

Many TOLI Trustees struggle to understand the concept of life insurance policy competitiveness, one of their responsibilities. This session will show the steps that need to be put in place to create a program to document the competiveness of policies and how to deal with noncompetitive policies, including proper documentation to mitigate Trustee liability. We will also provide actual case examples to bring the process to life.

10 Questions Every Trustee or Advisor Should Ask Before a Client Purchases or Continues a Life Insurance Policy



Barry D. Flagg, CFP, CLU, ChFC, GFS, Veralytic, Inc.
Thursday, June 2, 2016 at 2pm EST
• 1-HR CE For CFP® & CTFA (Financial Planning)

Register Here

This presentation will provide Trustees and Advisor's with practical questions to ask before the purchase or continuation of any life insurance product in order to reconcile the difference between prevailing life insurance industry practices designed to sell a policy versus proven Prudent Investor principles designed to manage life insurance as an asset pursuant to the client's best interests. It is provided by an industry expert and one of the architects of the Best Practices for Life Insurance Stewards.

Meet The ITM TwentyFirst University Faculty Team

Jason Hassman - ITM | TwentyFirst
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TOLI Policy Management

Michael Brohawn CFP®, CLU - ITM | TwentyFirst
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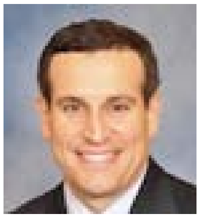
TOLI Policy Management



Jon B. Mendelsohn - Ashar Group
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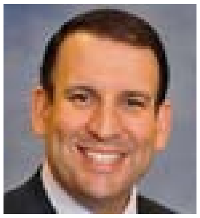
Life Settlement,Longevity, and Secondary Market Valuation (SMV®) Specialists



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Best Practices Standards for Life Insurance Stewards

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Hard to Value Asset Valuation and Consulting

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Hard to Value Asset Management & Recordkeeping

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