



Pre-acceptance Process for Unique and Hard to Value Assets

Presented By: Richard Jacobs, President – PDS Services





Upcoming Webinars

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

Buying and Selling Specialty Assets

John Rowland, Portfolio Manager, PDS Services
Wednesday, March 16, 2016 at 2pm EST

Developing a Compliant and Efficient Trust (ILIT) Administration Process

Jason Hassman, Client Relationship Manager, ITM Twenty First
Thursday, March 31, 2016 at 2pm EST

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

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

David Paul, Principal, ALIRT Insurance Research
Wednesday, May 4, 2016 at 2pm EST



Pre-acceptance Process for Unique and Hard to Value Assets

Richard Jacobs

President, PDS Services



Wednesday, February 17, 2016 at 2pm EST
1 Hour CE credit for CFP and 1.25 Hour CE
credit for CTFA (Fiduciary)



Purpose

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.



In Summary

In Africa I shot an elephant in my pajamas. How he got in my pajamas I'll never know.

-Groucho Marx



Why is this important?

Fact #1:

This year 1783 members of the “baby boom” generation will die a day.

In 10 years that will increase to 3,186 a day.

The Baby Boom Cohort in the United States: 2012 to 2060 Issued May 2014 P25-1141 By Sandra L. Colby and Jennifer M. Ortman Current Population Reports Population Estimates and Projections



Why is this important?

Fact #2:

Based on IRS statistics we project \$20 billion dollars of wealth in Estates in 2015.

50% of that \$20 billion comprised of real estate, small business and miscellaneous assets including oil and gas and tangibles.



Why is this important?



A review of the assets and circumstances of an account to determine its acceptability.

– The Author





Definition(s)

*OCC PERSONAL FIDUCIARY ACTIVITIES
HANDBOOK, 02/2015, Account Acceptance
Pre-Acceptance Reviews*

“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.”



Pre-acceptance vs. Initial

Why a four year old child could understand this. Run out and get me a four year old child, I can't make head or tail out of it.

-Groucho Marx



Pre-acceptance vs. Initial

While they may cover the same ground, with the same ultimate goal, these are two processes differentiated by the event of acceptance.



Pre-acceptance vs. Initial

*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.

*OCC UNIQUE AND HARD TO VALUE 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.



Discretionary vs. Directed

OCC UNIQUE AND HARD TO VALUE HANDBOOK, 08/2012

Initial post-acceptance review—12 CFR 9.6(b) and 12 CFR 150.210:

“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.”

Delaware Directed Trusts – Statutes in 41 States Robert M. Weylandtt, HOUSTON BUSINESS

& ESTATE PLANNING COUNCIL November 19, 2015.

Licensed in DE – State of DE Office of State Banking Commissioner

9 National Non-Deposit Trust Companies

8 State Non-Deposit Trust Companies

25 State Limited Purpose Trust Companies



The Regulatory Environment

Those are my principles, and if you don't like them... well, I have others.

-Groucho Marx



The Regulatory Environment

The Key Sources:

OCC UNIQUE AND HARD TO VALUE
HANDBOOK, 08/2012

OCC PERSONAL FIDUCIARY ACTIVITIES
HANDBOOK, 02/2015

The devil is in the details –

- Pay attention to “account” vs. “asset”

- The emphasis on conflict, BSA, AML

- The reference to environmental issues

- “Skill and expertise”

- Process, Process, Process



Why You Should Do It #1

Room service? Send up a larger room.

- Groucho Marx



Why You Should Do It #1

Risk Management:

- It will never get easier
- The chance to add value and do the right thing
- Reliance on your predecessor
- Don't forget conflict
- Beware the DE Directed Trust



Why You Should Do It #2

Imposition of Corporate Vision and Policy:

- Comes from the top
- Ability to shape the outcome
- Emphasis on “process”



Why You Should Do It #3

Profitability:

- The Regulators want it:
“A bank may also decide that certain asset types are too costly to manage and cannot be profitably held in a fiduciary account.”
OCC UNIQUE AND HARD TO VALUE ASSETS HANDBOOK, 08/2012
- Understanding your fee structure
- A fee analysis of the asset
- “This is not an eleemosynary organization” – former tyrannical boss of the Author



Why You Should Do It #4

Compatibility:

- “Internal conflict” or “who gets the bonus”
- Addressed in the “Initial Review”
- The problem with the “legacy asset”





The Standard Approach

Otis B. Driftwood (Groucho): It's all right, that's in every contract. That's what they call a sanity clause.

Fiorello (Chico): Ha ha ha ha ha ha ... you can't fool me. There ain't no sanity clause!

-A Night at the Opera



The Standard Approach

The OCC’S “Big 4” (and their assessment of level of risk that a fiduciary brings to the entire institution for each):

- Compliance Risk – **“inherently high”**
- Operational Risk – **“...can be substantial”**
- Reputation Risk - **“...also high”**
- Strategic Risk – if you try anything new **“...can increase”**

Emphasis mine

Keep in mind this is their starting point !



The Standard Approach

Some more stuff that you need to know:

- What the asset is (seems simple – it may not be)
- How much you will own
- How are you are going to get title
- How much is it worth



The Standard Approach

U&HTV Assets must be analyzed and an opinion provided.

OCC UNIQUE AND HARD TO VALUE ASSETS HANDBOOK,
08/2012

Initial post-acceptance review—12 CFR 9.6(b) and 12 CFR
150.210:

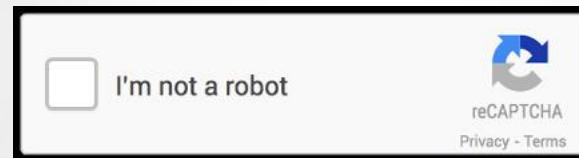
“Consistent with 12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs, the assets used to fund a personal fiduciary account must be reviewed by the bank as part of the pre-acceptance review process to determine whether it can properly administer the account”.



The Standard Approach

Format – It's important

When to use a check box and when not to...



Narrative – why its important to everyone.

Recommendations.....



Breaking it Down by Asset Type

From the moment I picked your book up until I put it down I was convulsed with laughter. Some day I intend reading it.

-Groucho Marx



Mineral, Oil and Gas Interests

Evidence of Ownership – This is real property!

You will need deeds, assignments and/or Bills of Sale from the predecessor recorded in the county of situs.

In some jurisdictions (Texas for example) there are shortcuts using probate documents

Beware 3rd generation trusts!

Valuation – Good luck with this!

The cost for a formal valuation & the opaque market

The OCC Handbook and the Informal Opinion of Value DYI method



Mineral, Oil and Gas Interests

Inspection – When it is important

- Reduced risk of mineral and royalty interests
- Parsing the working interest risk
- The OCC U&HTV weirdness

Risk Analysis – Mineral/Royalty Interest vs. Working Interests

- Protected class vs. a GP
- Mining Claims and Mines



Closely Held Businesses

Word of Warning – This asset class, comprised of small corporations (C & S), LLC's LP's, LLP's, PLP, Alternative Assets (Hedge Fund interests), GP's and FLP's is exploding in popularity among Estate Planners.

- You can wrap anything from a money laundering scheme to a Chipotle franchise in a CHB

Evidence of Ownership

- Assignments, Operating Agreements and “Handshake” agreements
- Tax documentation, from the Entity and the Owner

Valuation

- Internally produced
- 3rd Party and Tax Docs (the K-1)



Closely Held Businesses

Risk Analysis – Type of Enterprise

- Environmental Risk Analysis (the list of suspect industries)
- Potential BSA / AML & conflict issues

Risk Analysis – Jurisdiction & Current Standing

- Verification of “Good Standing”
- Transparency of Regulating Authorities (from DE to KY)

Risk Analysis – the Trust’s Position

- Type of entity (limited liability)
- The Trust’s ownership position (%)
- The Board of Directors of Managing Member

Risk Analysis - Contributing Factors

- Litigation / Regulatory Action
- The family and the investment horizon



Real Estate

Evidence of Ownership

- In the county of situs
- Do not forget encumbrances

Valuation

- The OCC U&HTVA Handbook and the DYI method
- Vetting an appraiser
- Broker's Opinions, Tax Values and the Internet

Inspections

- The "drive-by" has become the industry standard
- Use of the appraisal for interior
- Why a specialist is preferable on farms, ranches and vacant land
- How far to go on "complex" real property

Impending Action

- Market moves and the investment horizon



Loans, Notes & Mortgages

Evidence of Ownership

- DoT's and Assignments
- Do not forget encumbrances

Valuation

- Seems easy – but do the math
- Position vs. Value

Risk Analysis

- Pay status
- Security type
- Foreclosure
- Family involvement



One Last Quote

I intend to live forever, or die trying.

-Groucho Marx

Thank You

