



# 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:

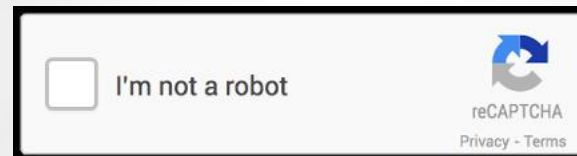
“Consistent with 12 CFR 9.6(a) for national banks and 12 CFR 150.200 for FSAs, the assets used to fund a personal fiduciary account must be reviewed by the bank as part of the pre-acceptance review process to determine whether it can properly administer the account”.



## 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 3<sup>rd</sup> 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
- 3<sup>rd</sup> 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

