2019 FALL FORUM

SOUTH DAKOTA
TRUST ASSOCIATION

OCTOBER 17-18

Sioux Falls Convention Center

Presented by The South Dakota Trust Association

October 14, 2019

Dear SDTA Members:

It's hard to believe that this year we kick off our fifth membership drive for the South Dakota Trust Association ("SDTA"). Our goal is to have an association that represents all disciplines impacted by the trust industry of South Dakota. As the trust industry continues to evolve our goal is to have an association that is proactive in marketing/branding, lobbying/trust law protection, education and philanthropy. These goals continue to be the tenets of our foundation.

In order to make a trade association work, we need people of a like mind to come together to unite for a cause that is well funded and has an active presence.

What have we accomplished?

- We completed in conjunction with Lemonly – a marketing services company located in Sioux Falls, a survey of all of the South Dakota trust companies, to better gage the overall economic impact the trust industry has had on South Dakota from employment to indirect beneficiaries like the hospitality and travel industry. We have attached a copy of the report so you can see first-hand what the trust industry means to South Dakota.
- SDTA successfully raised over $130,000 from our members as well as trust associations in Nevada, Tennessee, Delaware and New Hampshire to participate in the filing of an Amicus brief in the Supreme Court case *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, 588 U.S.- (June 21, 2019). The brief was filed with the United States Supreme Court. The Court recently unanimously upheld lower court findings that North Carolina's income tax imposed on the Kaestner Trust violated the Due Process Clause. Though the case is fact specific, we view it as a win for jurisdictional planning and hence South Dakota and the state's trust industry.
- We again hosted a very successful Cocktail hour at the 53rd annual Heckerling Institute in Orlando FL, where we had over 300 attendees join to learn about the advantages of SD trust law.
- We will hold our third Fall Forum in Sioux Falls where we expect over 100 members and other participants from around the country to come to Sioux Falls for a day and a half conference on topics related to South Dakota trust laws.
- Dakota Wesleyan University became the first university to implement a trust certificate program for graduate students. The program launched in January 2019. The first 6 graduates from the program will receive their certificates in December. This program has been approved by the American Bankers Association. As a result of Dakota Wesleyan's commitment to the trust industry, other schools in the state have shown an interest in creating similar programs.
- SDTA members were given an opportunity to participate in a legislative reception in Pierre where they had an opportunity to tell the South Dakota Trust story to state legislators from across the state as well as share our Lemonly survey with them.

- The SDTA established a donor advised fund (Trust for the Future Fund) at the South Dakota Community Foundation to facilitate grantmaking to nonprofits around the state as part of the association's philanthropic efforts.
- Lastly, we have held several webinars on various trust related topics for all members to join.

What does 2020 hold?
In January 2020, we will once again host an event at Heckerling under the South Dakota Trust Association banner. The 54th Annual Heckerling Institute will take place on January 13-17, 2020 at the World Center Marriott in Orlando. The South Dakota Trust Association will host a cocktail and hors d'oeuvre hour Wednesday January 15th at 5:45 pm. As a member of the SDTA you will be able to participate in this event, be part of the pre-conference marketing as well as have a table at the event to present your company's marketing materials. If you are interested in participating now is the time to sign up. The cost to participate is $2,500.

In February 2020, we are planning a Legislative event in Pierre. This event is a meet and greet with our state legislators. In addition, our legislative committee has engaged a lobbyist to represent the Association. This committee has recently formed a study group on blockchain and cryptocurrency to determine if SD needs to be proactive in changing its trusts laws to accommodate this new and growing sector.

Our education committee will continue its outreach to state and local universities to cultivate the future of the industry.

The Philanthropy Committee will determine the second round of Trust for the Future grant recipients and communicate that information to the membership. They will also be posting to the SDTA website additional information regarding volunteer opportunities in the areas of food security and programs for children and youth that members can engage in, whether individually or as a firm.

Lastly the Marketing and Outreach committee will build upon the success of this year's Fall Forum and hope to make it even bigger and better next year.

Will you consider joining?
Annual fees for 2019-20 are $1,000. Fees are the same for all organizations. Annual dues will go toward filling our goals as stated above.

Enclosed you will find membership form or an alternative way to register is by going to the website at www.sdtrustassociation.org where you can use PayPal to pay by credit card. Should you have any questions feel free to contact Angie Kuiper – Executive Assistant to the SDTA at 605-743-0927 or via email at angie@sdtrustassociation.org.

SOUTH DAKOTA
TRUST ASSOCIATION

We hope you will consider joining us to keep South Dakota strong!

Sincerely

Antony Joffe
President – Sterling Trustees

Jessica Beavers
SVP – Sawmill Trust Company

Mary Akkerman
Counsel – Ballard Sphar

Pat Goetzinger
Partner – Gunderson Palmer

Matt Tobin
Vice President – SDTC

Mike Dea
President – Equity Trust

Joel Black
Managing Director – First Trust Company

Matt McMillen
VP – Dorsey & Whitney Trust Company

SOUTH DAKOTA
TRUST ASSOCIATION

Company Name: _____

Company Representative: _____

Company Address: _____

Company City, State, ZIP: _____

Phone #: _____ Email Address: _____

List names of everyone at your organization that should receive emails from the SDTA:
Name:
Email:

Name:
Email:

Name:
Email:

Name:
Email:

Name:
Email:

My Company wishes to:

Join South Dakota Trust Association ☐ $1,000

Participate as a Sponsor at SDTA Reception at the 2020 Heckerling Institute ☐ $2,500
*You must Join as a member in order to participate in Heckerling
(please make your check to the South Dakota Trust Association)
Amount Remitted: _____

Our firm would like to make a donation to the Trust for the Future Fund ☐ $_____
(please make your check to the South Dakota Community Foundation)
Amount Remitted: _____

All Checks should be mailed to:

South Dakota Trust Association
PO Box 91222
Sioux Falls SD 57109

2018-2019 SDTA Directors

ANTONY JOFFE

Antony Joffe is the President of Sterling Trustees and manages Sterling's day-to-day activities, including operations, compliance, sales and marketing. He previously was president of a Pennsylvania-chartered trust company and spent 15 years in the financial services industry, working with emerging growth companies to complete public and private equity offerings, mergers and acquisitions transactions, valuations and other financial advisory work. As a principal at NY-based Bryant Park Capital, he helped establish the firm's Philadelphia office and was also a principal at FB Capital Partners, a $500 million private equity fund. A CPA, Antony has worked in the investment banking group of Janney Montgomery Scott and as an auditor in the Business Advisory Group at Coopers & Lybrand. He earned his MBA in finance from Temple University and his bachelor's degree in accounting from Emory University.

JESSICA BEAVERS

Jessica Beavers is Senior Vice President of Sawmill Trust Company. She is a founding Director of the South Dakota Trust Association, where she currently leads the initiatives for the Education Committee. She has twenty plus years of prior banking and trust administration experience. She is a Certified Trust and Financial Advisor (CTFA) and a Certified IRA Services Professional (CISP), having received these designations after satisfying the professional and educational requirements of the Institute of Certified Bankers.

On a national level, Ms. Beavers is a leader in the American Bankers Association (ABA), currently serving as the Chair to the Advisory Board Member of the ABA's Trust School Programs. She has previously participated as a CTFA Advisory Board Member to the Institute of Certified Bankers and on the ABA Trust Letter Advisory Board.

Ms. Beavers earned a BA degree and a Master's of Business Administration from the University of Sioux Falls.

PAT GOETZINGER

Pat is a partner in the Rapid City law firm Gunderson, Palmer, Nelson & Ashmore, LLP, where he leads the firm's Business and Estate Planning Group and serves on the firm's Executive Committee. He practices in the areas of business and estate planning with a focus on family run businesses, affluent individuals, business transactions, and real property law. Pat's practice has expanded to include service as a mediator, expert witness and court appointed fiduciary on business, trust and estate matters.

Pat serves on the American Bar Association Board of Governors, is past President of the South Dakota State Bar Association, and the South Dakota Bar Foundation, a Fellow in the American College of Trust and Estate Counsel (South Dakota State Chair), and a Fellow in the American College of Real Estate Lawyers. He is listed among the Best Lawyers in

America, Great Plains Super Lawyers, and Chambers USA High-Net-Worth 2018 rankings, America's leading Lawyers for Business in the categories of Corporate/Commercial Law and Real Estate Law, and Private Wealth Law.

Through his service to the State Bar Association and the Governor's Task Force on Trust Reform and Administration since its inception in 1997, Pat has been actively involved in drafting and supporting the enactment of trust and business legislation in the South Dakota Legislature.

Pat's desire to give back to his profession and the state is demonstrated by being the founder of Project Rural Practice, an initiative to restock rural main streets with attorneys and improve access to justice in rural areas. Pat especially enjoys the connection to the Black Hills & the Mount Rushmore National Memorial provided by his lifetime membership in the Mount Rushmore Society.

MIKE DEA

Mr. Dea has over 30 years of experience in the financial services industry. He has held multiple leadership positions at a number of banking institutions, most notably at Key Bank, where he was Commercial Real Estate Group Managing Director, Chief Financial Officer of the Corporate and Investment Banking Group, and Senior Vice President of Corporate and Investment Banking. Mike earned a BS in Accounting and an MBA from Kent State University.

MATTHEW TOBIN

Matthew Tobin is the Managing Director of the South Dakota Trust Company, LLC. His primary responsibilities include legislation management, special projects administration, new client/business development, general office administration, and development and management of the Private Family Trust Company business. Mr. Tobin was formerly a member of the law firm Siegel, Barnett & Schutz, LLC. where his private law practice focused on general and business litigation. He also received considerable experience in negotiations, mediation, and alternate dispute resolution. Prior to joining Siegel, Barnett & Schutz, Mr. Tobin was a partner in the law firm of Johnson, Heidepriem, Miner, Marlow & Janklow, LLP.

Mr. Tobin attended St. John's University in Collegeville, Minnesota, and received his Bachelor of Arts degree in 1994 with an emphasis in political science / government and economics. After college, Mr. Tobin spent approximately two years working for United States Senator Thomas Daschle. Mr. Tobin worked for Senator Daschle in Washington, D.C. and in the field office in Sioux Falls, South Dakota.

Mr. Tobin attended the University of South Dakota School of Law and received his Juris Doctor in 1998. While in law school, he received the Cali Award for Excellence, was a member of the Dean's List, was a member of the Moot Court Board, and served as the director of the R.D. Hurd Volunteer Law Society. After graduation from law school, Mr. Tobin served as a law clerk for the Honorable Roger Wollman, Chief Judge, U.S. Court of Appeals, Eighth Circuit, from 1998 to

1999. He is a member of the American Bar Association, State Bar of South Dakota, the Association of Trial Lawyers of America and the South Dakota Trial Lawyers Association.

Mr. Tobin is married (Tara) and enjoys spending time with his wife and children. He also enjoys sports, traveling, hunting, golf and coaching youth hockey.

MATTHEW MCMILLEN

Matthew McMillen is Vice President and Chief Trust Officer of Dorsey & Whitney Trust Company where he manages the trust administration and trust tax services departments while working with clients, attorneys and other advisors. As a CPA, Mr. McMillen has over 20 years of industry experience. He holds a B.S.- Accounting degree from the University of Wisconsin and a Master of Taxation degree from the University of Minnesota. He is also a graduate of the ABA Trust School program and Certified Trust and Financial Advisor (CTFA).

JOEL BLACK

Joel Black is the Managing Director of First Trust Company, LLC. Joel has over 30 years of experience in senior management or C-level positions across a broad spectrum of financial services, from publicly held to privately owned entities in both the for-profit and nonprofit sectors. Most recently he served as Chief Operating Officer for the Wealth Management Group at U.S. Bancorp. Joel holds a B.A. degree from Dakota Wesleyan University, an M.B.A. in Finance from the Carlson School of Management at the University of Minnesota, and has done doctoral work in business administration at Metropolitan State University. He is a Certified Trust and Financial Advisor (CTFA) and member of the West River Estate and Financial Planning Council.

MARY AKKERMAN

Mary Akkerman is counsel at Ballard Spahr, LLP where she guides clients through all aspects of fiduciary representation and estate planning, including dynasty trusts, domestic asset protection trusts, estate and trust administration, guardianships and conservatorships, business and tax planning, estate and gift tax planning, tax appeals, and related litigation. Mary is skilled at establishing public and private trust companies in South Dakota and regularly works with U.S. and international families and advisors on cross-border planning, non-resident alien trust formation, and international tax issues.

She was elected to the American College of Trust and Estate Counsel (ACTEC), a national organization of approximately 2,600 lawyers elected to membership by demonstrating the highest level of integrity, commitment to the profession, competence, and experience as trust and estate counselors. Her experience includes:

- Obtaining state charters for private family trust companies for ultra-high net worth families and assisted in formation of trust company entities, policies and procedures, and trust administration matters
- Regularly representing trustees in defense of high-stakes cases involving fiduciary claims

- Regularly representing interested parties in contested trust, estate, guardianship and conservatorship matters

Mary is also a member of the firm's Diversity Council.

American Bankers Association

South Dakota Trust Association Fall Forum

October 17, 2019

Phoebe A. Papageorgiou
American Bankers Association

Current Areas of Focus for ABA

- Congressional Developments
  - Retirement Legislation
  - Cannabis Banking: SAFE Banking Act
- Federal Regulatory Guidance
  - Financial Institution Standard of Care
  - Custody of Assets
  - Customer Due Diligence
- State Law Developments
  - Uniform Laws
  - Fiduciary Duties
  - Cannabis Legalization

Retirement Legislation

- Focus on retirement bills:
  - S.972: *Retirement Enhancement and Savings Act* (RESA)
  - H.R. 1994: *Setting Every Community Up for Retirement Enhancement Act* (SECURE) – Passed the House
  - S. 1431: *Retirement Security and Savings Act*
  - *IRA Preservation Act* – to be introduced

- Non-Spousal Inherited IRA Accounts
  - RESA: funds constituting decedent's retirement assets above $400K must be distributed in 5 years.
  - SECURE: all funds must be distributed within 10 years.

- IRA Preservation Act: IRS Employee Plan Compliance Resolution System (EPCRS) expanded to include IRAs

Cannabis Banking

- Growing industry on state level:
  - Legal for recreational adult use: 10 states & DC
  - Legal for medical purposes: 33 states

- Financial Institution Client Issues:
  - Cannabis-business investments
  - Cannabis businesses as real estate tenants
  - Trust disbursements for medical purposes
  - Employee benefit plans for cannabis businesses

Cannabis Banking: *SAFE Banking Act* (H.R. 1595)

- Bill introduced in Congress would prohibit federal banking regulatory from:
  - (1) limiting deposit insurance solely because institution provides financial services to a legitimate marijuana-related business;
  - (2) prohibiting or discouraging banks from offering financial services to such a business or persons affiliated with the business;
  - (3) taking any adverse supervisory action on a loan made to a person solely because the person either owns such a business or owns real estate or equipment leased to such a business.

- As specified by the bill, a depository institution shall not, under federal law, be liable or subject to forfeiture for providing financial services to a legitimate marijuana-related business.

SEC Regulation Best Interest

Broker-Dealers (BDs) must with respect to "retail customers":

- Disclosure: Material facts and conflicts.
- Care: Reasonable diligence, skill, and prudence to understand product and that it's in customer's *best interest*.
- Conflicts of Interest: Policies designed to identify and at a minimum disclose or eliminate conflicts of interest:
  - Material limitations on product offerings (e.g., proprietary only products)
  - Sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period.

- Final Rule: July 12, 2019, effective June 30, 2020

SEC *Form CRS* for Retail Investors

BDs and RIAs must deliver before a recommendation is made, an account is open, or a trade executed *Form CRS*:

- Contains information about services, fees and costs, conflicts of interest, legal standard of conduct, and existence of any individual or firm disciplinary history.
- May contain layered disclosure for additional information from the firm about above topics.
- Highlights SEC investor education website, *Investor.gov*.

Note: Retail Investor/Customer does not include bank fiduciary or advisory clients.

What About Department of Labor?

- After DOL Fiduciary Rule vacated by 5th Circuit in 2018, DOL coordinated with SEC on Reg Best Interest
- DOL expected to propose a new Fiduciary Rule and that would be potentially "aligned" with SEC's Reg BI
- What will future DOL guidance look like?
  - One or more prohibited transaction exemptions?
  - Amend five-part test?
  - Combination of both?
- Intent to cover insurance companies and banks

State Government Reaction to DOL/SEC

- Amend state laws despite Reg BI and DOL rewrite
- Nevada: broker-dealers/advisers providing investment advice now fiduciaries
- Proposals in MA, MD and NJ
- Patchwork quilt of fiduciary triggers, status, and duties
- State Government Sues SEC: exceed authority in finalizing rule; Reg BI undermines consumer protection for retail investors

OCC ANPR on "Fiduciary Capacity" & Custody Activities

- OCC contemplates on Fiduciary Capacity:
  - Expanding definition of "fiduciary capacity" to include roles that have authority over a trustee.
  - Examples include "trust director," "trust protector," and "distribution trust adviser."

- Rationale:
  - Reduce ambiguity and confusion for national banks and Federal savings associations.
  - Provide for uniform application of OCC regulations to trust activities that State laws describe with different terminology.

OCC ANPR on "Fiduciary Capacity" & Custody Activities

- OCC contemplates on Custody Activities:
  - Promulgating regulations for non-fiduciary custody activities.
  - Potentially would affect custody agreements for institutional and individual clients, holding domestic or foreign assets.
  - Cites the role of global custodians in processing tax reclaims.

- Rationale:
  - Heightened risks the custody business line poses to banks and savings associations
  - Importance of providing adequate safeguards for client assets.

OCC ANPR: ABA Comments

- Fiduciary Capacity Comments:
  - Unequal treatment of state and federal charters
  - Inherent conflicts with applicable law
  - Unintended consequences for non-fiduciary services (e.g., tax prep or planning services)

- Non-Fiduciary Custody Activities Comments:
  - Applicable law appropriately regulates business
  - Competitive disadvantages and limited service
  - Unequal treatment of state and federal charters

Broader Consideration of Custody of Client Assets

- Registered Investment Advisers:
  - RIA Custody Rule requirements and holding digital assets or trading non-delivery versus payment (DVP)

- Broker-Dealers
  - SEC and FINRA joint press release on meeting Customer Protection Rule and recordkeeping and financial reporting rules.
  - How properly hold digital assets?

Focus on Nondepository Charters

- Federal: OCC reviewing expectations and chartering requirements for nondepository charters (trust and fintech activities). Focus on capital, liquidity, safeguarding agreements.

- State: CSBS coordinating with state banking commissioners a review of chartering requirements. Also, considering ways to make RC-T information public. Lots of charter activity at state level.

Uniform Electronic Wills Act

Three goals for the Act:

1. Allow a testator to execute a will electronically, while maintaining protections the law provides for paper wills;
2. Establish execution requirements for electronic wills would result in a valid will without a court hearing to determine validity, if no one contests the will; and
3. Develop a process that would not favor a particular company or business model in the statutes.

Remote witnesses: Section 5 validates a will executed with remote witnesses. Section 8 imposes additional requirements.

Choice of law: Act links will's validity to testator's physical location at execution, or to domicile or residence at death.

Questions?

Phoebep@aba.com

202-663-5053

Legislative Update from Washington DC

This session will discuss the latest legislative and regulatory developments of interest to the trust industry, including Congressional bills, federal agency rules, and uniform state laws.

Phoebe A. Papageorgiou
Vice President, Trust Policy
American Bankers Association

Phoebe Papageorgiou is Vice President at the American Bankers Association. In this role, she oversees the advocacy efforts of the ABA's Trust Counsel Committee, Trust Taxation Committee, IRA Steering Committee, and Collective Funds Task Force. Her portfolio includes issues related to trust and wealth management services, fiduciary regulations and duties, tax reporting and preparation, investments, and bank custody services.

Prior to joining ABA in 2005, Phoebe worked for the U.S. Department of the Treasury in the Office of Domestic Finance. She received her law degree from The George Washington University Law School and her undergraduate degree from Carnegie Mellon University.

"HELPING IRA PLAN HIS IRA FROM THE IRA" TESTAMENTARY PLANNING WITH INDIVIDUAL RETIREMENT ACCOUNTS

South Dakota Trust Association
Fall Forum 2019

October 17, 2019
Sioux Falls, South Dakota

GEORGE D. KARIBJANIAN

Franklin Karibjanian & Law, PLLC

150 East Palmetto Park Road, Suite 800
Boca Raton, Florida 33432
Direct Dial: (561) 208-1272

Washington, DC Office
1101 Seventeenth Street, N.W., Suite 820
Washington, D.C. 20036
Direct Dial: (202) 495-2676

Fax: 202-463-3060
gkaribjanian@fkl-law.com

The Importance of Estate Planning for IRAs

- Example 1
  - Bojack is a 55 year old retired actor living in Bel Air, California. Bojack's assets are as follows:
    - Residence - $2,000,000
    - Stocks, Bonds and other Tradeable Securities - $1,000,000
    - IRA - $15,000,000
    - Life Insurance - $2,000,000

Individual Retirement Accounts – The Basics

- §408(a) definition
- Governing instrument must meet 6 requirements
- The Power of Compounding
  - Example 2 – Dev and his $100,000

Individual Retirement Accounts – The Basics

Chart 1 – Non-Tax Deferred

Growth Rate		6%				
Tax Rate		25%				
	Taxable Account			Tax Deferred Account		
Age	Int. & Growth	Taxes	Balance	Int. & Growth	Taxes	Balance
35			$100,000.00			$100,000.00
36	$6,000.00	($1,500.00)	$104,500.00	$6,000.00	$0.00	$106,000.00
37	$6,270.00	($1,567.50)	$109,202.50	$6,360.00	$0.00	$112,360.00
38	$6,552.15	($1,638.04)	$114,116.61	$6,741.60	$0.00	$119,101.60
39	$6,847.00	($1,711.75)	$119,251.86	$7,146.10	$0.00	$126,247.70
40	$7,155.11	($1,788.78)	$124,618.19	$7,574.86	$0.00	$133,822.56
**	**	**	**	**	**	**
71	$28,004.09	($7,001.02)	$487,737.85	$46,116.52	$0.00	$814,725.20

Individual Retirement Accounts – The Basics

Chart 2 –Tax Deferred

Growth Rate		8%				
Tax Rate		30%				
	Taxable Account			Tax Deferred Account		
Age	Int. & Growth	Taxes	Balance	Int. & Growth	Taxes	Balance
35			$100,000.00			$100,000.00
36	$8,000.00	($2,400.00)	$105,600.00	$8,000.00	$0.00	$108,000.00
37	$8,448.00	($2,534.40)	$111,513.60	$8,640.00	$0.00	$116,640.00
38	$8,921.09	($2,676.33)	$117,758.36	$9,331.20	$0.00	$125,971.20
39	$9,420.67	($2,826.20)	$124,352.83	$10,077.70	$0.00	$136,048.90
40	$9,948.23	($2,984.47)	$131,316.59	$10,883.91	$0.00	$146,932.81
**	**	**	**	**	**	**
71	$53,867.54	($16,160.26)	$711,051.50	$118,282.75	$0.00	$1,596,817.18

Individual Retirement Accounts – The Basics

- Asset Protection
  - Not so much –
    - California Code of Civil Procedure §703.140(b)(10)(E)
    - "Moffat Factors"
  - Clark v. Rameker
  - Florida:
    - Exempt under Fla. Stat. §222.21(2)(a)
    - Inherited IRAs also exempt under Fla. Stat. §222.21(2)(c)

Individual Retirement Accounts – The Basics

- Contribution Limits (§219(b)(1)(A))
  - Shall not exceed the lesser of:
    - The deductible amount ($5,000, adjusted for inflation), or
    - An amount equal to the compensation includible in the individual's gross income for such taxable year

Individual Retirement Accounts – The Basics

- Contribution Limits (cont.)
  - Catch-up contributions for individuals 50 or older - deductible amount is increased by the applicable amount, which is $1,000.
  - 2017 - $5,500/$6,500.

Individual Retirement Accounts – The Basics

- Non-Deductible Contributions (§219(g))
  - IRAs are supplemental retirement plans; therefore, they are secondary to other employer sponsored plans.
  - If the employee is an "active participant" in an employer retirement plan, the amount of the deduction for an IRA contribution is reduced, ultimately to $0.

Individual Retirement Accounts – The Basics

- Non-Deductible Contributions (§219(g))
  - Maximum amount of any non-deductible contributions is limited to the otherwise-deductible amount (i.e., $5,000 adjusted for inflation).

Individual Retirement Accounts – The Basics

- Rollovers (§408(d)(3))
  - Distributions are not taxable if they are rolled over in one of two ways:
    - The entire amount received is paid into an IRA or individual retirement annuity (other than an endowment contract) within 60 days; or
    - The entire amount received is paid into an eligible retirement plan within 60 days.

Individual Retirement Accounts – The Basics

- Distributions
  - §408(e)(1) - the IRA plan itself is generally exempt from taxation; distributions from a plan, however, are included in the recipient's gross income under §408(d)(1).
  - Not subject to the §1411 "net investment income" 3.8% tax. (§1411(c)(5))
  - Exception - if the account contains non-deducted contributions, each distribution contains a proportionate amount of basis and the balance of the account (§72(e))

Individual Retirement Accounts – The Basics

- Post-Death Distributions
  - §691 - "income in respect of a decedent"
  - Example 3 - Lucille and her $2,000,000 IRA – 37.8% effect pass through to the beneficiary
  - No §2053 deduction for income taxes - debt is undetermined so is not deductible
  - Some relief - the §691(c) Deduction

Individual Retirement Accounts – The Basics

- Qualified Charitable Distribution (§408(d)(8))
  - RMD is excluded from the participant's gross income, akin to a full deduction, as opposed to a deduction subject to an AGI limitation.
  - The amount of a qualified charitable distribution is limited to $100,000 per year.

Required Minimum Distribution Rules

- Required Beginning Date - Age 70 ½, which is 6 calendar months after the 70th birthday
- The IRA must be withdrawn at a minimum annual rate, which is determined under the IRS Uniform Life Table
- First Distribution Year - beneficiary is not required to withdraw the first RMD until April 1 of the following year
- Each Successive Year – withdraw by Dec. 31
- Multiple Accounts – withdraw from any account

Death of Account Participant

- Unpaid RMD – goes to beneficiary
- Designated Beneficiaries
  - Only individuals may be Designated Beneficiaries
  - Estates may NOT be Designated Beneficiaries
  - Trusts - Although a Trust is not an individual, it is possible to "look through" the trust and treat the individual trust beneficiaries as they were the Designated Beneficiaries

Death of Account Participant – Payout Rules

- Designated Beneficiary is surviving spouse - Rollover
- Death Prior to Pay Status
  - No Designated Beneficiary
    - 5 Year Rule
    - Could be 6 Year Deferral
    - Asset Protection Benefit

Death of Account Participant – Payout Rules

- Death Prior to Pay Status (cont.)
  - Beneficiary's Life Expectancy
  - Election Deadline Options
    - Plan could provide for 5 Year Rule (this is not a "unilateral beneficiary" option – the plan MUST have a provision allowing beneficiaries to choose)
    - Example 4 – Eleanor, Jason, Michael and the Election

Death of Account Participant

- Death During Pay Status
  - No Designated Beneficiary
    - Remainder of participant's remaining life expectancy
  - Designated Beneficiary
    - Single DB – longer of participant's life expectancy and beneficiary's life expectancy

Death of Account Participant

- Death During Pay Status (cont.)
  - Designated Beneficiary (cont.)
    - Multiple DB's
      - Multiple beneficiaries – life expectancy of oldest beneficiary.
      - Separate Account Rule – must establish by 12/31 of year after year of participant's death

Death of Account Participant

- Removing Beneficiaries – pay off by 9/30 of year after year of participant's death.
- Example 6 – Michael, George Michael and TBA
- What about additional estate taxes? PLRs 200432027 and 200432029

Death of Account Participant

- Spousal Rollover
  - The rollover election may be made at any time after the participant's date of death, including after the surviving spouse's own RBD.
  - There is no statute or regulation that gives instructions as to how to properly effect a rollover.

Death of Designated Beneficiary

- RMD does not change – once the RMD is determined as to the Designated Beneficiary, the RMD calculations remain regardless of how many deaths occur and Successor Beneficiaries are named.
- Example 7 – George Michael and Maeby

Roth IRA's

- Introduced in 1998, the Roth IRA allows for the elimination of income taxes on an IRA.
- The trade-off is that, at the time of conversion from a traditional IRA, all income taxes must be paid up-front.
- However, after the payment of income taxes, all distributions from the account – even as to the income and growth after the conversion – not tax deferred but TAX FREE.

Roth IRA's

- Two types of contributions to a Roth
  - Regular contributions
    - Same limits as traditional IRAs
    - Phase outs for 2018
      - Single $120,000 to $135,000
      - Joint $189,000 to $199,000
    - Contributions may continue to be made after age 70 1/2.
  - Qualified Rollover Contributions

Roth IRA's

- Roth's and RMD Rules
  - During the lifetime of the account owner, there is no RBD and thus no RMD requirements.
  - Death of Account Owner:
    - Once death occurs, the RMD rules apply as to the Designated Beneficiary.
    - RMD rules are applied under the approach that the Roth owner died prior to his/her RBD

Roth IRA's

- Qualified Distributions
  - Made after the "5 Year Period" (starts on 1/1 of the year of the first Roth contribution)
  - Is made:
    - On or after the date of the participant's attaining age 59 ½;
    - After the participant's death; or
    - Is attributable to the participant's being totally disabled.

Roth IRA's

- Non-Qualified Distributions
  - A "Non-Qualified Distribution" still receives favorable tax treatment as compared with distributions from a traditional IRA.
  - Roth IRA's consist of two sources of funds – the participant's post-tax contributions, and the growth in excess of the contributions.

Roth IRA's

- Non-Qualified Distributions (cont.)
  - Ordering Rules:
    - Participant's contributions
    - If regular contributions and rollover contributions, regular contributions first
    - If from rollover contributions, FIFO
    - Within a particular rollover contribution, the dollars that were includible in gross income by virtue of the rollover are exhausted first
    - Earnings

Trusts as Beneficiaries

- Accounting Principles - UPAIA §409, UFIAPA §409 andS.D. Stat. Ann. § 55-13A-409
  - UPAIA
    - QTIP Trusts and Rev. Rul. 2006-26
    - 10% vs. actual income and principal
  - UFIAPA
    - Passed in July 2018
    - Now approaches retirements like regular investment accounts (if possible)
    - If not possible, then actuarily

Trusts as Beneficiaries

- Accounting Principles - UPAIA §409, UFIAPA §409 andS.D. Stat. Ann. § 55-13A-409
  - Compare to approach taken under S.D. Stat. Ann. § 55-13A-409

Trusts as Beneficiaries

- See-Through Trusts vs. Non-See-Through Trusts
  - See-Through: Trust Beneficiaries treated as DB's
  - Non-See-Through: Treated as if no DB, meaning:
    - If the participant was not in pay status: the 5 Year Rule applies.
    - If the participant was in pay status: payments continue based on the participant's life expectancy.

Trusts as Beneficiaries

- See-Through Trusts
  - Trust Beneficiaries treated as DB's
  - 5 Requirements
    - Valid under state law.
    - Irrevocable or become irrevocable upon participant's death
      - PLR 200537044 – trust protector's ability to amend administrative provisions is permissible

Trusts as Beneficiaries

- See-Through Trusts
  - 5 Requirements (cont.)
    - Trust must identify beneficiaries – general provisions OK (i.e., "issue") so long as it is possible to identify the class member with the shortest life expectancy
    - Certain documentation must be provided to the plan administrator.
    - All trust beneficiaries must be individuals.

Trusts as Beneficiaries

- Conduit vs. Accumulation Trusts
  - Conduit – RMD paid to beneficiary
    - Popular because all other beneficiaries are disregarded
    - Simple to create
    - Can provide creditor protection where Inherited IRAs aren't protected
    - Not good for dynasty planning
    - Wastes exemption
    - Bad for special needs

Trusts as Beneficiaries

- Conduit vs. Accumulation Trusts (cont.)
  - Accumulation – RMD paid to Trust
    - Good for dynasty planning
    - No waste exemption
    - Also resolves asset protection issues for states where Inherited IRAs are not protected

Trusts as Beneficiaries

- Conduit vs. Accumulation Trusts (cont.)
  - Accumulation – RMD paid to Trust (cont.)
    - Older beneficiaries or takers under POA can ruin RMD calculation
    - Income taxes may be higher by keeping most of RMD inside the trust

Trusts as Beneficiaries

- Trust Provisions to “correct” accumulation trust
- Sentence #1:
  - *Notwithstanding any provision herein to the contrary, after September 30 of the year after the Settlor's death, no benefits from any Individual Retirement Account established and maintained under Section 408 of the Code or a Qualified Pension, Profit-Sharing or Stock Bonus Plan established and maintained under Section 401 of the Code (referred to in this Declaration as an "IRA") may be used or applied for the payment of any debts, taxes or other claims against the Settlor's estate as provided for hereunder.*

Trusts as Beneficiaries

- Trust Provisions to "correct" accumulation trust
- Sentence #2:
  - *If a beneficiary of a trust hereunder has a testamentary power of appointment over all or any portion of said trust, and if said trust is the beneficiary of any benefits from any IRA, the beneficiary shall not be permitted to appoint any part of said IRA to a charitable organization or to an individual who is older than the beneficiary whose life expectancy is being used to calculate distributions from said IRA, in shares, equal or unequal, and subject to such lawful trusts, terms and conditions, as the beneficiary shall appoint by Will, and any part of said IRA not so appointed shall be disposed of as provided in said trust.*

Trusts as Beneficiaries – Char. Rem. Trusts

- Provides for family members and charity
- Even though a non-individual is named as the beneficiary, there is no income tax recognition on the distribution to the CRT; the tax is paid subsequently on the annuity or unitrust payments to the beneficiary.

Trusts as Beneficiaries – Char. Rem. Trusts

- Problems:
  - Regardless of the investment structure, the class of income under the tier system remains based on the original classification.
  - Greatly diminished effect of the §691(c) deduction

Guidelines for the Beneficiary Designation

- Care and concern should be given to the naming of the beneficiaries; failure to property implement the designations could lead to a lack of a Beneficiary Designation and failure to maximize the payout of the IRA.
- 6 Steps to Consider

Guidelines for the Beneficiary Designation

- Step #1 – Discuss the Plan with the Client about Including the IRA
- Step #2 - Obtain Pertinent Account Information
- Step #3 – Think Through the Plan
- Step #4 – Prepare the Designation and Rider
- Step #5 – Submit and Negotiate with Custodian
- Step #6 – All else fails, create an IRA Trust

2019 Congressional Action to Overhaul IRA Provisions

- IRA reform may be upon us by the end of 2019
- Two Congressional Acts are pending
  - House: "Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act")
  - Senate: "Retirement Enhancement and Savings Act of 2019" (the "RES Act")

2019 Congressional Action to Overhaul IRA Provisions

- Both are intended to provide simplification to retirement planning and make plans available to more taxpayers
- Examples include incentives to creating plans, increased pctgs. for automatic employer wage deferral, stricter loan req. from plans (i.e., preventing loans via credit cards), additional penalty-free withdrawal circumstances for a "qualified" birth or adoption, and plan inclusion for part-time employees

2019 Congressional Action to Overhaul IRA Provisions

- The House passed the SECURE Act on May 23, 2019 by a near-unanimous vote
- The Senate has not voted on the RES Act or has announced whether it will adopt the SECURE Act
- Nothing appears imminent; the initial thought that reform would occur in the Fall, but no indication has been given on whether this will occur.

2019 Congressional Action to Overhaul IRA Provisions

- Yikes…do I have to change everything now?
- As said in the previous slide, change is not imminent but if change occurs, the current Act says that change would occur on 1/1/20; thus, thought should be given to what clients would do if change occurs
- Also, so much more has to be done - the two Acts have major differences that would have to be resolved

2019 Congressional Action to Overhaul IRA Provisions

- Because these are major changes, though, it is important to be educated on what is happening so that if the law changes, we can be ready to determine what must be done to our clients' plans

2019 Congressional Action to Overhaul IRA Provisions

- SECURE Act Highlights for Estate Planners
  - Section 106 – the prohibition on contributions by individuals over 70 ½ would be repealed
  - Section 113 – the age for beginning RMD's would be extended from 70 ½ to 72; presumably the same rules for the initial RMD would apply.

2019 Congressional Action to Overhaul IRA Provisions

- SECURE Act Highlights for Estate Planners (cont.)
  - Section 401 – the RMD rules upon death would be completely overhauled. With certain exceptions, distributions would NO LONGER BE BASED ON THE BENEFICIARY'S LIFE EXPECTANCY – the entire account must be distributed to the beneficiary no later than the end of the ***10th calendar year following the year of the IRA owner's death***

2019 Congressional Action to Overhaul IRA Provisions

- SECURE Act Highlights for Estate Planners (cont.)
  - Exceptions to Stretch Prohibition Rules:
    - Spouses (rollovers are still authorized)
    - Disabled or Chronically Ill
    - Individuals who are not more than 10 years younger than the employee

2019 Congressional Action to Overhaul IRA Provisions

- RES Act Highlights for Estate Planners
  - Section 108 – the prohibition on contributions by individuals over 70 ½ would be repealed.
  - Section 109 – IRA's can hold shares in an S Corp that qualifies as a Bank.

2019 Congressional Action to Overhaul IRA Provisions

- RES Act Highlights for Estate Planners (cont.)
  - Section 501 - – the RMD rules upon death would be completely overhauled. With certain exceptions, distributions would NO LONGER BE BASED ON THE BENEFICIARY'S LIFE EXPECTANCY – ***the entire account must be distributed to the beneficiary no later than the end of the 5th calendar year following the year of the IRA owner's death***

2019 Congressional Action to Overhaul IRA Provisions

- RES Act Highlights for Estate Planners (cont.)
  - Exceptions to Stretch Prohibition Rules:
    - Spouses (rollovers are still authorized)
    - Disabled or Chronically Ill
    - Individuals who are not more than 10 years younger than the employee
    - ***Per Beneficiary Exception of $400,000, valued as of the date of death***

2019 Congressional Action to Overhaul IRA Provisions

- Key Differences between the Acts:
  - SECURE Act increases RMD age to 72; RES Act makes no change
  - RES Act has a $400,000 per beneficiary allowance to maintain existing stretch rules; SECURE Act does not

2019 Congressional Action to Overhaul IRA Provisions

- Why Eliminate the Stretch Rule?
  - The Ways and Means Committee believes that the tax subsidy for retirement savings should phase down after the lives of the individual and surviving spouse, except in the case of certain other beneficiaries.

2019 Congressional Action to Overhaul IRA Provisions

- True it's way early, but questions abound
  - What about trusts? Good question. No guidance is given as to how these new rules would be applied to trusts.
  - The $400,000 Exclusion…is this per account or per account owner? Unclear.

2019 Congressional Action to Overhaul IRA Provisions

- Under either Act, if the new rules go into effect, i.e., 5 or 10 year mandatory payout, must an RMD be taken each year? Probably NOT – it would appear as if this provision would emulate the 5 Year Rule, meaning that, unless funds are needed, IRA funds could be held within the inherited account for the maximum period for tax growth and deferral.

“HELPING IRA PLAN HIS IRA FROM THE IRA”: TESTAMENTARY PLANNING WITH INDIVIDUAL RETIREMENT ACCOUNTS

Been confused in the past about estate planning with IRAs? Are you troubled about whether the proper terminology is “RMD” or “MRD”? Are you wondering if you’re about to get a “hall pass” for your lack of IRA planning knowledge on account of potential legislative reform? Wonder no more. This presentation will take you through the nuts-and-bolts of IRA planning, from required distributions to coordinating the beneficiary designation with the estate plan, and will also discuss the potential legislative revisions and explain why reform may create more confusion!

George D. Karibjanian is a Founding Member of Franklin Karibjanian & Law, a national boutique law firm based in Washington, D.C., with additional offices in Boca Raton, Florida and Naples, Florida. George practices predominantly in the firm’s Boca Raton office. George is Board Certified by theFlorida Bar in Wills, Trusts & Estates and is a Fellow in the American College of Trust and Estate Counsel.He earned his B.B.A. in Accounting from the University of Notre Dame in 1984, his J.D. from the Villanova University School of Law in 1987, and hisLL.M. in Taxation from the University of Florida in 1988. George has practiced his entire legal career in South Florida (over 28 years), practicingexclusively in the areas of estate planning and probate and trust administration, and also represents numerous clients with respect to nuptialagreements. George has participated in over 140 formal presentations, either individually or as part of a panel discussion, to national, state-wide and local groups, and has over 60 publication credits in national and regional periodicals and journals. Born and raised in Vineland, New Jersey (in the heart of South Jersey), George has called Boca Raton home since 1988. When not attending Miami Marlins home games, George is any one or more of reading anything and everything regarding the entertainment industry or is keeping current and/or binge-watching television programming that skews way below his supposed demographic. George’s 2016 personal highlights begin on January 21 when he was fortunate to see “Hamilton” at the Richard Rodgers Theater in New York, and then on April 4, he was in attendance at NRG Stadium in Houston, Texas, to watch his law school alma mater, Villanova University, win the 2016 NCAA Men’s College Basketball championship.

On January 15, 2014, George was presenter at the prestigious 48th Annual Heckerling Institute on Estate Planning in Orlando, Florida, speaking on a panel discussion titled, “Living and Working with the Uniform Principal and Income Act,” focusing on the tax effects on the power to adjust trust principal to income, the power to convert an income trust to a unitrust, comparing the various unitrust statues and focusing on potential litigation facing fiduciaries in this area.

On the topic of same-sex estate planning, George has lectured at various conferences and estate planning councils throughout the United States and has published numerous articles in publications such as Steve Leimberg’s LISI Estate Planning Newsletters, Estate Planning Journal, Trusts & Estates Magazine and the Florida Bar Journal. George has also been quoted by several publications and websites. George’s other lectures have included topics such as Portability,

Decanting, Trustee Selection and Duties, the Principal and Income Act, Current Developments in Estate Planning and Taxation, Representing a Client with Potential Capacity Issues, Whether a Supplemental 706 is Required, Inter-Vivos QTIP Planning, Prenuptial Agreements for the Estate Planner and the Advantages and Disadvantages of Domestic Asset Protection Trusts.

For the American Bar Association's Section of Taxation, he is currently serving as the First Vice-Chair of the Estate and Gift Tax Committee; was the

Chairperson for the Section's Comments on the Basis Consistency Regulations, the Chairperson for a 2011-12 Section Task Force Subcommittee

Advocating Changes to the Portability Provisions Added by the 2010 Tax Act; and a contributing draftsman to the Section's 2012 comments to the IRS on decanting.

For the American Bar Association's Section of Real Property Trusts & Estates, he is a current Vice-Chair of the Estate and Gift Tax Committee within the Section's Income and Transfer Tax Planning Group.

For the Florida Bar's Real Property Probate & Trust Law Section, he is current Chair for the Section's Asset Protection Committee; has been the Co-Vice Chair – Probate & Trust and National Events Editor for the Section's "ActionLine" publication since 2012; the Co-Chairperson of the RPPTL Ad Hoc

Committee regarding potential statutory changes in light of a change in Florida's DOMA laws; a member of the Ad Hoc committee to study changes to Florida's decanting statutes; the Chairperson and primary draftsman of the Section's 2012 comments to the IRS on decanting, a member of the RPPTL

Ad Hoc Committee that drafted a statutory change in response to Florida's Morey v. Everbank decision; and a current member to the Section's Executive Council.

George is also a member of the Greater Boca Raton Estate Planning Council and the South Palm Beach County Bar Association.

George is currently on the Professional Advisory Committee for the Boca Raton Museum of Art and for the George Snow Memorial Scholarship

Foundation, and is on the Board of Directors for the Palm Beach County Wealth & Estate Planning Seminar. Previously, George served as President

and a member of the Board of Directors of the Notre Dame Alumni Club of Boca Raton (1996-1997), a member of the St. Jude's Church (Boca Raton)

Financial Education Council (1994-1996), and Vice President and a member of the Board of Directors of the Boca Raton Girls Fastpitch Softball

Association (2004-2008).

Cryptocurrency Panel

This panel session is designed to give trust professionals a working knowledge of the latest cryptocurrency developments. Discussion will be held around understanding of industry opportunities. And answer questions such as: How are financial institutions adapting? What can we expect in 2020? What is South Dakota doing on the legislative front to stay current?

Jay Schulman, Moderator

Jay Schulman, Principal, RSM US LLP Jay leads Cryptocurrency and Blockchain practice for RSM. Jay is the National Leader for Blockchain and Digital Assets at RSM. Bringing together all of the services across RSM including Audit, Tax, and Consulting, Jay leads the firm's capability in addressing both enterprise blockchain technology and the adoption of digital assets such as bitcoin.

He has helped a major commodities exchange roll out an initial coin offering, consulted multiple trading firms on the security of their cryptocurrency trading strategies, developed strategies for adopting blockchain and taught numerous classes on the basics of blockchain and cryptocurrencies.

Rodrigo Vicuna

Rodrigo Vicuna is the Chief Financial Officer at BitGo. Rodrigo has over ten years of experience at the intersection of financial services and technology. Prior to BitGo, Rodrigo worked at the Boston Consulting Group, where he focused on the digitalization of legacy capital markets infrastructure and service providers. He co-authored BCG's global perspective on emerging FinTech trends and potential opportunities for traditional finance to innovate and led the modernization of consumer loans for one of Chile's largest banks. Rodrigo guest lectures for Carnegie Mellon University's Chief Risk Officer and Chief Information Security Officer executive education programs. Rodrigo holds a bachelor's degree in economics with an emphasis in accounting from UCLA and an MBA from the Wharton School at the University of Pennsylvania.

Carey Miller

Carey Miller is an attorney with Woods Fuller Shultz & Smith P.C. who practices in the areas of business, finance, and intellectual property law. She forms business entities, and assists with capitalization, negotiating contracts and identifying intellectual property rights. Her work includes formation and advising of South Dakota chartered trust companies as well assisting South Dakota businesses working on the blockchain platform. Carey is an active member of the Business Law Committee (BLC) of the South Dakota State Bar Association. She chaired the subcommittee which worked on legislation to signal that South Dakota was open to blockchain businesses. That legislation was sponsored by independent legislators and approved by the South Dakota legislature.

The Evolving 21st Century Family

EDMUND W. GRANSKI, JR. • (C) 201.914.4115 • (O) 347.329.4433 • ED@EDMUNDGRANSKI.COM

The more developed world is undergoing important demographic changes and religious, sociological and cultural shifts that impact the formation of families.

In 2019...

Individuals are living considerably longer lives

29 countries provide for gay marriage on a national level

"Wealth" is no longer tangible

Recognition of children born out of a legal marriage

Decline in marriage rates and increases in the percentage of couples who live together without marrying

IVF and other scientific methods of birth

Increased influence of human rights principles, including non-discrimination on grounds of sexual orientation and the equal treatment of children

These shifts have a profound impact on a family's intention to plan for it's future.

- How do we define “family”?

- What do these shifts in demographics and religious, sociological and cultural attitudes mean to an individual’s wealth transfer plan?

- What practical applications does this have for advisors in the various common law systems, civil code systems and where two or more jurisdictions are relevant?

- One Particular Issue – Who is an Heir?

Historically, societies favored naturally born children of legally married parents.

- Bloodlines were favored
- Primogeniture was not uncommon
- Marriages were social and economic contracts
- Estates consisted primarily of land
- Certainty was important

In today's society...

- The definition of wealth is liberalized and is less tangible. Certainty is less important.
- Marriages are considered to be partnerships.
- A large percentage of marriages end in divorce.
- A large percentage of individuals have more than one marriage during their lifetimes.
- An increasingly large percentage of individuals never marry and cohabitate with another in a relationship.
- Same sex marriages are accepted and increasingly common.

These changes in marriage and cohabitation patterns profoundly impact one important segment of the population...

Children.

When does a parent-child relationship exist for inheritance purposes with regard to:

- Unmarried Couples
- Adopted Children
- Stepchildren
- Same Sex Couples
- Where only one is a biological parent
- Where neither is a biological parent
- Reproductive Technologies
- Donor and Child
- Surrogacy Agreements
- Posthumous Conception

How do we manage the evolution of...

- A testator's presumed will?

- The assumed duty to provide for children and what a decedent "ought" to have intended?

- The valid policy requirements of the state or states in which such testator lived and/or where such children live?

How do we balance the needs/rights of the surviving spouse in relation to:

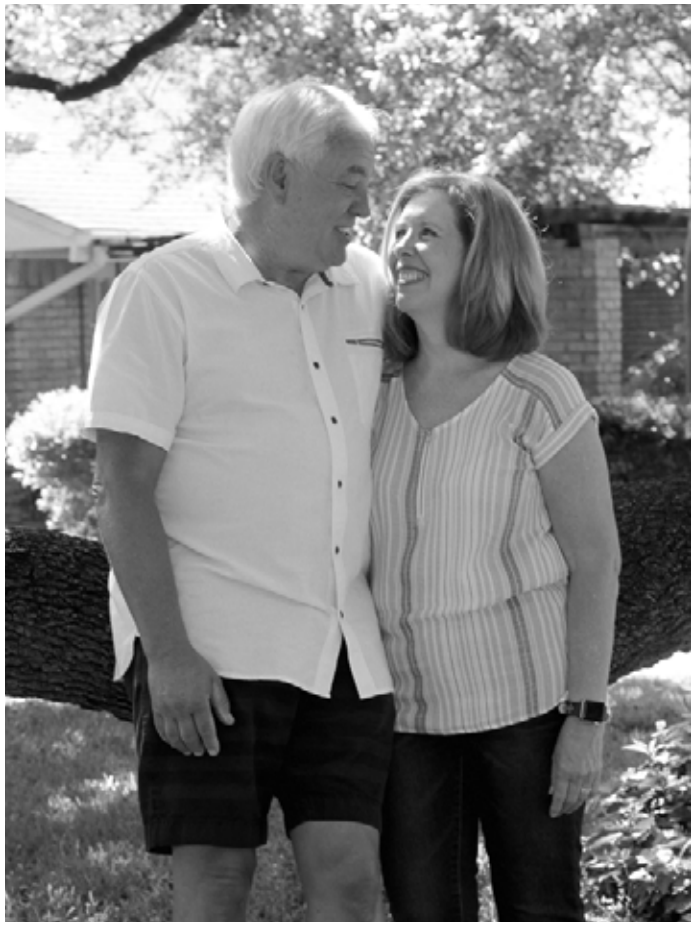
- Children of the marriage?
- Children outside the marriage?

Changes in demographic, sociological thought and cultural values:

- Marriage as a partnership and not a social contract
- Spouses will live longer
- Estates are no longer tangible and are often impacted by the laws of multiple jurisdictions

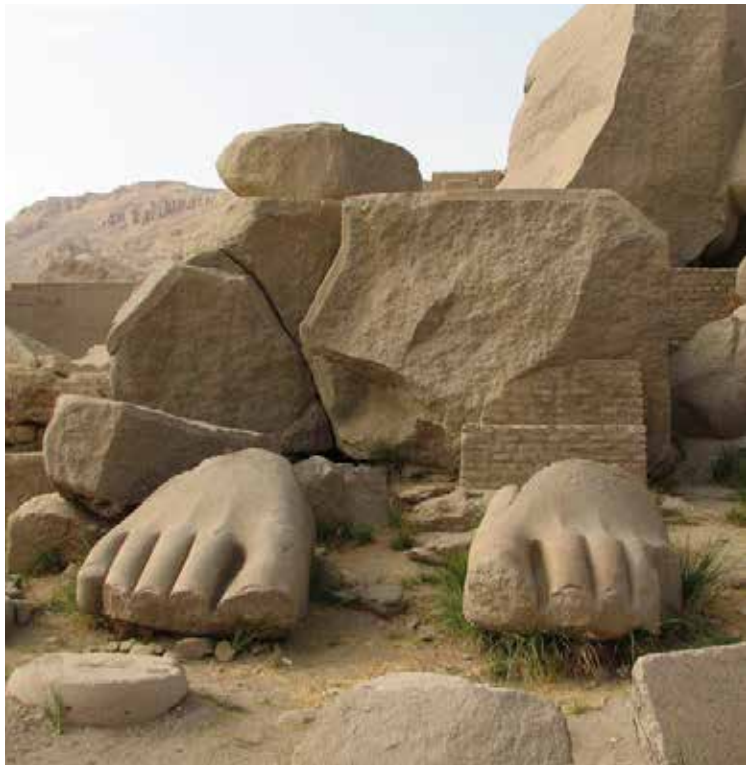
Current frontiers exist as a consequence of the increased emphasis on individual freedom, human rights and less emphasis on families created by marriage contracts and bloodlines.

Cohabitants



- Should they qualify as heirs? If so, how much should they receive? What preconditions should be met?
- Can non-spousal cohabitation exist alongside marriage?
- How do societies create rules in this area that are reasonably straightforward and accessible?

Trust Planning



- How do we plan for the evolving family in terms of trusts, some of which may be intended to be "perpetual" in nature?

- How do we plan for a settlor's intent if, over time, the nature of a family changes in a profound way?

Milestones in the use of A.R.T.

1770
First reported intrauterine insemination

1950
First child born using frozen sperm

1986
First child born using a frozen egg

2004
Child born using sperm frozen for 21 years

Ownership Issues

Ownership and the use of genetic material:

1. Is genetic material property?

Yes. Embryos may be treated differently, though.

2. Entitlement to and use of genetic material –

Who can use?

Who gets to decide?

To whom does genetic material and resulting embryo belong?

- *Sperm Donor?*
- *Egg Donor?*
- *Person commissioning use?*
- *Surrogate?*

Succession Issues

1. When does class close?
2. Who will be included in the class?
3. When is the administration of the estate concluded?
4. How long does a trustee or executor need to wait?
5. Onus on trustee or executor to seek out genetic material? Determine who can use it and by when – give notice of distribution of estate.
6. Onus on trustee or executor if given notice of genetic material?
7. What is the liability of the trustee or executor re: distibuting estate – delay to people alive at death of deceased vs. including people who are not yet born?

Evolving 21st Century Family

The more developed world is undergoing seismic demographic changes and religious, sociological and cultural shifts that impact the very definitions of "family", "children", and "succession". How do these changes impact the laws that are the building blocks on which our families rely when planning for their family's future? We will explore questions and practical applications for families and their advisors arising in various common law systems, civil law systems, and where the laws of multiple jurisdictions are relevant.

Edmond Granski

I was born and spent my childhood in Plainfield, New Jersey, a suburb of New York City. Time spent with my brother, sister and cousins, as well as music, reading, and exploring the outdoors, defined my early years. I was a scout and continue as a lifetime member of the National Eagle Scout Association.

Sports became increasingly important – I ran cross country and middle distances competitively for my high school, my university, and at a club level thereafter, including the marathon for several years. Today, I continue as a lifetime runner and an avid outdoorsman – cycling and hiking are important parts of my everyday life.

I received a Bachelor of Science degree from Boston College in Chestnut Hill, Massachusetts, and a Juris Doctor and Masters in Law degrees from Villanova University School of Law in Villanova, Pennsylvania, where I served on the Honors Board.

I began practicing law in Boston, Massachusetts in 1986. Later, from August, 1996, to February, 2002, I was an associate and then equity partner of the New York law firm Cadwalader, Wickersham & Taft. From February, 2002, to February, 2004, I was a senior equity partner in the New York offices of the London based law firm Withers LLP. From February, 2004, to September, 2006, I was Managing Director, UBS AG, Head of Wealth Planning for the Americas (Argentina to Canada, ex. USA) and deputy in charge of Wealth Planning globally. I am also Senior Advisor to Meritus Trust Company in Hamilton, Bermuda.

I am a Fellow of the American College of Trust and Estate Counsel. I am a member of the Bars of the States of Colorado, New York and New Jersey. Formerly, as a member of the American Bar Association, I served as Chair of the International Estate Planning subcommittee of the Estate and Gift Tax Committee (1997-2005) and the Foreign Trusts Subcommittee of the Fiduciary Income Tax Committee (1997-2005).

I am a member of the Collaboration for Family Flourishing. I am a member of the International Dark Sky Association and a lifetime member of the National Eagle Scout Association.

I’ve had the good fortune of having committed, talented teachers and mentors throughout my life.

I live in Glen Rock, New Jersey, and spend considerable time in the Hudson Valley and Colorado. My four children, each taking risks and following his or her passion, inspire me daily.

Ethical Issues in Estate Planning & Wealth Management:

Why Standards of Conduct Are Not Enough

South Dakota Trust Association Fall Forum
October 2019

About the Speaker

Steve Goodman is owner and president of TrainWorks, a leading provider of customized, independent training in wealth management, customer service, and business ethics.

Currently, Steve travels the country extensively as one of the lead instructors for the American Bankers Association's in-bank training programs. He is also on the faculty of the Pacific Coast Banking School in Seattle, where he teaches wealth management concepts to private bankers and commercial lenders, and where he has been named one of the top three instructors for six years in a row. In addition, Steve is an instructor at the Southeastern School of Banking, where he teaches sales, ethics and transfer tax techniques to non-trust personnel and has been on the faculty for more than 25 years. Besides training, Steve also writes a quarterly Newsletter that addresses the latest financial and legal developments affecting high net worth taxpayers.

Before forming TrainWorks, Steve worked in the financial services industry where he was a trust administrator, business development officer and a regional manager in charge of both trust and retail brokerage services. Steve attended undergraduate school at the University of Tennessee in Knoxville, where he earned a B.S. degree in Communications, with high honors, and then attended Cumberland School of Law in Birmingham. He then graduated, with honors, from the National Graduate Trust School at Northwestern University.

Steve has been licensed to practice law in Alabama and Tennessee.

Ethics in Estate Planning & Wealth Management:
Why Standards of Conduct Are Not Enough

I. The science of ethics: a review of common themes

A. The bad news: the average American in personal and professional lives

B. The good news: the nature of the lying and cheating

C. Ethical values are developed early

D. Personal and professional ethics standards tend to overlap

E. Almost all major ethical lapses started small

F. Individuals are incapable of recognizing their own conflicts of interest

Identifying conflicts in others: almost no one can recognize his or her own conflicts, but most individuals are keenly aware of conflicts in other industries—attorneys can identify conflicts in the financial planning profession, for example, but not in their own, and the reverse is true.

Behavioral economists at Carnegie Mellon University conducted a study of doctors and financial advisers in which the participants were divided equally into two separate groups, and each group was asked to review drafts of regulatory proposals that would try to limit conflicts of interest issues in both professions.

Afterwards, when asked about proposals for the financial advisers, the doctors were "outraged" that the proposals would allow the advisers to accept various gifts—everything from free pens and lunches to educational junkets—from the investment companies the financial advisers worked with. But those same doctors told the researchers that those identical benefits, when offered to them, would not influence their judgment.

Similarly, the financial advisers found it appalling that doctors would be able to accept the gifts from pharmaceutical companies, but imposing those same restrictions to their own profession, the advisers said, would be "unnecessary and onerous." *See "Conflict of Interest? Moi?,"* J. Zweig, *Wall Street Journal* 10/6 – 7/12.

G. Rationalization: financial, entitlement, time restraints or *de minimis* reason

II. The science of ethics: reasons for ethical lapses

A. Significant financial rewards (along with reduced punishments)

B. Bystander affect

III. Ethical lapses are everywhere: sample headlines

IV. Ethical lapses are everywhere: in our businesses

V. Ethical lapses are everywhere: in our sports

VI. Ethical lapses are everywhere: in our schools

VII. Ethical lapses are everywhere: in our law firms

A. Code of Professional Conduct specifies the following:

Rule 8.4. Misconduct

(a) A lawyer shall not:

(1) violate or attempt to violate these Rules;
(2) induce another to engage in conduct, or give assistance to another's conduct, when the lawyer knows that conduct will violate these Rules;
(3) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;
(4) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

B. Rationalization & fewer punishments: there is always a reason

1. Signing in at Heckerling

2. CLE seminars

3. Attorney Lee Mark ("Lee") Smolen
   a. Facts

In March 2015, Smolen was suspended from practicing law in Illinois because he "falsified expense reports and taxi cab receipts to his law firm [and obtained] reimbursement for cab rides he did not take." In total, Smolen submitted approximately 800 taxi receipts totaling almost $70,000 for taxi charges that were never incurred. *See In re Smolen,* Synopsis of Hearing Board Report and Recommendation ("Report"), Comm. No. 2013PR00060, January 2015.

According to the Report, Smolen had an accounting degree from the University of Illinois, and passed the CPA exam with "one of the highest scores in the state." He then received his law degree from the University of Chicago and joined the well-regarded firm of Sidley Austin (Sidley), the sixth-largest law firm in the United States. At the Chicago-based firm, Smolen was the "co-global coordinator" of Sidley's real estate practice and "a member of the firm's executive committee." He also had very close—and very important—ties with one of Sidley's largest clients, Wells Fargo, which accounted for approximately $20 million of the firm's annual revenue.

The Report also indicates that several of Smolen's colleagues at Sidley testified at his disciplinary hearing that Smolen never seemed satisfied with his salary, even though he was making approximately $3.5 million annually (although Smolen testified that he was satisfied with his compensation). In addition to his $3.5 million salary, which ranked him among the highest paid partners at the firm, Smolen also submitted significant practice-related expenses that Sidley reimbursed. When the firm's general counsel became concerned about Smolen's unusually large "practice development expenditures" in August 2012, he began an internal investigation that focused on whether all of the charges had been legitimately incurred.

According to the Report, the investigation discovered that many of Smolen's expenses had, in fact, been fabricated. The investigation found, for example, that Smolen had driven to work and "parked his car virtually every day that he also charged the firm for cab rides of $70 to $80."

To submit the false charges, the Report says that Smolen would cover the dates and amounts on old taxi receipts with new dates and amounts. He would then photocopy the "falsified receipts" and give the copies to his secretary who, Smolen testified, "was not very good so he tried to give her as little work as possible." Because the submitted expenses appeared authentic, the firm's accounts payable personnel issued

reimbursement checks to Smolen. Ironically, Smolen was also the firm's "billing partner," which actually gave him "'virtually absolute control'" over the account to which he was submitting his expenses, according to the Report.

When confronted about the charges, Smolen said he "felt entitled to the money" because of his work ethic—he often came in early and left late—which resulted in approximately 3,500 billable hours one year. In addition, Smolen essentially argued that he fabricated expenses because completing accurate reports would require too much time, and he needed that time both to devote to the firm and "to spend with his family," particularly after his mother became seriously ill in 2007. Besides, Smolen testified, the expenses he legitimately incurred would largely balance with the ones he fabricated because he used the funds from the false cab receipts "to pay for client entertainment"—expenses he paid himself, without submitting them to the firm for reimbursement.

Eventually, the firm's management committee decided to terminate his partnership interest, but Smolen resigned before the termination actually became effective. The firm then hired KPMG, at a cost of $258,000, to conduct an audit of Smolen's expenses. The audit revealed a number of questionable expenses, especially ones Smolen allocated to practice development, though KPMG also recognized that Smolen might have unusually large practice management expenses because "Wells Fargo was a very significant client."

Still, KPMG identified approximately $69,800 in cab rides from 2007 to 2011 that "were not acceptable expenses," along with an additional $379,000 of expenses that the firm reimbursed, including airfares, $1,000 restaurant gift cards and country club meals, "for which they could not find a sufficient underlying basis." After Smolen left the firm, the two parties agreed to deduct $400,000 from his capital account to "reimburse the firm for the fabricated expenses, the expenses that were not explained, and the KPMG investigation."

b. Disciplinary hearing

When Smolen's case came before the disciplinary commission, several attorneys and both current and former clients testified on his behalf. Among those testifying was Mark Myers, an executive vice president of Wells Fargo. Meyers said that he had known Smolen for approximately 20 years and that Smolen displayed "high character and high levels of integrity and honesty." Meyers also indicated that, while Wells had suspended its professional affiliation with Smolen during his disciplinary proceedings, "it would do business with Respondent [Smolen] 'when this

situation is behind him.'" Another client, Donald Keummler, a partner in the private equity firm of Pacific Coast Capital Partners, testified that his firm was continuing to use Smolen's services and that he had "a high opinion of [Smolen's] truthfulness and veracity."

At the conclusion of the hearing, the Illinois Attorney Registration and Disciplinary Commission (the Commission) found that Smolen had violated the Rules of Professional Conduct. In reaching that conclusion, the Commission rejected Smolen's explanation that he did not believe "he was doing anything wrong"—an argument that the Commission found "implausible."

Specifically, the Commission found that Smolen was in violation of Rule 8.4(a)(4) of the 1990 Rules and Rule 8.4(c) of the 2010 Rules. Rule 8.4 provides the following: "It is professional misconduct for a lawyer to…engage in conduct involving dishonesty, fraud, deceit, or misrepresentation."

c. Fewer consequences

Having found him in violation, the Commission recommended a suspension of one year. In recommending a one-year suspension, the Commission said there were mitigating factors, namely Smolen's community involvement, including his service as a member of the Dean's Business Council at the University of Illinois. There was also evidence that Smolen suffered from obsessive-compulsive disorder, among other illnesses, though the Commission said there was conflicting testimony of their impact between those illnesses and Smolen's actions. The Illinois Supreme Court adopted the Commission's report in an Order issued March 12, 2015 (M.R. 27199).

Meanwhile, in 2013—two years before the Supreme Court issued its Order of Suspension—Smolen joined another law firm, DLA Piper, "one of the largest business firms in the world," according to the firm's web page. That prompted one legal blogger to write:

"*In a bygone era, large law firms would have steered clear of someone like Smolen…. But times have changed. Firms are willing to take chances on people—well, maybe not on recent law school graduates or young lawyers, but on partners with possible portables. Presumably the temptation of Lee Smolen's book of business, even in a reduced or tarnished state, was too great for DLA Piper to resist. Welcome to Biglaw in 2013. Happy Hunger Games!" See* "Above the Law," David Lat 7/10/13.

C. Significant financial rewards: "When the pot is enticing enough…."

1. 60 Minutes story: are you the James Silkenat or the Jeffery Herrmann?

2. *Mardigian v. Goldberg,* Mich. No. 152655, 6/21/18

By issuing an equally split decision recently, the Michigan Supreme Court may allow attorney Mark Papazian and his family to keep bequests of $14 million from one of his clients, even though it was Papazian who drafted the Will that included that provision.

a. Facts and trial court decision

The case developed after the attorney, Mark Papazian, a partner with Giarmarco, Mullins & Horton, PC, drafted various estate planning documents for Robert (Bobby) Mardigian. Mardigian, who was both a client and a friend, was divorced at the time and had no children. Under the terms of the Will, after Mardigian died of lung cancer in 2012, approximately $14 million of his $17 million estate would be distributed to Papazian and his family—$5 million in trust for each of his Papazian's two children and approximately $4 million to Papazian, the scrivener. But Mardigian's surviving family members, including his brother and nieces, along with Mardigian's girlfriend, filed an objection to the proposed distributions with the local probate court.

In November 2013, the probate court issued a summary judgment in favor of Mardigian's family, essentially ruling the documents Papazian drafted invalid. *See generally, Detroit Free Press* 4/11/15. The court reached that outcome largely because, as in most states, under the Michigan Rules of Professional Conduct, attorneys are generally prohibited from accepting a substantial bequest from their clients unless the attorney is related to his or her client, a requirement not met in this case. Bequests to a client's attorney are also allowed under the Rules if another, independent lawyer drafts the documents. In those situations, the attorney's law partner is often asked to draft the client's Will.

But then, Papazian appears to have known those Rules—he just didn't follow them. In fact, in court documents, the Mardigian family argued that Papazian had initially claimed that his law partner—not Papazian—had drafted Mardigian's estate planning documents. The Plaintiff's attorney maintained that it was only five days before the probate court trial that Papazian admitted in court filings that he, not his law partner,

had drafted Mardigian's Will. And that admission, the Plaintiffs claimed, came only after his law partner, attorney Roy Luttman, testified in a deposition that he had "absolutely" not drafted Mardigian's Will. For more background on this case, *see generally*, P. Egan, "Family Fights Attorney Getting Millions From Client's Will," *Detroit Free Press*, 4/10/15, http://www.freep.com/story/news/local/michigan/2015/04/10/attorney-receiving-millions-will-drafted-wealthy-client/25611217/.

b. *Papazian v. Goldberg,* Mich. Ct. App. (Adv. Sheet Ver.) 10/8/15

Papazian appealed, arguing that, notwithstanding the Rule violation, he was still entitled to the bequests because he did not exert undue influence on Mardigian. According to Papazian, violating the Rules only meant that he could be subjected to disciplinary action by the Board of Professional Responsibility—not that the Will was necessarily invalid.

In a split decision, the Michigan Court of Appeals agreed, ruling in the Fall of 2015 that, while Papazian violated the Rules of Professional Conduct, the Will he drafted was not *void ab initio*. Instead, the Court said, he has the burden to prove that he did not exercise undue influence on his client, Bobby Mardigian. The Court therefore reversed the trial court's holding and remanded the case back to that court for additional proceedings.

In reaching that outcome, the appellate court specifically acknowledged that Papazian had breached Section 1.8(c) of the Michigan Rules of Professional Conduct, which provides

> *"A lawyer shall not prepare an instrument giving the lawyer or a person related to the lawyer as parent, child, sibling, or spouse any substantial gift from a client, including a testamentary gift, except where the client is related to the donee."*

The Court of Appeals ruled that an earlier Michigan Supreme Court case, *In re Powers* (375 Mich. 150, 1965) required the Court to remand this case "for further proceedings." In *Powers*, the state's highest court found that a Will leaving the majority of a testator's property to either the drafting attorney or his family "was not necessarily invalid." Instead, the Supreme Court said, there is only a presumption that undue influence has been exerted.

Relying on *Powers*, the Court of Appeals went on to write that, while Papazian violated the Rules of Professional Conduct, the rules are not to be construed in such a way as to "make it clear that the public policy of this state *prohibits*" the actions that he took [emphasis added].

Instead, the Court concluded that, while the Rules "*may* constitute definitive indicators of public policy," they do not conclusively do so. In fact, the Court wrote,

"Accordingly, while the violation of MRPC 1.8(c) is clearly unethical conduct, it is not *clearly* conduct against public policy." [Emphasis in the original].

One justice, Judge Deborah Servitto, dissented in this case, arguing that *Powers* "was decided long before the 1988 enactment of the MRPC, or even its predecessor, the Code of Professional Conduct." She concluded that "once the trial court has found the terms of a trust or instrument of disposition to be contrary to public policy the legal effect of the instrument is a forgone conclusion: Papazian could not be a beneficiary of his client's property."

c. *Mardigian v. Goldberg,* Mich., No. 152655 (6/29/16) 6/21/18.

The seven-member Michigan Supreme Court granted *certiorari* and issued an equally divided decision (3-3) last year. There was no majority decision because one of the Supreme Court justices (Justice Wilder) was on the Court of Appeals when it heard the case. But in issuing an equally split decision, the Supreme Court allowed the Court of Appeals opinion to be controlling. The case was therefore remanded to the probate court, where Mardigian will be able to argue, because of the Court of Appeals decision, that he should keep the bequests, despite violating the Rules of Professional Conduct, because there is "only a rebuttable presumption of undue influence."

Interestingly, during oral argument, the attorney for the Mardigian family specifically argued that, *"When the pot is enticing enough, when, say, it holds $16 million, then lawyers are going to be tempted to risk the disciplinary sanctions for a chance at inheriting the fortune."* (Oral Argument, at 5:35, Published 12/7/17 (emphasis added)). That argument is, of course, consistent with the findings of research, too. For the oral argument before the Michigan Supreme Court, *see* https://www.youtube.com/watch?v=egK5kkoXUSY. The full opinion, as well as the amicus briefs and video, may all be accessed online here: https://courts.michigan.gov/Courts/MichiganSupremeCourt/oral-arguments/2017-2018/Pages/152655.aspx.

D. Conflicts of interest

1. Conflicts of interest and its role in legal malpractice

Insurers generally agree that estate-planning issues are the most likely area to generate the highest financial awards for claims of legal malpractice. That is the conclusion of an annual study conducted by Ames & Grough, an insurance broker based in Washington, D.C.

The survey of the nine largest providers of legal malpractice insurance found that the biggest malpractice judgments were most likely to be focused on cases involving trust- and probate-related issues, followed by claims for malpractice related to corporate and securities laws. And "by far" the single biggest reason for an award—conflicts of interest—is often preventable. But with the growing number of law firm mergers, suits alleging conflicts have become an increasing concern among carriers. That's largely true, carriers say, because conflicts of interest are often identified after the merger has occurred, and that timing can lead firms to ignore them when they are finally discovered—months or years later. *See Insurance Journal* 7/10/15.

2. *Gunster, Yoakley & Stewart v. McAdam*, 965 So.2d 182 (Fl. Dist. Ct. of App. 2007).

This relatively famous case is focused on Model Rule 1.7, which governs whether a lawyer may represent multiple parties. Subsections (a) and (b) of the Rule provide:

(a) "except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
(1) the representation of one client will be directly adverse to another client; or
(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person or by a personal interest of the lawyer."
(b) "notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
(2) the representation is not prohibited by law

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
(4) each affected client gives informed consent, confirmed in writing."

a. Case background

This case developed after Charles McAdam, Jr. ("McAdam"), a resident of Palm Beach, Florida, died on January 3, 2003. Before his death, McAdam met several times with a local, prominent estate-planning attorney, Daniel Hanley.

Hanley was a partner in Gunster, Yoakley & Stewart, P.A. ("Gunster"), where he is the head of the firm's trusts and estate department. Hanley initially met McAdam in April 1998, to discuss various estate-planning concerns. During that meeting, Hanley reviewed McAdam's assets, along with several of his existing estate-planning documents. After that review, the two of them discussed possible alternatives, including the creation and funding of a revocable trust, in conjunction with a pour-over Will that named might name a corporate fiduciary.

According to Hanley, he told McAdams that, if he decided to name a corporation as either a Personal Representative or Testamentary Trustee, he should consider either U.S. Bank or J.P. Morgan (JPM). Hanley said he told McAdam that the firm had "worked for and with both of these entities and held them in high regard." *See* Initial Brief of Appellants, Fl. Dis. Ct. of App. at 5 (8/28/06).

McAdam and Hanley met again in May 1998, and during that meeting, Hanley says, McAdam informed him that he wanted to name JPM as both a Co-Personal Representative and as Co-Trustee. He also wanted to include a provision in his trust that allowed the trust beneficiaries—his two sons—to remove JPM after two years of service, with or without cause. McAdam never met with representatives from JPM, but Hanley says he provided McAdam with an estimate of fees JPM would likely charge for serving in those capacities.

On June 5, 1998, McAdam executed his Will and Revocable Trust. Simultaneously, Hanley gave him documents that summarized how his trust would operate. No assets were transferred into the trust. Instead, included as part of the operational document was a paragraph that specifically said, *"You are responsible for transferring assets into your Trust." See id.* at 6 – 7 (emphasis in the Brief).

b. Litigation

After McAdam died, his sons became concerned about the role and the fees that JPM would charge. Similarly, JPM was concerned because one of the sons who had been managing a portfolio on his father's behalf in a New York brokerage would not surrender the assets. The two sons then filed suit in 2005 against both the law firm and JPM seeking $3.3 million in damages. The bank was eventually dropped from the suit, after agreeing to resign its positions, but the litigation against the firm continued.

c. Claims & verdict

Among other claims, the sons argued that Hanley selected JPM because it was a valuable client, and naming them in several fiduciary capacities would, essentially be "some kind of kickback." *See* "Heirs to Gannet suing West Palm Beach lawyer, law firm," *The Florida Times-Union* 11/4/05. They also claimed that the law firm had a fiduciary duty to ensure the trust was funded, and that by not meeting that duty, the estate incurred significant and unnecessary estate administration expenses.

At trial, the jury awarded $1.2 million against the firm. The trial court granted a slight remittitur, and entered final judgment of $1,043,430. The Court of Appeals affirmed. In reaching that outcome, the appellate court found that there was sufficient evidence that the law firm had "implicitly agreed to" fund McAdam's revocable trust. And because of that implicit agreement, the trial court was correct in submitting the question of whether the firm had a duty to oversee the funding to the jury. *See Gunster, Yoakley & Stewart v. McAdam*, 965 So.2d 182 (Fl. Dist. Ct. of App. 2007).

3. *Wittenberg University v. Martin*, (Ohio Case, 2015)

In 2015, Wittenberg University, a Lutheran-affiliated liberal arts school in Springfield, Ohio, filed suit against its the law firm. In the suit, the University alleges that the firm, Martin, Browne, Harper and Hull (Marin Brown), breached a variety of fiduciary duties. The suit also named partners Glenn Collier and David Weaver as defendants. Among the principal allegations: that both the individual partners and the firm had multiple conflicts of interest.

In the suit, the school says that one of the partners at the firm used his influence to convince the University to use its endowment to buy the

Springfield Museum of Art in 2010, which was operating with a deficit in excess of $300,000. According to the suit, one of the firm's partners was also on the Museum's Board of Directors, presenting a clear conflict of interest.

The University argues that both Collier and Weaver withheld material information not only when the school bought the Museum, but also when it made other investments. The school maintains that the attorneys' judgment was biased not only because of their involvement with the Museum, but also because of their community involvement—ties to the Turner Foundation (a local charitable foundation established in 2001 by Harry Turner as part of his estate plan to be "a catalyst for the improvement of life in Springfield and Clark County").

The University alleged other breaches, some related to the Museum purchase and some not. According to the school, the Museum purchase was in violation of the endowment's "Statement of Investment Policy," which the firm drafted. In the complaint, the University alleges that, under the Policy, all conflicts must be disclosed in writing in advance of any discussion. In addition, according to the school, the endowment loaned the proceeds to buy the Museum to the University, also in violation of its Investment Policy, which prohibited borrowing endowment funds, absent specific Board approval and even with that approval, only within specified limits. But according to the suit, even though the firm knew that lending endowment funds was prohibited, it told the endowment managers that loaning money to the University was permitted.

The suit also claims that the firm violated other duties: it used its relationship with the University in a way that benefited several other clients and drove more legal work to the firm. And, the suit alleges, the firm also allowed the endowment to purchase real estate, above the endowment's withdrawal limits.

There were also several terse emails between the parties that suggested a soured relationship between the parties—at least between the firm and the president of the University. And those emails raised some questions about the identify of the "client"—the firm claimed that, in its view, the University's Board, not its President, was the firm's client. In an email to the University's Board Chair, one of the partners wrote:

> *"I know that Dave made this observation during an earlier meeting with Laurie. My understanding is that Laurie did not appreciate this position. She may have thought that we serve as a 'staff' legal counsel who would report and owe a duty of loyalty to the President."*

See T. Dwyer, "Witt's Lawsuit Against Former Firm Moves Along," *The Torch*, 9/5/15.

The firm denied any wrongdoing. It also filed an answer in June 2015 seeking dismissal of the complaint based on the statute of limitations. In May 2016, the University dropped its suit, without prejudice. Representatives at the school said they continued to believe their claims were valid, and they would focus their efforts on settling their claims privately. If those efforts are unsuccessful, the school said, they would re-file their complaint in the future. The firm, meanwhile, said it believed it had been vindicated.

4. *In re Mills*, N.C. Ct. App. No. COA13-1440, 9/2/14

In lengthy litigation that the North Carolina Supreme Court designated as an "exceptional case under Rule 2.1 of the General Rules of Practice," the Court of Appeals has held that a personal representative (PR) may be removed when evidence exists to support *mere allegations of misconduct* and conflicts of interest—not that misconduct has actually occurred.

The decision, in a case with a number of both substantive and procedural issues, developed after Harold Mills ("Harold") died in February 2008, followed by the death of his wife Audree nearly two years later, in January 2010. Prior to their deaths, the couple, who had accumulated substantial wealth and had no children, consulted Thomas Hartsell ("Thomas"), a financial adviser, to assist them with their financial and estate planning needs. Harold initially met Thomas in March 2006 because the couple's attorney, Fletcher Hartsell ("Fletcher"), who was Thomas's brother, had recommended him. Three months after that initial meeting—in June 2006—Harold Mills executed his Will, which named Thomas as his Personal Representative (PR).

Several months later, Harold and Audree formed H & A Mills Properties, LLC, transferring "substantially all" of their assets into that entity. In a separate agreement, Thomas was also named as one of the LLC managers.

In February 2007, the couple created a charitable remainder unitrust (CRUT). The trust specified that the couple would receive a 6.5% unitrust distribution for the rest of their lives, and any remaining interest after both of their deaths would be distributed to the McGill Baptist Church. Fletcher (the attorney), who had drafted the CRUT, was also named trustee.

Only a year after funding the CRUT (on February 19, 2008) Harold died, survived by his wife, Audree. Thomas was appointed PR of Harold's estate the next day. But three months later, in May 2008, Audree was adjudicated incompetent, and her nephew, Ray White, was appointed as her guardian.

As Audree's guardian, White attempted to recoup some of the property that she had previously transferred by filing suit (*White v. Hartsell*) against several parties, including the trust itself, Fletcher as trustee of the CRUT, Thomas as both manager of the LLC and PR of Harold's estate, and McGill Baptist Church. The complaint alleged several causes of action including undue influence and various breaches of fiduciary duties. White also asked the court to invalidate the CRUT, which would return the trust assets to Audree's and her husband's estates.

After Audree died in January 2010, her husband's nephew filed another complaint, this one asking the court to remove Thomas as PR of Harold's estate. Following an initial hearing in August 2012, the Assistant Clerk concluded that Thomas had "a private interest that…is adverse to his being able to fairly and properly carry out his duties," and that his letters of testamentary should be revoked. Following a number of hearings and other proceedings, this case eventually reached the Court of Appeals, which affirmed his removal.--*In re Mills,* N.C. Ct. App. No. COA13-1440, 9/2/14

Observation: In its opinion, the appellate court outlined a number of issues and conflicts of interest that seemed to trouble the Court. The Court noted, for example, that Harold Mills' nephew had filed a petition to determine both Harold's and his wife's competency in September 2005—less than a year before the couple made significant estate-planning decisions and property transfers. In addition to questions about the couple's competency, the Court wrote that there were numerous conflicts of interest.

To identify the conflicts, the Court largely relied on the "findings of fact" as outlined by the Assistant Clerk. As part of those findings, the Assistant Clerk had written that, as a manager of the LLC, for which he was paid $150,000, Thomas had a "'great deal of control'" over the business—the asset he used to fund the CRUT, which his brother drafted and under which his brother was serving as trustee. In addition, the appellate court noted that, as PR of Harold's estate, Thomas had to determine whether to proceed with litigation against Wachovia Bank for mismanagement of the estate's funds, even though Thomas' wife was employed at the Bank.

But the Court wrote that "even more significant" was the conflict that Thomas faced in deciding whether to join the litigation that was trying to invalidate the CRUT. As the Court noted, if the trust were determined to be invalid, its assets would be returned to Mills' estates, but Thomas had a personal interest in "establishing that he committed no wrongdoing and in vindicating his and his brother's actions." Accordingly, removing Thomas as Mills' PR—without a trial verdict for any specific wrongdoing—was appropriate. For additional background in this lengthy dispute involving many of the same parties, *see Bland v. Mills*, No. COA13-628, N.C. Ct. App. 1/21/14.

VIII. Ethical lapses are everywhere: in financial advice and wealth management

A. Codes of conduct

Various wealth management advisers, including Certified Trust Financial Advisers (CTFAs), financial planners, trust officers and accountants are governed by largely similar Codes of Conduct.

1. The Board of Certified Financial Planners (CFPs) has adopted its own Code of Professional Conduct in an effort to "establish the highest principles and standards." *See* Certified Financial Planner Board of Standards, Inc., *as outlined at* http://www.cfp.net.

   a. Principle 1 – Integrity: Provide professional services with integrity.

      Integrity demands honesty and candor which must not be subordinated to personal gain and advantage. Certificants are placed in positions of trust by clients, and the ultimate source of that trust is the certificant's personal integrity. Allowance can be made for innocent error and legitimate differences of opinion, but integrity cannot co-exist with deceit or subordination of one's principles.

   b. Principle 2 – Objectivity: Provide professional services objectively.

      Objectivity requires intellectual honesty and impartiality. Regardless of the particular service rendered or the capacity in which a certificant functions, certificants should protect the integrity of their work, maintain objectivity and avoid subordination of their judgment.

B. The Institute of Certified Bankers (ICB) has adopted a similar Code of Ethics that applies to, among others, CTFAs.

1. "Preamble: The Institute of Certified Bankers (ICB) recognizes the importance of promulgating a code of ethics that emphasizes the conduct, competency, knowledge, professionalism, integrity, objectivity, and responsibility of each person qualifying as a candidate for certification. Therefore, the Board of Directors of ICB has received and adopted the following Code of Ethics"

2. Applicants agree to: "1. Conduct my professional affairs in a manner that avoids a conflict of interest or the appearance of a conflict of interest. If I become a party to a conflict, or the appearance of a conflict is created, I shall inform my supervisor as soon as possible."

C. Examples of why these standards were not enough

1. Objective investment advice from financial advisers

   a. Despite many of the principles outlined earlier (requiring objective advice and disclosure of conflicts), there is at least one study suggesting that not all financial service providers apply them. In fact, the study suggests that the research is largely correct: the financial impact influences the financial advice that the average investor is likely to achieve.

   b. Study: "The Market for Financial Advice: An Audit Study," MIT Sloan Prof. Antoinette Schoar, Harvard University Prof. Sendhil Mullainathan and University of Hamburg Prof. Markus Noeth, *as reported by Financial Advisor Magazine* 4/11/12.

      In the 2012 study, participants had hypothetical investment portfolios that ranged between $45,000 and $105,000. They made 284 visits to various financial advisers in the Boston area. With rare exception, the study found that the financial advisers downplayed the investment management fees and generally moved investors from whatever strategy they started with into different, usually more expensive, investment vehicles. Even broadly diversified portfolios with low-cost indexed funds were reallocated, leading the authors of the study to write, "So they [the financial advisers] were willing to make the client effectively worse off." *See id.* The researchers ultimately concluded that the study's results suggest that financial advice is often biased by the financial interests of the advisers giving it.

2. Objective financial advice from trust departments: allegations of self-dealing in selecting investments

a. On December 19, 2014, JP Morgan released a report of nearly 100 pages, entitled "How We Do Business," that described in detail the bank's recent actions to enhance its compliance and ethical standards. The report was issued largely because JPMorgan, after paying fines of several billion dollars for regulatory violations and related legal expenses, was pressured for more transparency in its asset management business by the Sisters of Charity of Saint Elizabeth in New Jersey. The bank also said that more than 700 employees in its investment management division had received ethics training that focused on conflicts of interest. *See Bloomberg Businessweek,* 1/8/15.

b. Apparently another reason for the bank's new report: pending litigation

(1). Two church-related charities have file suit against JPMorgan's trust department alleging that the Bank invested the charities' trust assets in the Bank's own investment products, even though the products were "toxic" and had poor Morningstar ratings. According to the charities, Christ Church Cathedral of Indianapolis and the Sandscrest Foundation (which benefits the Episcopal Diocese of West Virginia) the Bank made the investments because, as the funds' investment manager, it would increase its fees. According to the complaint, the trusts incurred fees as high as 8%, with total fees of $13 million for Christ Church alone. *See generally id.* The Bank says the suit is "meritless." For additional background about the allegations in this case, *see Bloomberg Businessweek,* 1/8/15.

(2). Similar allegations were made in a letter the bank received in from a library in Illinois, the Parlin-Ingersoll Public Library in Canton, Illinois. The Library alleges that the Bank invested $750,000 of its funds in a commodity fund that it managed even though the fund had "no performance history." When the bank sold the fund in March 2013, it took a $254,000 loss. The Library's director maintains that the Bank invested approximately 30% of the Library's funds in JPMorgan's products. The bank denies any wrongdoing in this case, too. *See generally id.*

IX. Start of my own ethical journey: stealing a competitor's presentation

X. How do we avoid ethical lapses?

A. First, have a little humility.

The dean of Harvard Business School, Nitin Nohria, has written an article for the *Washington Post* that summarized the consistent findings of the research: none of us is as honest and forthright as we think we are, and neither are our colleagues. Nohria says we are simply deceiving ourselves if we think otherwise (though he refers to it as an "illusion" rather than as a "deception"). Having a little humility—realizing our and our colleagues' shortcomings—is particularly important when we are facing a highly stressful situation, significant economic rewards, or extreme time restraints. *See N. Nohria, "*You're not as Virtuous as you think," *Washington Post,* 10/15/15.

B. Secondly, watch gradual erosion.

Significant unethical or illegal acts almost always started as small ones: "moral transgressions [are] incremental" and that slope is slippery. *See id. See also,* A. Shlaes, "Pulling Down State Credit Ratings," *Forbes*, 10/14/15 (describing a Christmas ham that George Lefcoe received while serving as a member of the Los Angeles County Regional Planning Commission).

It takes 20 years to build a reputation, & five minutes to ruin it.
If you'll think about that, you'll do things differently.

--Warren Buffett

Success will come and go….but integrity is forever.

--Amy Rees Anderson, *Forbes*

We are better than we think…
but not quite what we want to be.

--Nikki Giovanni, Virginia Tech Professor, during the Memorial Service for 32 Slain College Students, April 16, 2007

Nashville, Tennessee

Remember Sportsmanship?
Our athletes are simply polluted products of a poisoned culture

By Randy Horick

In 1940, back when Ivy League football still mattered in the rankings, undefeated Cornell visited Dartmouth on a damp, bone-chilling late-autumn afternoon.

The Big Red had not lost in three seasons. The Associated Press had ranked them No. 1 in the country all year. En route to their 6-0-0 record, they had crushed Ohio State, Army and Syracuse and outscored their opponents by an average of 30-2. But underdog Dartmouth, coached by the legendary Red Blaik, played with great determination before its home crowd, keeping the bigger, quicker, more experienced Cornell team on its heels. Early in the fourth quarter, Dartmouth kicked a field goal to break a scoreless tie.

With its title hopes on the line, Cornell drove to the Dartmouth 6-yard line with 45 seconds to play. Three straight runs brought Cornell to the 1-foot line, where they called timeout with nine seconds remaining. The referee, Red Friesell, flagged the Big Red for delay of game and stepped off five yards. On the ensuing play, a Dartmouth defender broke up a pass in the end zone, and the home crowd cheered the amazing upset.

On the field, the officials weren't so sure. Because of the penalty, Friesell was confused whether the previous play had occurred on third or fourth down. The linesman was convinced it had been third down. So Cornell received the ball for one last play, with three seconds remaining. This time, the last-gasp pass over the middle was good for a touchdown.

After the Big Red kicked the meaningless extra point, the officials ran off the field. Not until they had showered did someone approach Friesell in the locker room to tell him that all the reporters in the press box were positive that Cornell had received an extra down.

"If that's true," Friesell said, "I'll try to reverse the score."

In 1940, of course, there was no television, much less instant replay to consult. To document what really happened on the field, Friesell and the other officials had to wait 24 hours for the game film to be developed. The film clearly showed what the refs had missed. But under the rules of the Eastern Collegiate Football Association, Friesell was powerless to reverse the score. Once the result had been officially recorded, it stood. Cornell was home free.

Though their team was not at fault, Cornell's staff was uncomfortable with the game's conclusion. That night, Big Red coach Carl Snavely and university president Edmund Day sent a telegram to their counterparts at Dartmouth: "We

congratulate you on the victory of your fine team. The Cornell touchdown was scored on a fifth down, and we relinquish claim to the victory and extend congratulations to Dartmouth." The record books now show the final score as Dartmouth 3, Cornell 0. The gesture of sportsmanship not only cost Cornell the game but its chance at a national championship.

We can't imagine that such a thing would happen today—because it wouldn't. And it didn't in 1990, when unbeaten Colorado benefited from a similar fifth-down error on the game's final play to beat Missouri—and went on, unlike Cornell, to share the national title.

No one was surprised when Colorado's coach, Bill "Promise Keeper" McCartney, opted not to forfeit to Missouri. What big-time coach would have acted differently? After all, Colorado didn't cheat. Refs make game-changing mistakes, and refs are part of the game. And the price of such a forfeit in 1990 would have been much higher than in 1940; it would have cost Colorado's program millions in revenue. Apoplectic boosters would have prevented it.

The then-and-now comparison really illuminates how we live in a world that is not just materially different from the world of 1940 but different in mind and spirit, too. Maybe that's all the more reason to tell this story. We live in an era when sportsmanship is as quaint as hoop skirts and curtsies. In our sports, as in our businesses, the ends justify the means—especially when the ends can be so irresistibly lucrative. Every week's news seems to bring fresh confirmation that Carl Snavely would be laughed out of town today, or worse, even if he were just a peewee league coach.

I could live with a sportsmanship bar that's lower than where Snavely set it. But things are so bad these days, most of us would be delighted if we could get athletes and coaches just to stop actively cheating.

We've come to expect payoffs and grade "management" from college coaches. That's only news when some program speeds by at 110 mph while everyone else is going 80, or when the details are particularly salacious, as with Colorado's call-girl hookups.

And it's harder to believe that Ken Lay and Bernie Ebbers and corporate accounting scandals are isolated examples of golden ends justifying slaggy means. Our athletes are simply polluted products of a poisoned culture.

***

Carl Snavely and Nashville's Grantland Rice, who wrote that winning is less important than how you play the game, would surely disapprove. Who cares? They're dead.

Ethical Issues in Estate Planning & Wealth Management: Why Standards of Conduct Are Not Enough

Virtually all wealth management advisers—attorneys, financial planners, and planned giving professionals—face ethical dilemmas regularly. From representing multiple clients to determining reasonable fees, the underlying principles are often the same and the research is clear: increasing the financial impact will alter our ethical views. Most professions have adopted general Standards of Conduct and Practice, similar to the Rules of Professional Conduct for attorneys, that are aimed at guiding professional decisions. But even after adopting those Rules, there seems to be increasing number ethical lapses nationwide among all professions. This course will review court cases that illustrate those ethical breaches and how to avoid them. Ultimately, the participants leave with one question: are my ethical principles based on the associated economic rewards—are they only a matter of degree?

Steve Goodman is owner and president of TrainWorks, a leading provider of customized, independent training in wealth management, customer service, and business ethics.

Currently, Steve travels the country extensively as one of the lead instructors for the American Bankers Association's in-bank training programs. He is also on the faculty of the Pacific Coast Banking School in Seattle, where he teaches wealth management concepts to private bankers and commercial lenders, and where he has been named one of the top three instructors for six years in a row. In addition, Steve is an instructor at the Southeastern School of Banking, where he teaches sales, ethics and transfer tax techniques to non-trust personnel and has been on the faculty for more than 25 years. Besides training, Steve also writes a quarterly Newsletter that addresses the latest financial and legal developments affecting high net worth taxpayers.

Before forming TrainWorks, Steve worked in the financial services industry where he was a trust administrator, business development officer and a regional manager in charge of both trust and retail brokerage services. Steve attended undergraduate school at the University of Tennessee in Knoxville, where he earned a B.S. degree in Communications, with high honors, and then attended Cumberland School of Law in Birmingham. He then graduated, with honors, from the National Graduate Trust School at Northwestern University.

Steve has been licensed to practice law in Alabama and Tennessee.

Economic Assessment and Fixed-Income Outlook

Presented by:

William E. Ehling, CFA
Vice President
Fixed-Income Market Strategist
Client Portfolio Manager
Federated Investment Management Company

19-10135 (10/19)

Federated Taxable Fixed-Income Decision Tools

	Current Positioning as of October 3, 2019	
	Current	**Rationale**
DURATION MANAGEMENT	**Small overweight**	**Trading a 1.90-1.45 range near term in U.S. Treasury 10 year yields. Agreement on tariffs and trade and/or fiscal stimulus test the highs. Hard BREXIT, weak global growth, and risk asset volatility test the lows.**
SECTOR ALLOCATION	**Overweight: Emerging Markets/International**	**Despite the volatility of risk asset markets, we don't see signs of recession. However, valuations of multiple sectors concern us.**
	Neutral: Investment-Grade Corporates, Mortgage-Backed Securities, High-Yield, and Commercial Mortgage-Backed Securities	**Valuation issues have us at neutral. No signs of recession in our credit work, but statistically "alpha" is much harder to earn at these levels.**
	Underweight: Treasuries and Agencies	**Marginal underweight given neutrality in other sectors. Global uncertainty on multiple fronts, economic growth, tariffs and trade, BREXIT, etc., suggest a flight to quality bid supports pullbacks in government yields.**
YIELD CURVE ANALYSIS	**Looking for more steepening**	**Weak global Purchasing Managers' Index suggests this may be more than a "mid-cycle policy adjustment." Add incrementally absent fiscal policy changes.**
CURRENCY MANAGEMENT	Neutral to U.S. dollar	The U.S. dollar remains the best house in a bad neighborhood. With rate differentials and growth differentials still favoring the U.S. dollar, we are still tactically trading specific currency pairs. Major monetary, fiscal, or foreign policy changes have historically marked the end of U.S. dollar rallies.
SECURITY SELECTION	Continue to overweight select lower-quality credits. Investment Grade value in BBB, consumer facing sectors and financials. High Yield value in "selective" higher beta credits.	We are upgrading the quality of our portfolios with a keen eye on cyclicality and valuation. As in our sector allocation, we currently see no signs of recession.

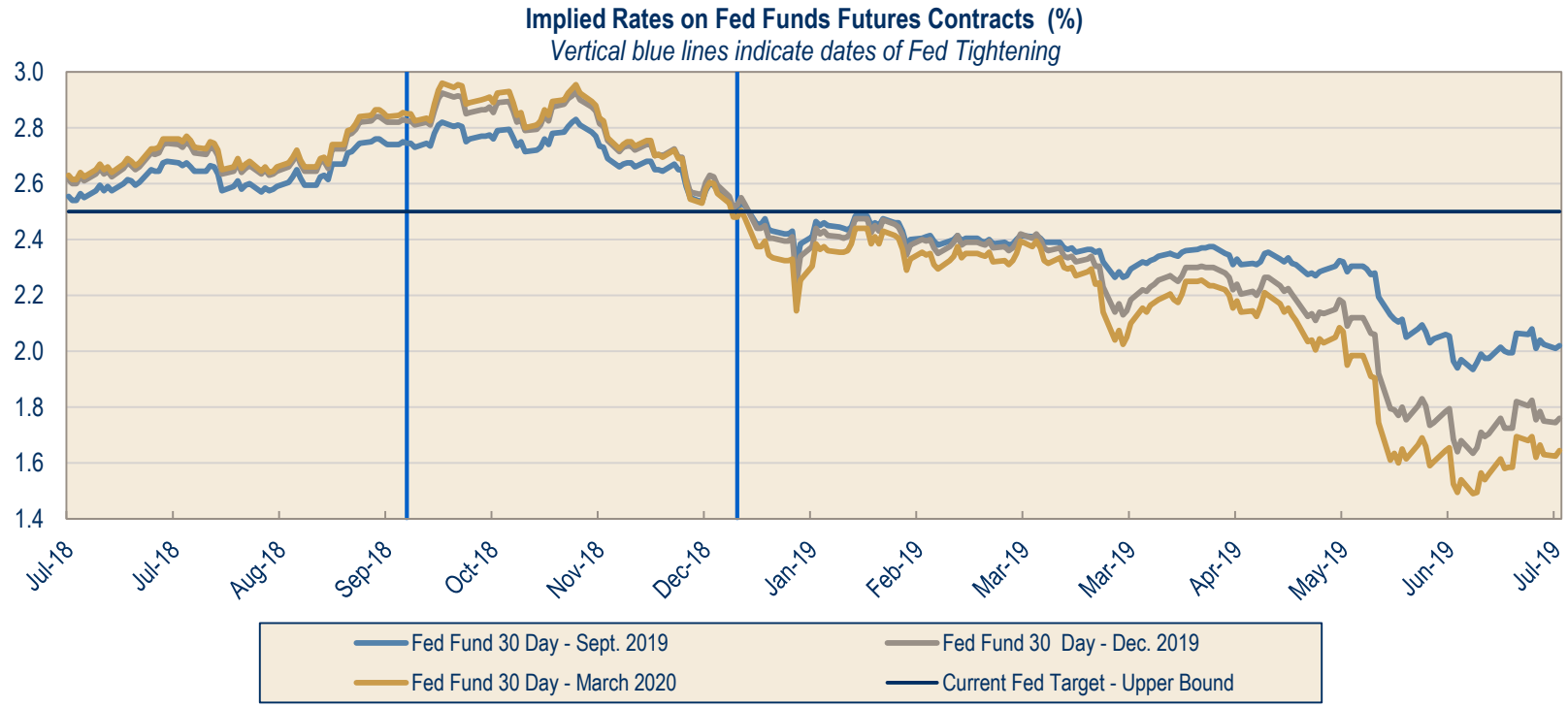
Bold text indicates change in positioning and/or rationale from previous month.

Federated Tax-Exempt Fixed-Income Decision Tools

	Current positioning as of October 8, 2019	
	Current	**Rationale**
Duration Management	**Modest long**	**Persistent trade conflict, slowing global growth, geopolitical risks and Fed easing should exert some downward pressure on Treasury yields from current levels. Muni-to-treasury ratios have reset higher to more attractive levels.**
Yield Curve	Neutral on slope and shape of muni yield curve.	Risks to slope and shape of muni curve appear balanced.
Credit Quality	Neutral on AAA-rated securities and AA-rated securities	Higher quality, highly liquid bonds are an important part of diversified portfolios.
	Neutral on A-rated securities	Valuation is somewhat rich, limiting prospects for outperformance and warranting some reduction in exposure.
	Neutral on BBB-rated and below-investment-grade securities	Valuation is somewhat rich, limiting prospects for outperformance and warranting some reduction in exposure.
Credit Sector Allocation*	Neutral on state general obligation (GO) bonds	General state credit quality has improved. Some states face elevated pension funding challenges and slower economic growth, affecting idiosyncratic ratings and spreads.
	Neutral on local general obligation (GO) bonds	Local GO credit quality is stable and valuations fair. Remain selective among locals that may face downside risks from pension underfunding.
	Positive on below-investment-grade charter schools	Stable credit fundamentals and fair valuations.
	Negative on low-quality small colleges and universities	Falling demand and heightened competition presents downside risk for small, high-tuition colleges.

**Neutral allocations are recommended for sectors and portions of sectors not listed above where valuation and risks seem balanced.*
Bold text indicates change in positioning and/or rationale from previous month.
Positive, Neutral and Negative refer to recommended positioning relative to market/benchmark weightings.

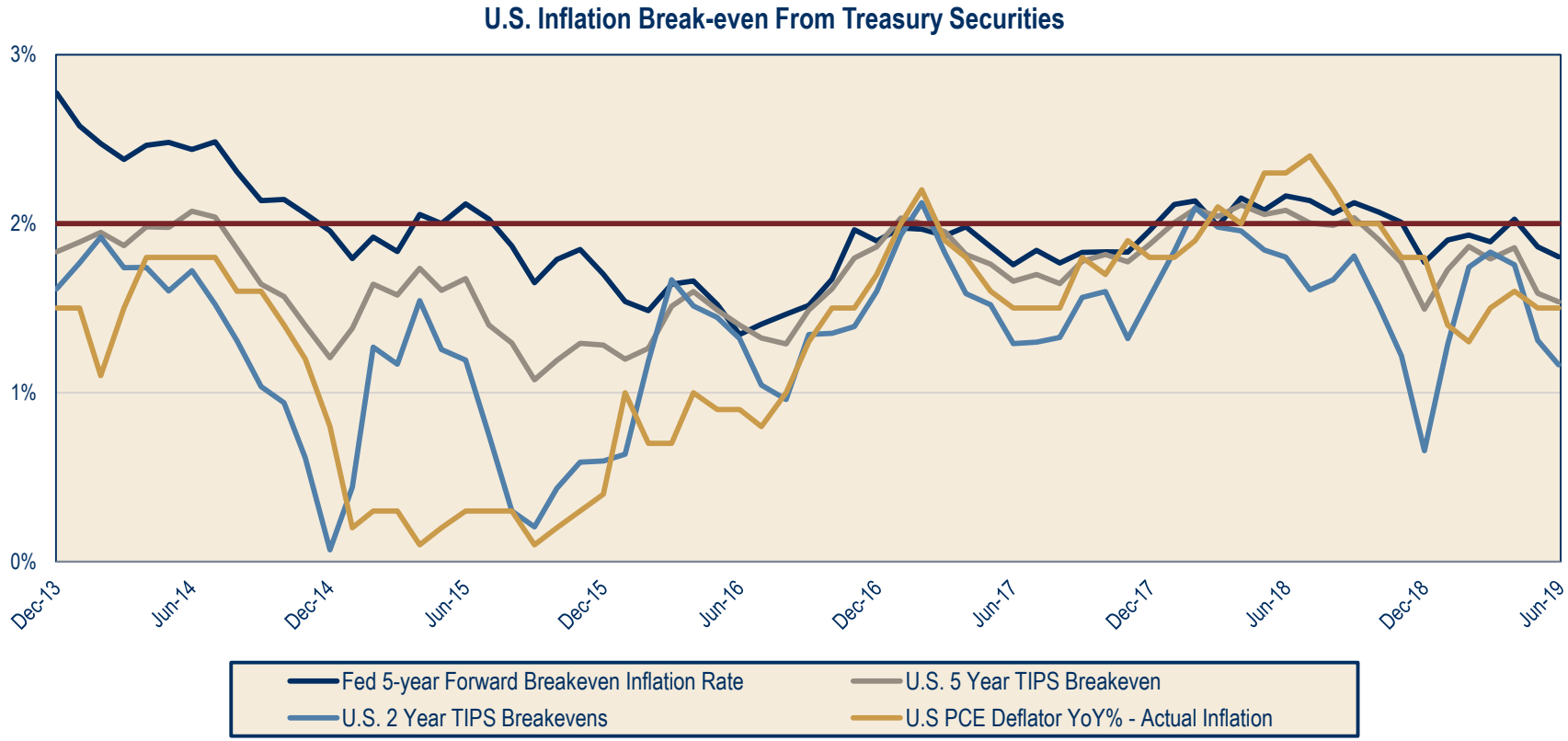
Expectations for Fed Action Flipped Rapidly from Tightening to Easing



- The Fed and the markets are engaged in a complicated dance to determine market interest rates. Sometimes the Fed leads and sometimes the markets lead on the dance floor.
- The Fed led the market during most of the gradual tightening of 2018, but leadership shifted to the markets in Q418 amid slowing global growth, falling inflation, trade confrontation and concerns of excessive Fed tightening.
- The Fed signaled a patient pause in early 2019, but the markets took leadership again, pricing in lower short rates as trade confrontation lingered, inflation remained benign and global growth faded. The Fed is now poised to follow.

Source: Bloomberg as of 7/15/2019

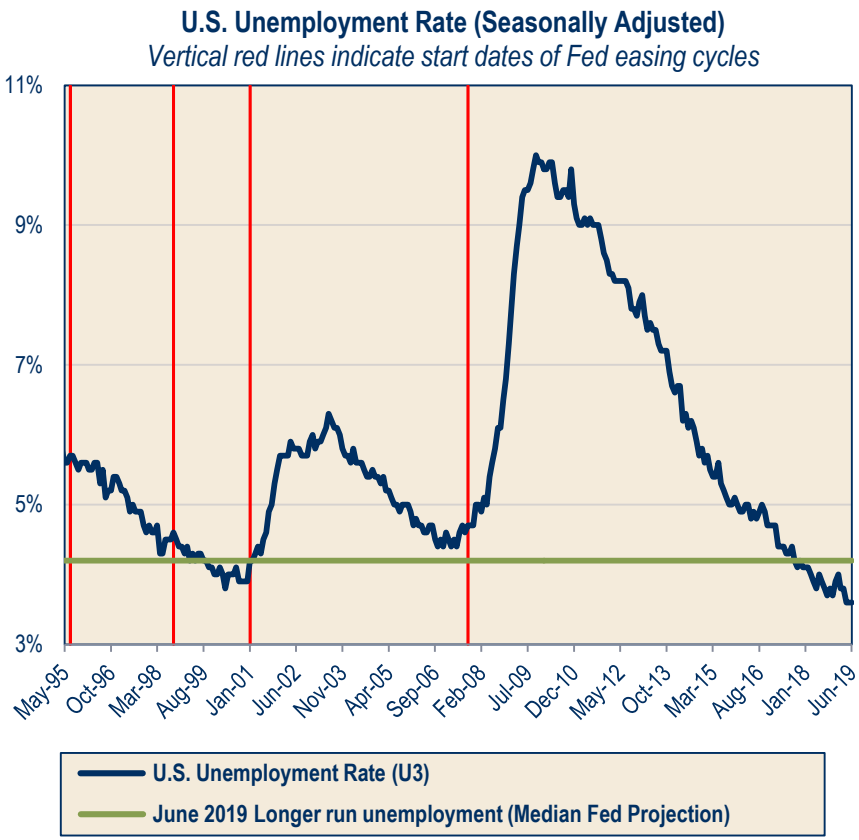
Low Inflation Expectations Provide Flexibility for Fed

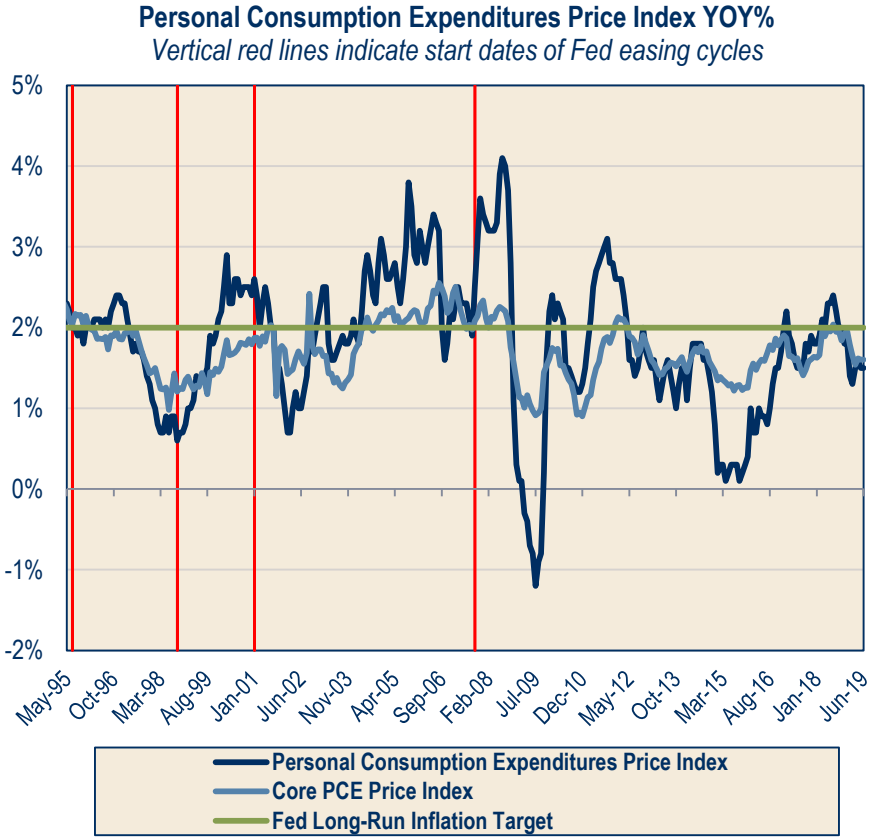


- Actual and expected inflation have rarely met the Fed's 2% target in recent years.
- Thus, the Fed can be preemptive with rates by easing to address growth risks with little fear of inflation or inflation expectations getting out of hand and rising rapidly.
- Such a pro-growth, proactive Fed, however, may fuel financial excesses with adverse consequences in the future. The Powell Fed seems willing to make that trade in the near term.

Source: Bloomberg, all data as of 6/30/19

Status of Fed's Dual Mandate When Fed Has Started Easing

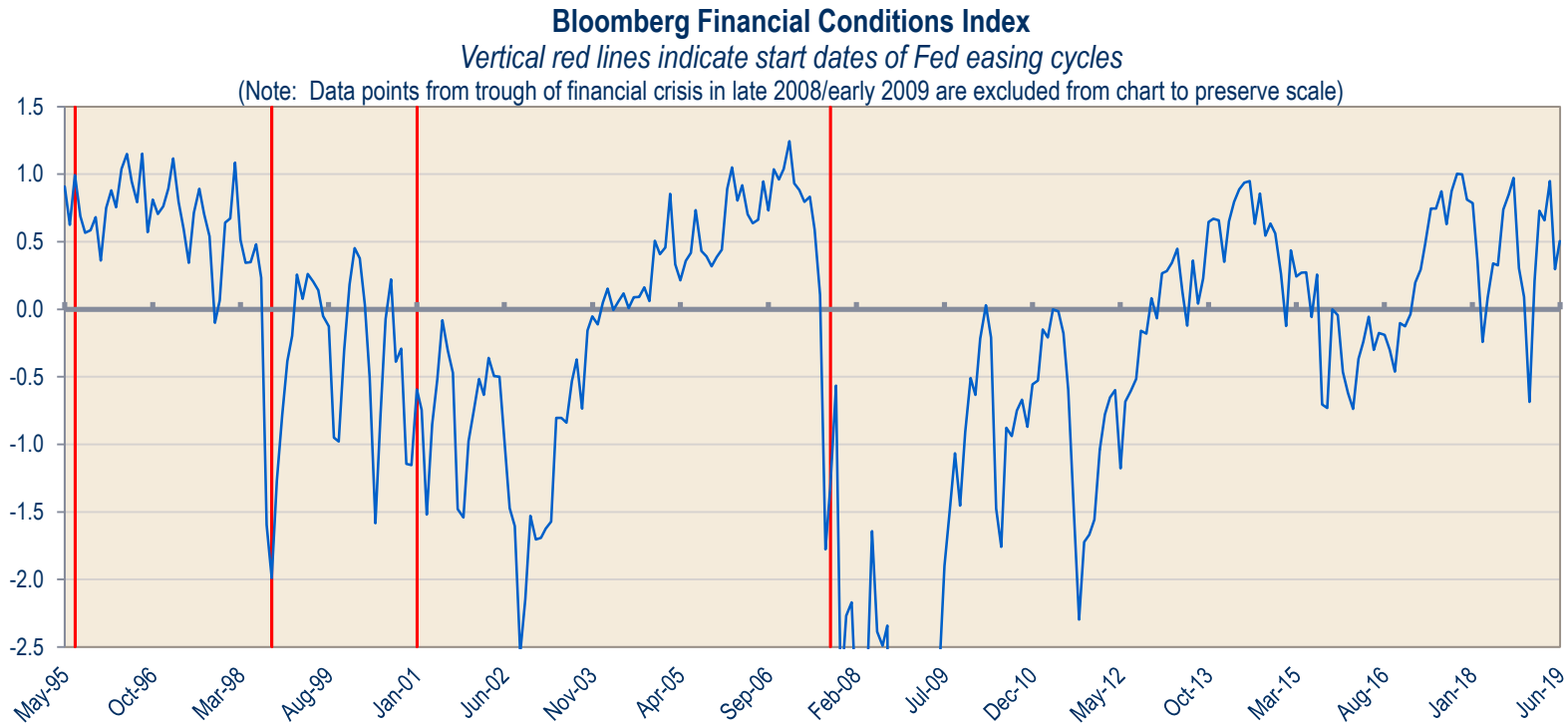




- The last four Fed easing cycles started when the unemployment rate had risen at least 0.3 percentage points from its 12-month trough and core PCE had been trending down (1995, 1998 & 2007) and/or was below 2% (2001).
- A Fed ease at the end of July would be consistent with prior practice regarding core PCE inflation, but would be somewhat early regarding unemployment, which is only up 0.1 percent point from its recent trough.

Source: Bloomberg, U.S. Unemployment Rate, Total in Labor Force, Seasonally Adjusted, Period as of June 30, 2019. U.S. Personal Consumption Expenditures Price Index Year over Year as of June 2019.

Financial Conditions When the Fed Has Started Easing

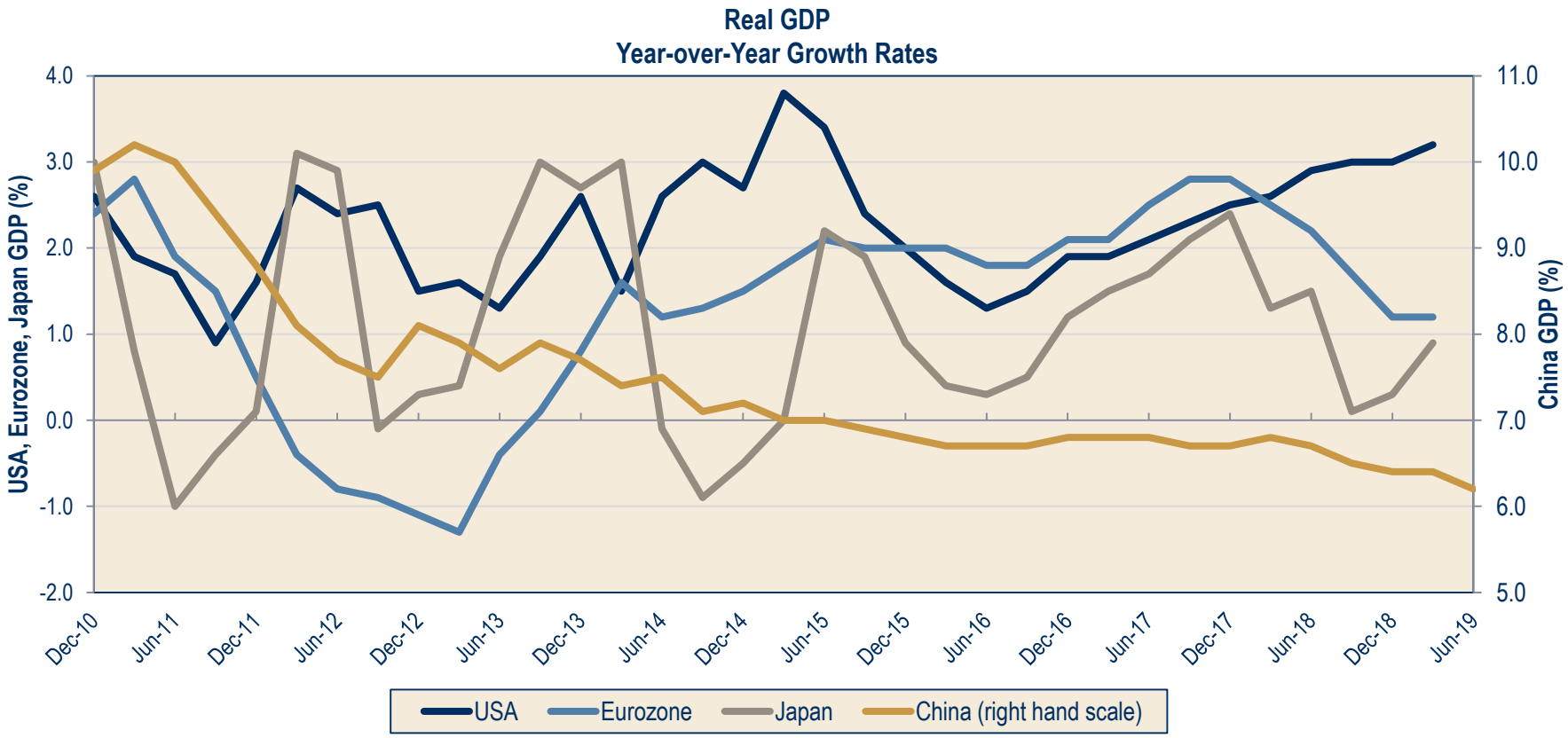


- Financial conditions are key considerations for monetary policy makers as the level of equity valuations and credit spreads serve as a transmission mechanism for monetary policy and can affect economic growth.
- Three of the last four Fed easing cycles began after financial conditions had deteriorated sharply in September 1998, January 2001 and September 2007.
- The 1995 cycle, however, occurred when financial conditions were favorable. An ease at the end of July would be similar, occurring at time of favorable market conditions to ward off rising risks to the outlook.

Source: Bloomberg as of 6/28/19

The Bloomberg U.S. Financial Conditions Index tracks the overall level of financial stress in the U.S. money, bond, and equity markets to help assess the availability and cost of credit. A positive value indicates accommodative financial conditions—higher stock prices, tighter spreads--while a negative value indicates tighter or restrictive financial conditions.

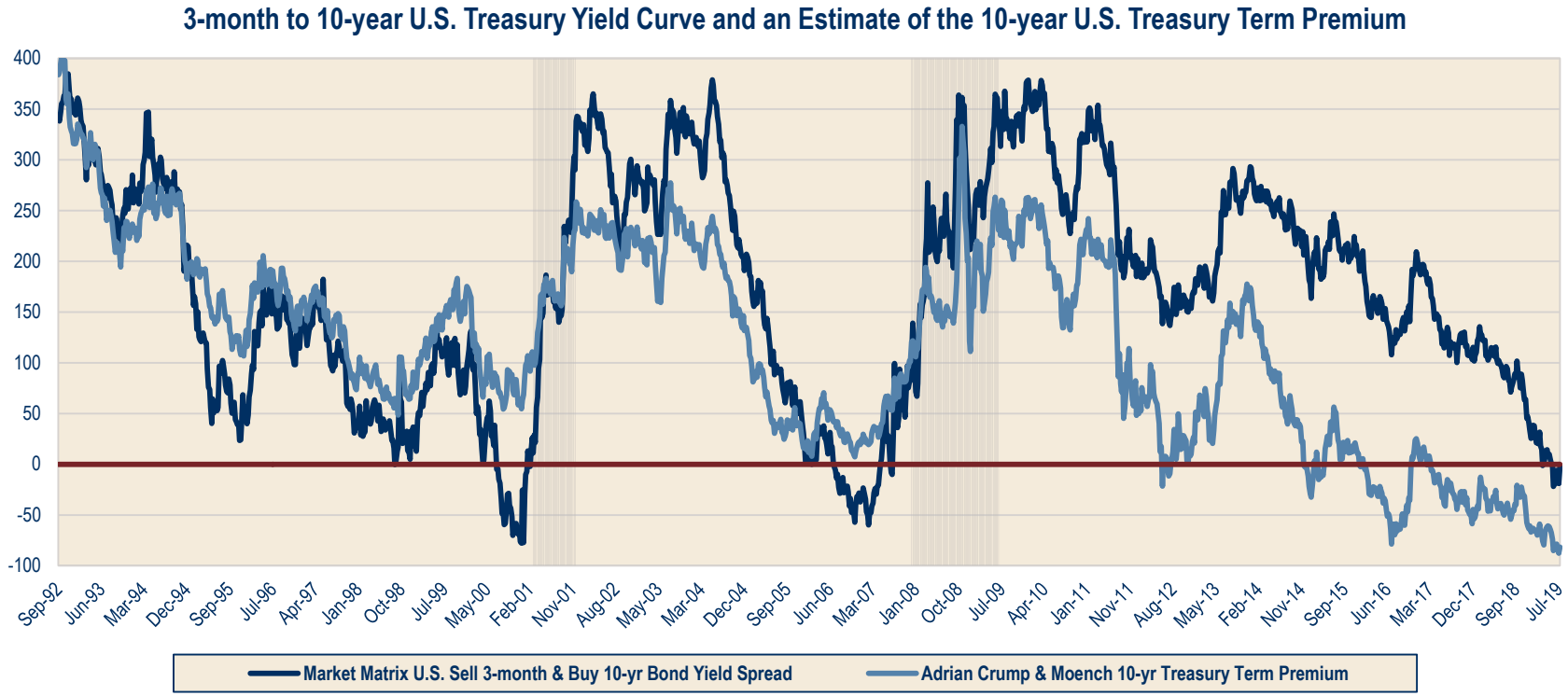
Growth in Three of the World's Largest Economies Has Been Weak-U.S. is the Exception



- China's growth remains in a gradual downward trend which would likely be worse if adjusted for politically motivated overstatement of its economic activity.
- A sharp slowdown in manufacturing has weighed on Eurozone growth. Japan's growth reached near zero in late 2018 and has since rebounded, though a planned October consumption tax increase presents risk.
- U.S. growth, in contrast, has been strong, around 3.0%, supported by the consumer. However, weaker capex, net exports and inventory accumulation should slow growth in Q219.

Source: Bloomberg, GDP US Chained 2009 Dollars YoY SA, Eurozone GDP Chain Linked 2005 Prices, Japan GDP Real Chained NSA YoY% as 3/31/2019. China GDP Constant Price YoY as of 6/30/2019.

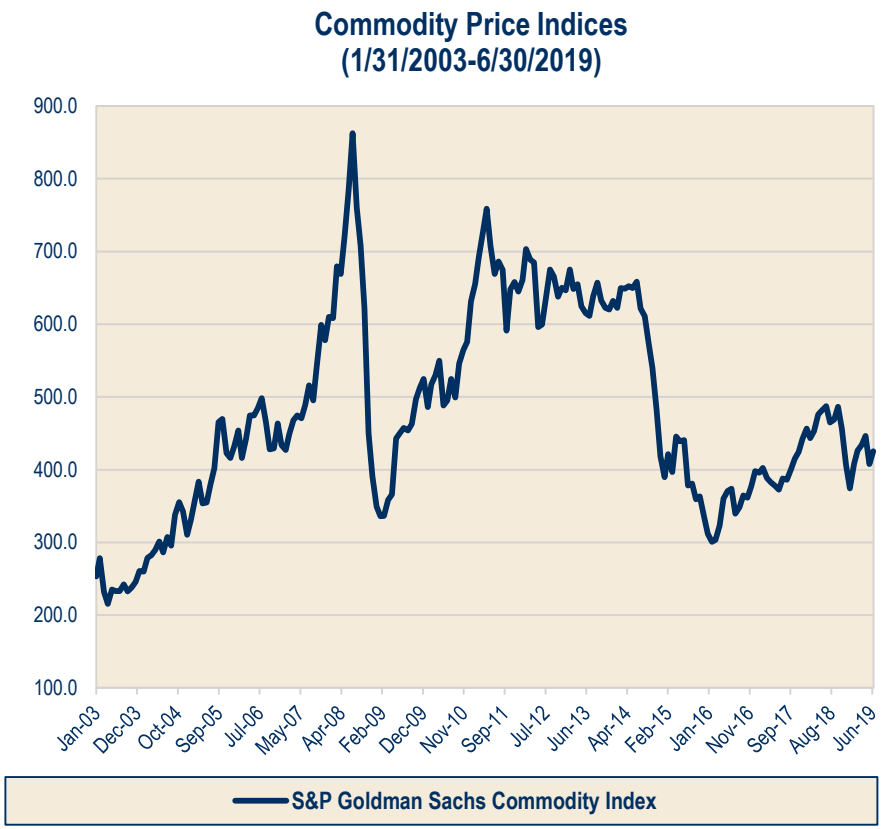
Interpreting the Inversion of the 3-month to 10-year U.S. Yield Curve

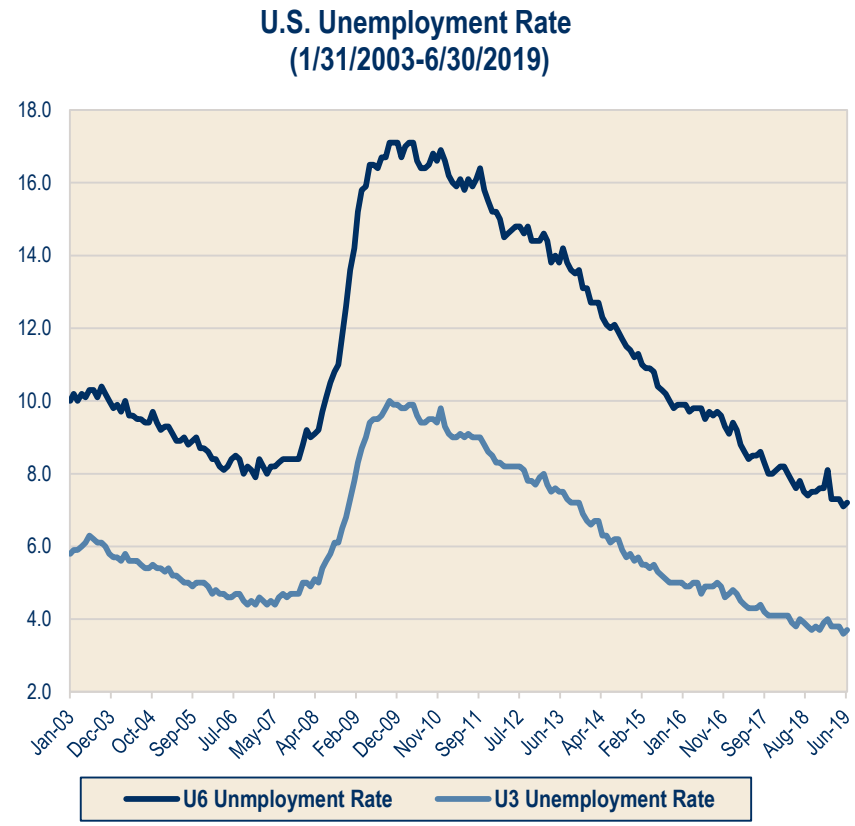


- The 3m/10y Treasury Yield curve has historically signaled a recession when the slope falls and remains below zero.
- When the curve inverted prior to previous recessions, the 10-year term premium was at zero or higher. Currently, it is sharply negative, increasing chances that the recent modest 3m/10yr inversion may not signal oncoming recession.
- The Fed has strongly signaled a likely ease in policy rates at the July FOMC, allowing 3-month bill yields to decline and the 3m/10y yield curve to steepen back to near a zero basis point spread.

Source: Bloomberg as of July 12, 2019. Shaded areas represent periods of recession. Term premium represents the divergence between the observed yield to maturity on an intermediate or long term security relative to the geometric average of market expectations of short term rates over the term of the bond.

Will Inflation Finally Accelerate?

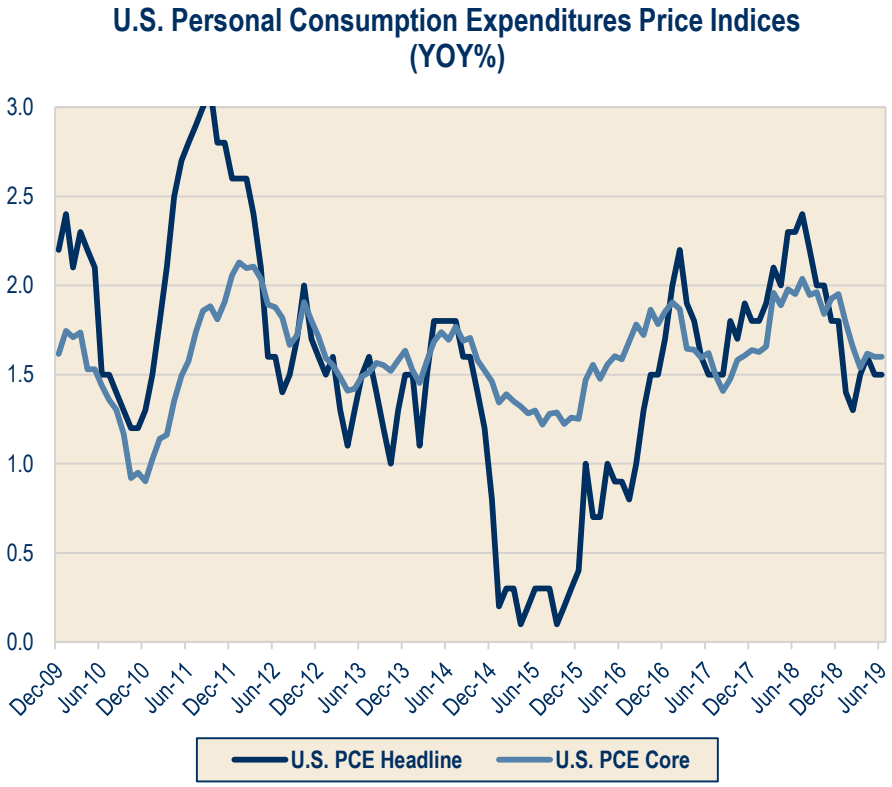


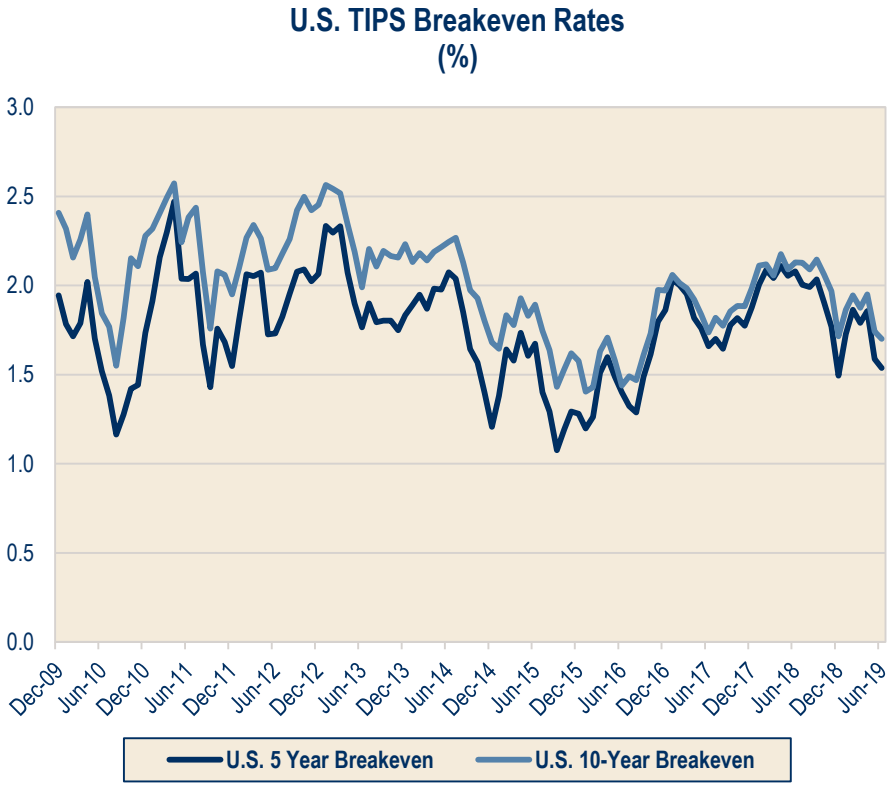


- Raw materials prices—including energy and metals—have risen notably since their recent lows in late 2015/early 2016.
- Labor market slack has returned to low levels not seen since before the financial crisis and recession.

Source: Bloomberg as of 6/30/19.

Will Inflation Finally Accelerate?

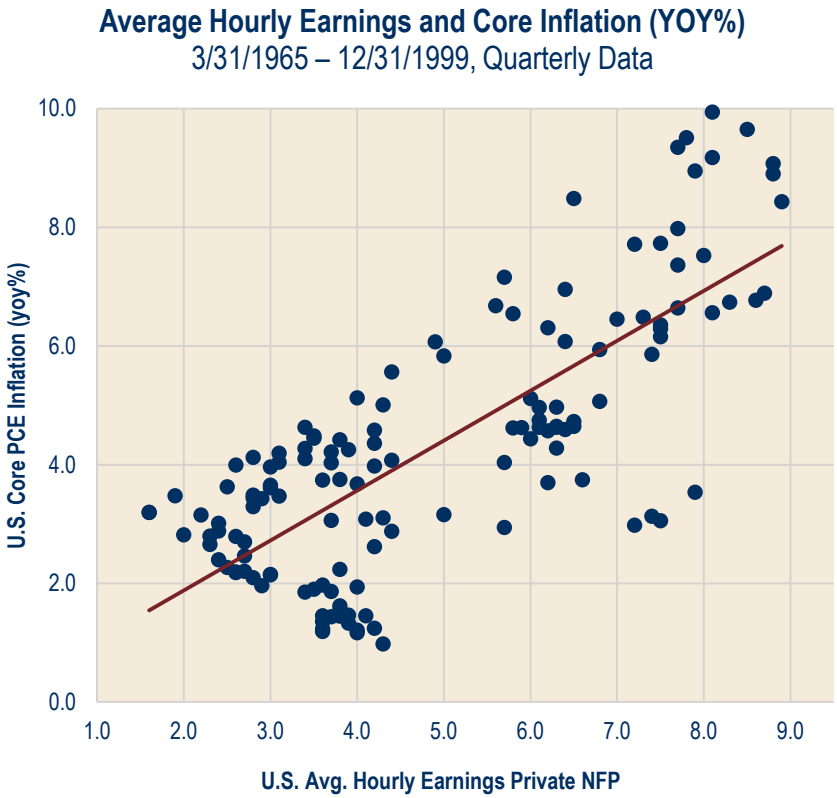


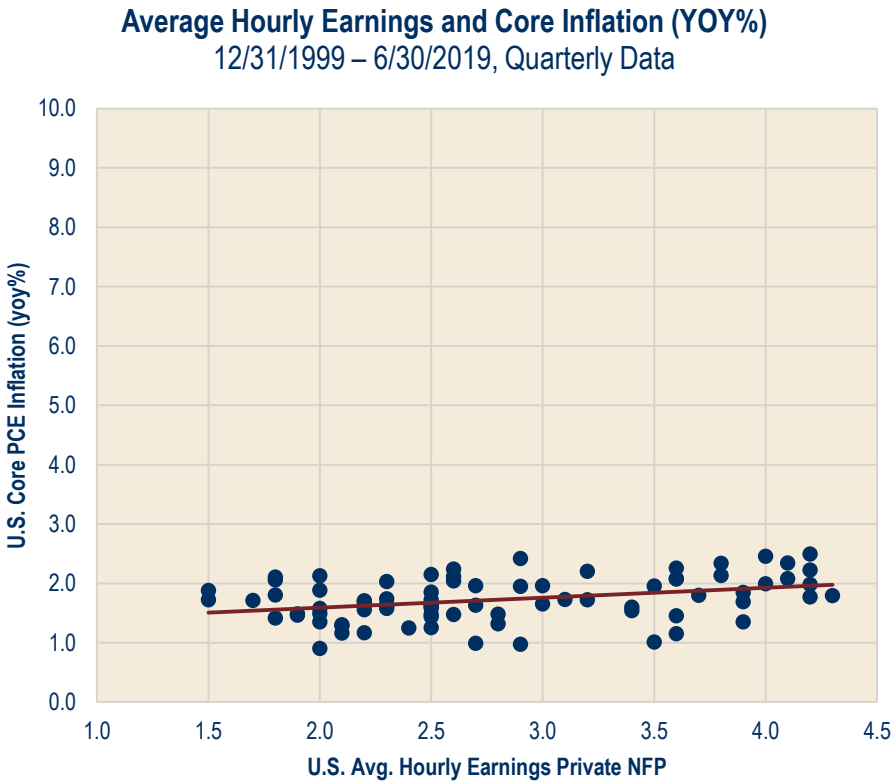


- Headline & core PCE inflation have remained generally below the Fed's 2% target since the last recession.
- Inflation breakeven rates from Treasury TIPS reflect this recent history, but have inflected to about 2% lately.

Source: Bloomberg as of 6/30/19

Will Inflation Finally Accelerate?

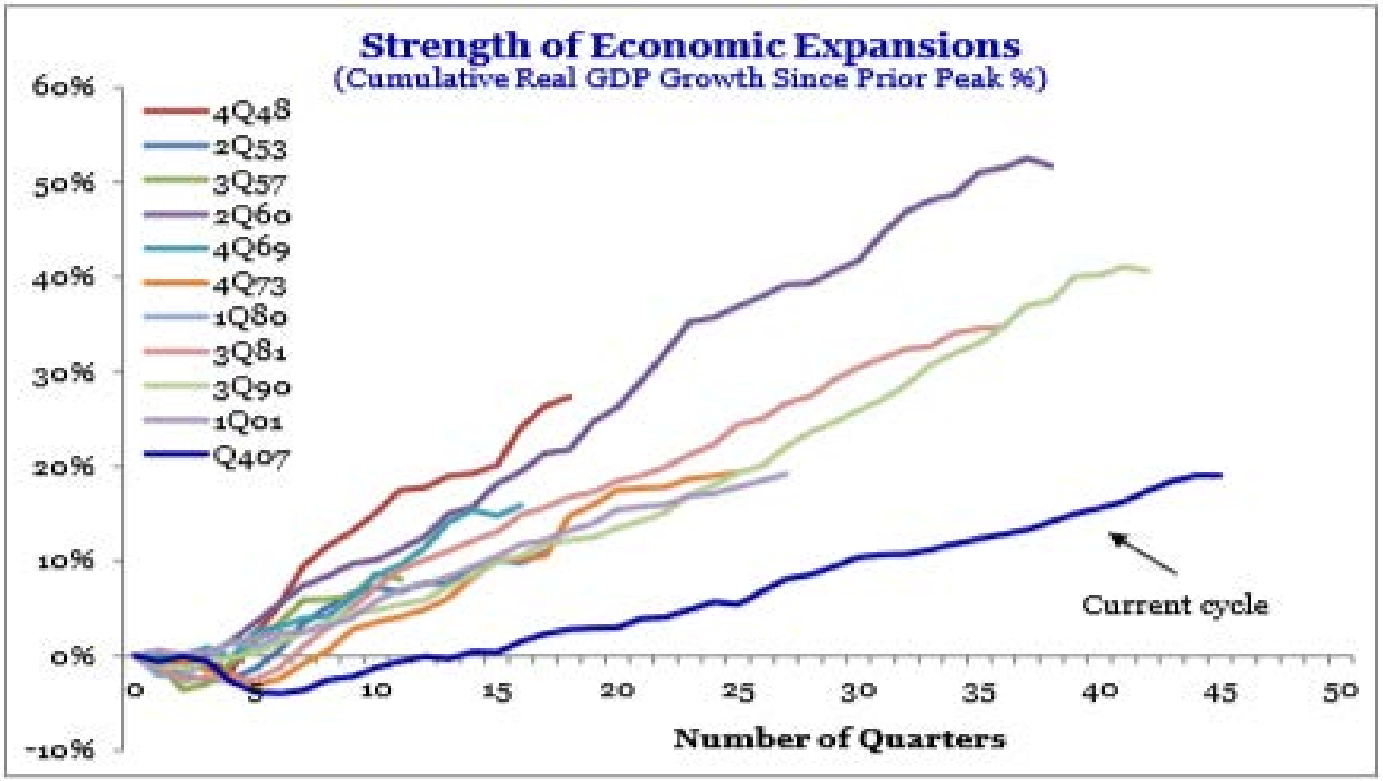




- The relationship between wages and overall core inflation was strong and highly significant for many decades.
- What forces caused this relationship to weaken profoundly in this century? Globalization & trade, demographics, technological advancements, financial crisis, commodity price collapse? All of the above.
- Even as wage growth accelerates, expect the pass-through to general inflation to remain somewhat muted.

Source: Bloomberg as of 6/30/19

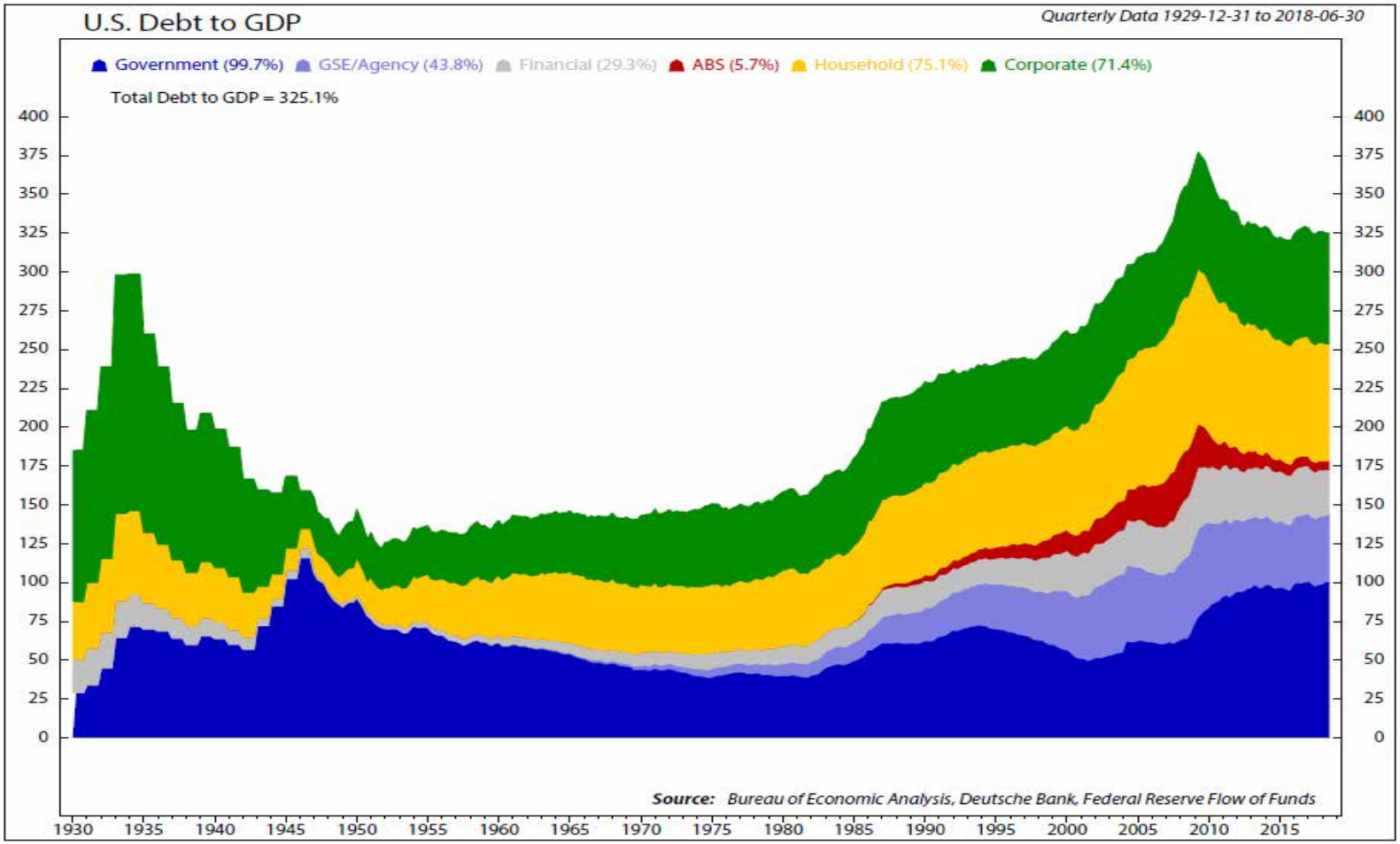
Economic Expansion



Deleveraging after the financial crisis, aging demographics, low investment, low productivity and fiscal policy actions & constraints have combined to limit the pace of the recent economic expansion.

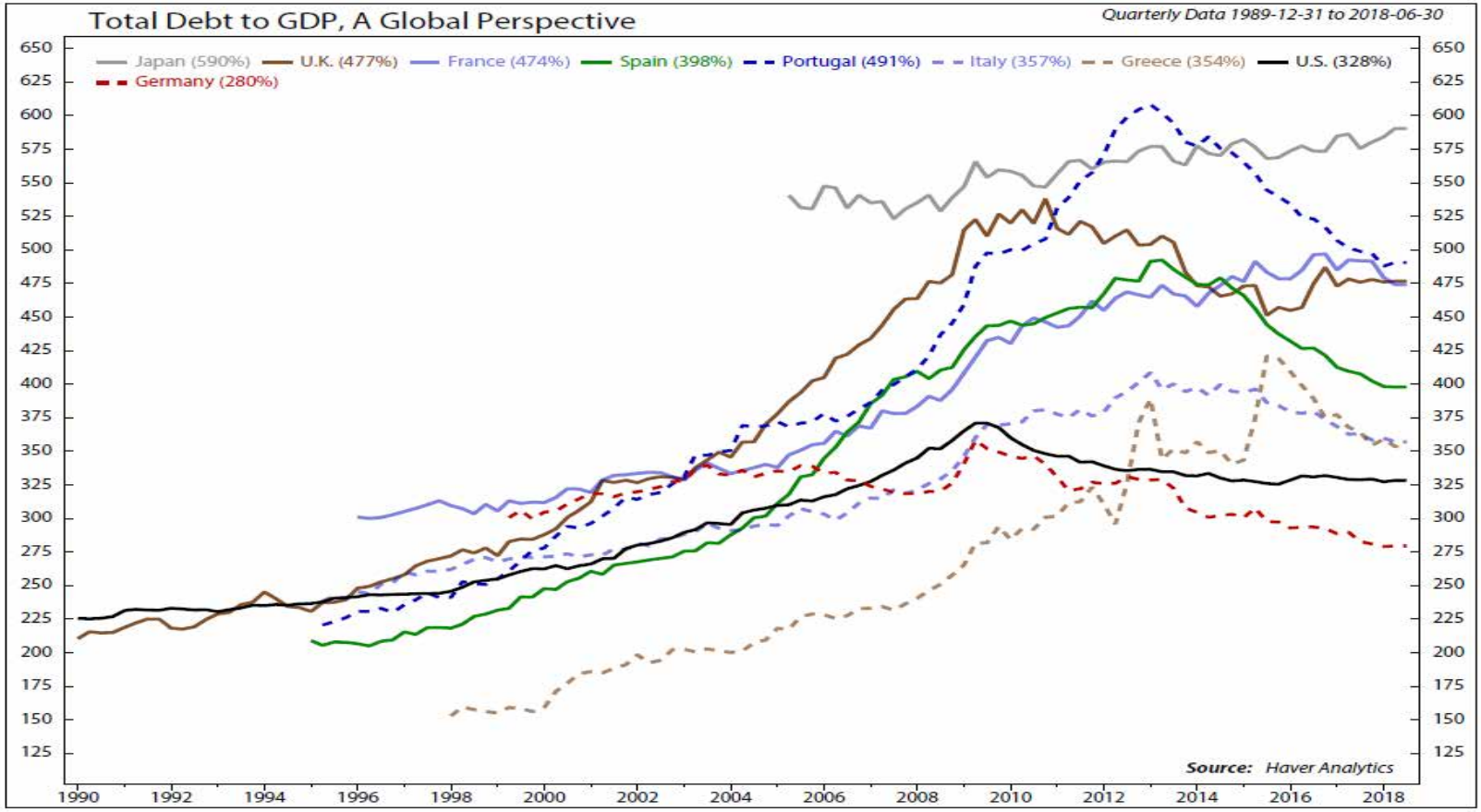
Source: Strategas, 5/21/2019

Global Concern: Growth of Debt Has Exceeded Growth of GDP



The high debt burden in the U.S. seems to be a restraint on accelerating growth.

Excessive indebtedness is a global phenomenon.



The high debt burden across the developed world will continue to restrain global growth

Labor Force Growth and GDP – Trend Shows Continued Slow Growth

Country	1980 mln	2000 mln	80-00 % Δ	2015 mln	00-15 % Δ	2030 mln	15-30 % Δ	2050 mln	30-50 % Δ
China	473.9	765.7	62%	928.6	21%	880.0	-5%	733.4	-17%
India	326.0	532.4	63%	736.6	38%	911.8	24%	1,029.1	13%
USA	130.1	167.6	29%	192.5	15%	196.1	2%	211.3	8%
Indonesia	65.5	114.4	75%	150.0	31%	176.6	18%	190.5	8%
Brazil	56.9	96.5	70%	126.2	31%	140.9	12%	135.5	-4%
Pakistan	33.6	60.9	82%	95.0	56%	132.3	39%	181.4	37%
Nigeria	31.9	52.6	65%	78.2	49%	119.7	53%	201.9	69%
Bangladesh	33.4	63.0	88%	89.5	42%	114.8	28%	123.5	8%
Russia	82.6	89.4	8%	93.9	5%	79.3	-16%	72.1	-9%
Mexico	27.8	51.8	86%	71.8	39%	88.6	23%	95.3	8%
Japan	69.9	78.2	12%	71.0	-9%	63.6	-10%	50.4	-21%
Philippines	20.1	37.2	85%	53.8	45%	69.2	29%	87.1	26%
Ethiopia	14.9	26.3	77%	43.0	64%	71.2	66%	110.3	55%
Viet Nam	23.1	41.3	78%	58.6	42%	63.4	8%	63.3	0%
Egypt	19.5	32.3	66%	48.5	50%	62.5	29%	84.5	35%
Germany	44.8	51.4	15%	49.1	-4%	43.1	-12%	37.9	-12%
Iran	16.6	31.3	89%	50.9	63%	57.3	12%	53.9	-6%
Turkey	19.7	33.6	70%	45.8	37%	52.7	15%	54.5	3%
D.P. Congo	11.2	19.3	73%	31.2	62%	52.7	69%	97.7	86%
Thailand	21.6	38.1	76%	44.4	17%	41.8	-6%	33.0	-21%
UK	31.3	34.7	11%	37.9	9%	38.7	2%	40.2	4%
France	30.3	34.8	15%	36.4	5%	36.2	-1%	36.4	1%
Italy	31.9	35.6	11%	35.4	0%	32.2	-9%	26.8	-17%
South Africa	13.1	22.8	75%	30.5	34%	35.3	16%	40.0	13%
Myanmar	15.3	24.9	62%	31.2	25%	37.2	19%	38.8	4%
Tanzania	7.6	14.0	86%	22.0	57%	36.5	65%	67.3	85%
S. Korea	19.1	29.4	54%	33.4	13%	30.8	-8%	24.8	-20%
Colombia	12.1	21.6	78%	29.1	35%	32.5	12%	31.7	-3%
Spain	20.5	25.3	24%	28.5	13%	26.3	-8%	21.2	-19%
Kenya	5.9	12.7	114%	20.7	63%	32.3	56%	51.1	58%
WORLD	**2,160**	**3,292**	**52%**	**4,235**	**29%**	**4,837**	**14%**	**5,423**	**12%**
More developed	622	720	16%	758	5%	713	-6%	676	-5%
Less developed , ex. least	1,374	2,288	67%	3,041	33%	3,463	14%	3,727	8%
Least developed	164	284	73%	437	54%	662	52%	1,019	54%
EUROPE	**398**	**442**	**11%**	**455**	**3%**	**412**	**-9%**	**370**	**-10%**
NORTHERN AMERICA	**144**	**187**	**29%**	**215**	**15%**	**219**	**2%**	**235**	**8%**
OCEANIA	**12**	**18**	**45%**	**22**	**28%**	**26**	**16%**	**31**	**20%**
ASIA	**1,241**	**2,020**	**63%**	**2,639**	**31%**	**2,944**	**12%**	**3,038**	**3%**
Eastern Asia	585	906	55%	1,071	18%	1,012	-6%	841	-17%
South-Eastern Asia	158	279	76%	373	34%	431	16%	461	7%
South-Central Asia	448	744	66%	1,052	41%	1,317	25%	1,509	15%
Western Asia	50	91	82%	144	58%	185	29%	226	22%
LATAM & CARIB.	**164**	**276**	**68%**	**367**	**33%**	**429**	**17%**	**450**	**5%**
AFRICA	**200**	**350**	**75%**	**537**	**53%**	**807**	**50%**	**1,299**	**61%**
Northern Africa	45	82	82%	121	47%	154	27%	199	29%
Sub-Saharan Africa	155	268	73%	416	55%	653	57%	1,100	68%

Source: Evercore ISI, China Research, July 12, 2017

Technological Change: is more perfect information undercutting pricing power?

Yesterday, the Supercomputer

Today's Handheld

"Today, your cell phone has more computer power than all of NASA back in 1969, when it placed two astronauts on the moon."

-- Dr. Michio Kaku

Source reference: http://www.phonearena.com/news/A-modern-smartphone-or-a-vintage-supercomputer-which-is-more-powerful_id57149#LlSzY53wTmeITdy4.99

Post-WW II: An ideological war between Capitalism and Communism

Adam Smith

"The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas."

-- John Maynard Keynes

Capitalism has won!

Karl Marx

Selected Fund Profiles as of September 30, 2019

	Total Return Bond Fund	Bond Fund	Strategic Income Fund	Floating Rate Strategic Income Fund	Institutional High Yield Bond Fund
Portfolio Total Assets	$8.3 billion	$1.4 billion	$687.2 million	$983.5 million	$6.7 billion
Description	Pursues total return	Pursues current income consistent with preservation of capital	Pursues a high level of current income	Pursues total return consistent with current income and low interest rate volatility	Pursues a high level of current income
Investment Strategy	Invests in a broad, strategic mix of bond sectors: primarily U.S. government and investment-grade corporate; also high-yield and emerging markets (including trade finance); high yield allocation limited to 25%.	Invests primarily in investment-grade corporate bonds; may also invest up to 35% in high-yield, lower-rated bonds.	Invests in a strategic mix of bond sectors: U.S. high quality (government, asset-backed and corporate), U.S. high-yield and international (emerging and developed). Tactical allocation to levered company equities.	Invests primarily in a strategic mix of floating rate fixed-income investments, which pay interest at rates that increase or decrease with changes in the market rates.	Invests in below-investment-grade securities, providing exposure to the higher-yielding, lower-rated, corporate bond market.
Benchmark	Bloomberg Barclays U.S. Aggregate Bond Index	75% Bloomberg Barclays U.S. Credit Bond Index/25% Bloomberg Barclays U.S. High Yield 2% Issuer Capped Index	35% Bloomberg Barclays Mortgage-Backed Securities Index/40% Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index/25% Bloomberg Barclays Emerging Markets USD Aggregate Index	55% Credit Suisse Leveraged Loan Index/15% ICE 1-Month Libor/30% ICE BofAML 1-Year U.S. Treasury Note Index	Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index
Morningstar® Category	Intermediate Core-Plus Bond	Corporate Bond	Multisector Bond	Bank Loan	High Yield Bond
Duration	+/- 20% of index	+/- 20% of index	+/- 20% of index	Negative two (-2) years to positive three (+3) years	+/- 20% of index
Share Classes	A: TLRAX R: FTRKX B: TLRBX R6: FTRLX C: TLRCX SS: FTRFX IS: FTRBX	A: FDBAX F: ISHIX B: FDBBX IS: FDBIX C: FDBCX R6: FDBLX	A: STIAX F: STFSX B: SINBX IS: STISX C: SINCX R6: STILX	A: FRSAX C: FRICX IS: FFRSX R6: FFRLX	IS: FIHBX R6: FIHLX
Portfolio Manager(s)	Donald Ellenberger Todd Abraham, CFA Mark Durbiano, CFA Ihab Salib B. Anthony Delserone, Jr., CFA Christopher McGinley Jerome Conner, CFA* R.J. Gallo, CFA*	Brian Ruffner Mark Durbiano, CFA B. Anthony Delserone Jr., CFA Christopher McGinley Bryan Dingle, CFA*	Mark Durbiano, CFA Donald Ellenberger Todd Abraham, CFA Ihab Salib Christopher McGinley B. Anthony Delserone, Jr., CFA Nathan Kehm, CFA*	Mark Durbiano, CFA Steven Wagner B. Anthony Delserone Jr., CFA Todd Abraham, CFA Christopher McGinley	Mark Durbiano, CFA Steven Wagner

*Portfolio manager since January 2018
Portfolio composition is subject to change.
Duration is a measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

Disclosures

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

High-yield, lower-rated securities generally entail greater market, credit/default and liquidity risks and may be more volatile than investment grade securities.

There is no guarantee that the funds will achieve their investment objectives. Mutual funds are subject to risks and fluctuate in value.

Investors should carefully consider the fund's investment objectives, risks, charges and expenses before investing. To obtain a summary prospectus or prospectus containing this and other information, contact us or visit FederatedInvestors.com. Please carefully read the summary prospectus or prospectus before investing.

Market Update

The presentation is intended to give a quick overview of the U.S. and global macroeconomic outlook and the opportunities currently available in the global fixed income markets.

Bill Ehling, fixed-income market strategist, is part of the team responsible for formulating Federated's fixed-income positioning strategies. Bill provides information and insight to clients and consultants with regard to fixed-income products. He joined Federated in 2004 and has more than 25 years of investment experience. Bill's previous associations include director, institutional sales, Barclays Capital; vice president, global government fixed-income sales, Deutsche Bank Securities; foreign institutions fixed-income sales, Morgan Stanley (Japan Ltd); U.S. and Canadian fixed-income specialist, The Nomura Securities Co., Ltd. (Tokyo). He earned his bachelor's degree from Princeton University and MBA from New York University, Leonard N. Stern School of Business. He is a CFA charterholder.

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Analyzing the Decision in the Wake of the 2017 Tax Act

South Dakota Trust Association: 2019 Fall Forum

October 17, 2019

Domingo P. Such, III

Perkins Coie LLP

Agenda

1. Review of Tax Laws and Recent Changes
2. Review of Family Office Investment Structure with a Profit Interest
3. Case Study: Revocation of an S-Election
4. Case Study: Check the box election for LLC
5. Summary and Questions

1. Review of Tax Laws and Recent Changes

Decreasing Tax Rates

U.S. federal tax rates	2017	2018
Highest marginal corporate tax rate	35%	21%
Highest marginal individual income tax rate	39.6%	37%
Highest marginal individual long term capital gain rate	20%	20%
Highest marginal individual qualified dividend rate	20%	20%
Net Investment Income Tax	3.8%	3.8%
Pass-through – w/ 20 percent QBID	N/A	29.6%

Notes

- Under prior law, graduated rates applied with a maximum of 35%. Under the new law, the US federal corporate income tax rate is a flat 21% at all levels.
- The decrease in individual tax rates is a temporary provision set to expire beginning in the 2026 tax year.

Individual Taxes – Exemptions and Deductions

Elimination of Personal Exemptions

Increased Standard Deduction

Modification to many Itemized Deductions:

- New limitations on state and local tax deductions and home mortgage interest deductions
- **Elimination of miscellaneous itemized deductions**
- Elimination of itemized deduction phaseout
- Increase in charitable cash contribution limitation

Deduction Changes Applicable to Trusts

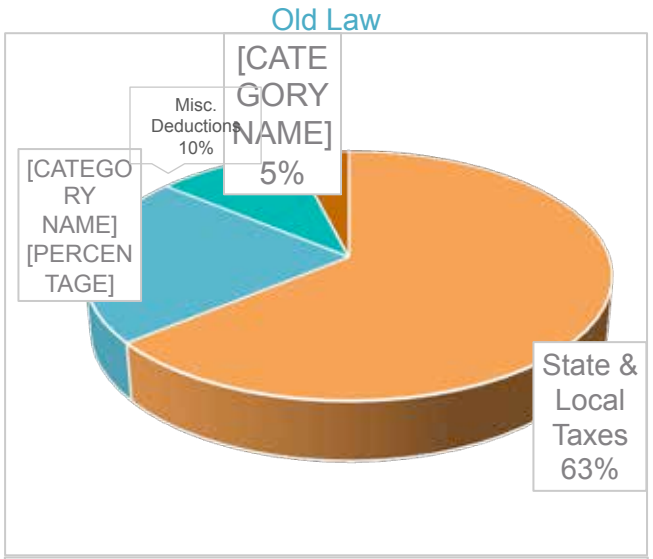
$10,000 Limitation on State and Local Taxes

2% Itemized Deductions Eliminated

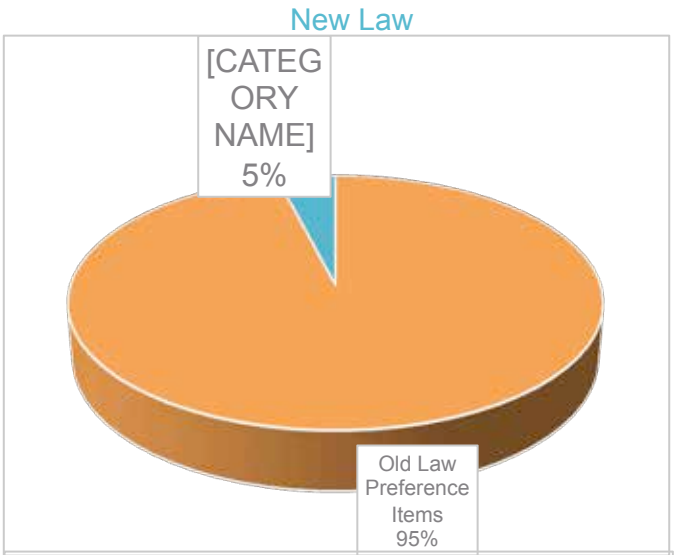
Trustee fees remain deductible

Tax determination and preparation fees remain deductible

AMT Past vs. Present for Individuals



Source: Department of Treasury 2012



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Qualified Business Income Deduction

General Rule

- Deduction for individuals and trusts of up to 20% of qualified business income
- Applies to domestic businesses income, qualified REIT dividends, and qualified publicly traded partnership income
- Does not apply to wages or guaranteed payments paid by the business to the owner

Several Limitations Apply

- Wage/Asset Limitation – The deduction cannot exceed the greater of:
  - 50% of the taxpayer's allocable share of W-2 wages paid by business; or
  - 25% of such W-2 wages, plus 2.5% of the original acquisition cost of depreciable property
- Professional Service Income – The deduction is available for professional services businesses, but benefit is eliminated above the phase in range
- Both limitations phased in for taxable income between $157,500-$207,500 for a single return and $315,000-$415,000 for a joint return

Qualified Business Income Deduction

Specified services include:

- Performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services
- Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its owners or employees
- Performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities

Disqualified Items:

- Short-term or long-term capital gain/loss
- Dividend income
- Interest income unless connected with trade or business
- Various other foreign currency, derivative income, and investment income/deductions

Net Operating Losses (NOLs)

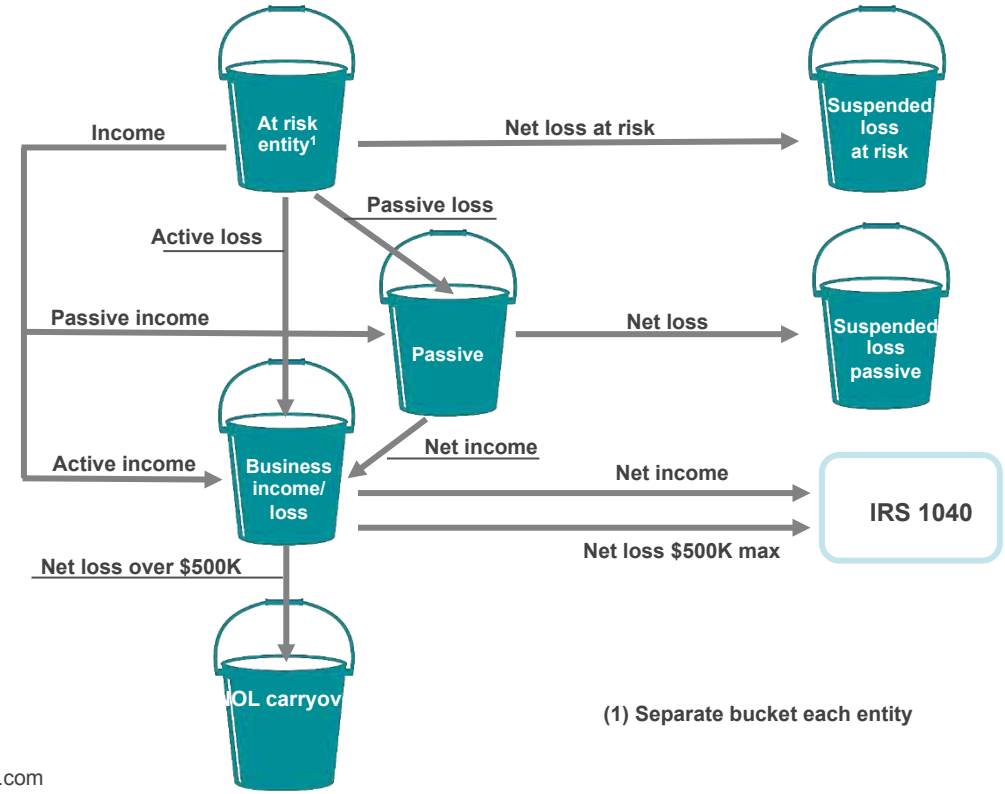
NOLs

- Corporations and individuals will only be able to offset 80% of their taxable income for losses arising in tax years beginning after December 31, 2017 (20% of remaining income is taxed at 21%)
- Corporations and individuals will be able to carryforward losses generated in tax years ending after December 31, 2017 indefinitely (previously 20 years)
- Corporations and individuals will no longer be able to carryback NOLs generated in tax years ending after December 31, 2017

Limitation on Business Losses Individuals

- Net business losses of individuals only able to offset up to $500,000 of non-business income ($250,000 for single filers)
- Excess treated as a NOL carryforward to the next taxable year (80% taxable income limitation)

Business Income/Loss



(1) Separate bucket each entity

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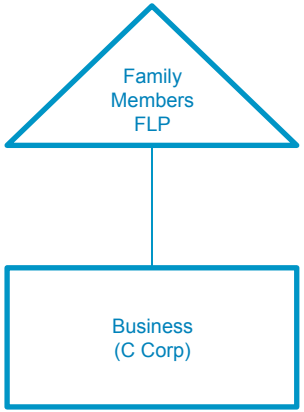
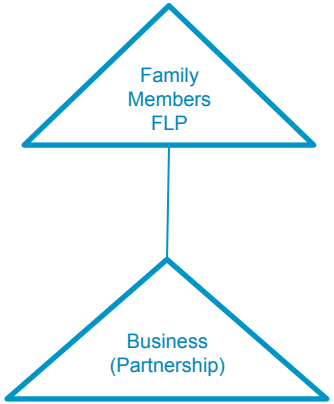
Case Study – Tax Structure for Operations

Option A – C Corporation Structure



Option B – Partnership Structure



Current Tax on Operations/Distributions

Entity Type	Corporation – Earnings Distributed	Partnership – No QBID	Partnership – Full QBID
Effective Tax Rates			
Current Tax Rate	21.0%	37.0%*	29.6%*
Tax on Distributions	23.8%	0	0
Effective Tax Rate – Combined	39.8%	37.0%	29.6%
Effective Tax Rate – Total – Prior Law	50.5%	39.6%	39.6%
*Note: Partners may also be subject to additional 3.8% net investment income tax if they are passive investors.			

Operations and Exit Analysis

Entity Type	Corporation – No Earnings Distributed	Partnership – No QBID	Partnership – Full QBID
Acquisition Price	$10,000,000	$10,000,000	$10,000,000
Impact of Taxes on Yearly Cash Flow			
Taxable Income Over 5 Years	$20,000,000	$20,000,000	$20,000,000
Federal Income Taxes / Required Tax Distributions	($2,100,000)	($3,700,000)	($2,960,000)
Operating Cash Flow	$17,900,000	$16,300,000	$17,040,000
Sale Exit Analysis			
Sale Price for Stock / Partnership Interest	$30,000,000	$30,000,000	$30,000,000
Less, Outside Tax Basis	($10,000,000)	($26,300,000)	($27,040,000)
Taxable Gain	$20,000,000	$3,700,000	$2,960,000
Federal Income Tax – LT capital gain	($4,760,000)	($740,000)	($592,000)
After-Tax Cash Proceeds on Exit	**$25,240,000 (1)**	**$29,260,000 (2)**	**$29,408,000 (2)**

Notes:
(1) If the c-corp assets were sold for the same purchase price (tax at 21%) and net proceeds were then distributed (tax at 23.8%), the Partnership sales would likely produce significantly more “cash proceeds”.
(2) Ordinary income tax on hot asset, if any, would reduce the after-tax “cash proceeds”.

Case Study – Real Life Examples

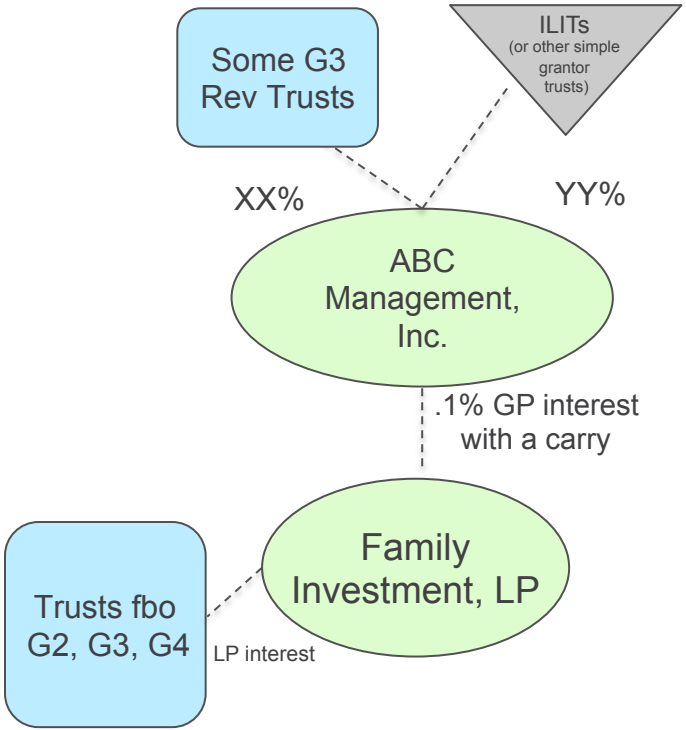
2. Case Study Family Office Investment Structure with a Profit Interest

Family Facts:

G1 is no longer with us
G2 remaining members are elderly
G3 is middle aged and includes many members
G4 are children

Basic Profit Interest Structure

- ABC Management, Inc. contributes liquid assets to FLP having a value equal to .1% of the total contributions to be made thereto, and receives the .1% GP interest.
- ABC Management, Inc. should be adequately capitalized to fund expected expenses for the next 12 to 18 months.



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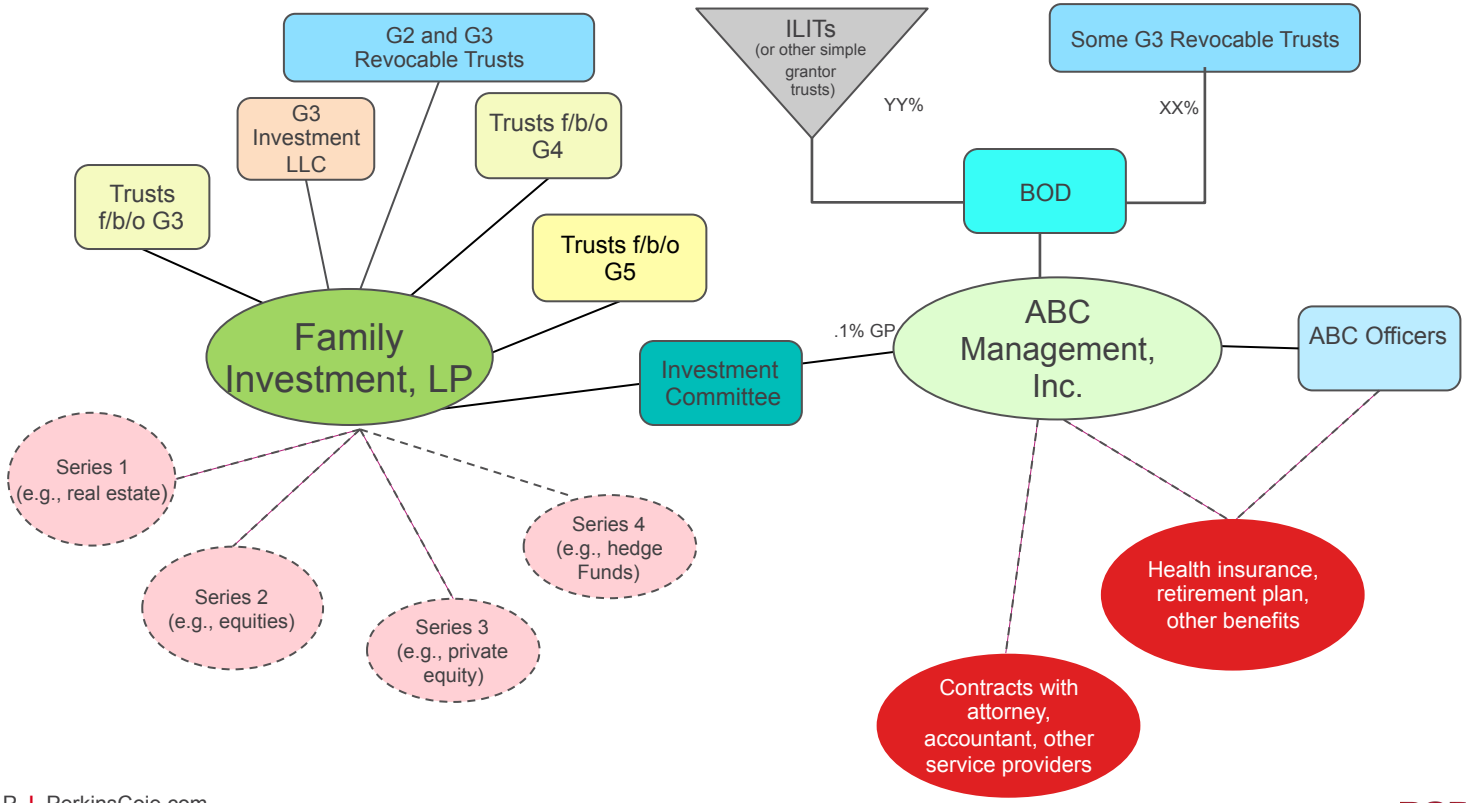
Example – Detailed Structure



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Managers and Directors of Family Office Entities

- ABC Management, Inc.
  - Directors
    - Maybe G2
    - Some G3
  - Officers
    - G3 – President/Secretary
    - G3 – CEO
    - Nonfamily Employee – COO
    - Nonfamily Employee – CFO

Calculation of Management Fee & Profit Interest

- ABC Management, Inc. is compensated for its efforts as general partner of by means of: (1) a profits interest and (3) its capital interest as GP.
  - Management Fee: ABC Management, Inc. will charge a management fee to family members for services not covered under the general allocation of expenses. For example, family members not invested in the Investment LP will be billed separately for services and family members who use services not included in the profits interest will be billed separately. No other fees not based on profits will be charged to the family.
  - Profits Interest: At the end of each calendar year, taking into account the management fee for each quarter of that year, ABC Management, Inc. is allocated an amount equal to 22% of the "Fund Profits" for that year.
  - .1% GP Interest: Finally, ABC Management, Inc. is allocated .1% of Fund's profits, determined after the amounts described above have been paid.

Payment of Management Fee & Profit Interest

- ABC Management, Inc. is paid $1,500,000 per quarter ($6 million per year) for its expected profits interest and management fee.
- As the previous year's tax return is prepared and filed, the exact profits interest is calculated, and a true-up payment is made to cover any amount not covered by the quarterly payments.
- If the $6 million payment exceeds ABC Management, Inc.'s profits interest, any excess is treated as an advance or payment of a previously earned amount (as applicable).
- As projected for 2020, ABC Management, Inc. will earn management fees and profits interest allocations of $4 million. Earnings are expected to increase each year. Peaks and valleys in earnings are expected and spikes in the FILP income can create windfalls in profits interests.

Impact of Structure for Management Fee & Profit Interest

- The family had a recent liquidity event but can use the new structure to stay in business together and continue the legacy.
- Family members not otherwise eligible to participate in some investments will become eligible through their investment in the FILP.
- The family will achieve pricing advantages, efficiency advantages, better investment diversification and will be able to better maintain asset allocations when they pool their investment funds.
- Partners can trade investments within the FILP on a tax-free basis.
- It is expected that ABC Management Company will earn a reasonable profit over the first 5 years of its participation as a profits interest owner and a GP.
- Approximately $38 million of expenses that would otherwise be nondeductible if paid by the family will be converted to tax deductible expenditures over the first 5.5 years which will conservatively reduce the family's tax liability by approximately $15 million during this time frame.
- Estate Planning opportunities will also arise from the transfer of ownership interests in ABC Management to the ILITs and from potential transfers of the Investment LP ownership interests at discounted values.

Case Study Continued – S election/common ownership

3. Case Study: Revocation of an S-Election and Common Ownership Issues

Background

- ABC Management, Inc. operated as a C corporation from inception to 1987 when it made a Subchapter S election. As today, ABC Management, Inc. has approximately $22 million of undistributed C corporation E&P and approximately $22 million of accumulated adjustment account balance (undistributed S corporation earnings).
  - Since 1987, ABC Management, Inc.'s income has thus been subject to only one level of tax (at a maximum rate of 23.8%* on dividends and long-term capital gains, or 43.4%* on other types of income) rather than two levels of tax (35%** when earned by ABC Management, Inc. and 23.8%* when distributed).
- ABC Management has and will also receive certain management fees not dependent on the level of investment income earned by the FILP from the family members.
  - These fees have been taxed at the 43.4% tax rate pre-2017 TCJA
- ABC Management, Inc. will receive a "profits interest" (a.k.a. "carry") in the Family Investment LP ("FILP").
  - As a result, the family members who ultimately pay the income tax on ABC Management, Inc.'s income would receive the benefit of the lower tax rate on long-term capital gains to the extent that a portion of ABC Management, Inc.'s profits interest allocation consisted of a capital gain related to an asset that had been held for at least one year by a Fund.

* Includes 3.8% Net Investment Income Tax on dividends, capital gains and certain other passive income.
** Federal Tax Only.

Common Ownership ABC Management and Family Investment LP –NO LOOK THRU-

-----Ownership Percentage-------

	ABCM	FILP	Common
G2	0.07%	0.00%	0.00%
G3	99.93%	40.20%	40.20%
G4	0.00%	38.53%	0.00%
MS	0.00%	21.27%	0.00%
Totals	100.00%	100.00%	40.20%

Common Ownership ABC Management and Family Investment LP –WITH LOOK THRU-

-----Ownership Percentage-------

	ABCM	FILP	Common
G2	0.07%	0.00%	0.00%
G3	99.93%	55.64%	55.64%
G4	0.00%	44.36%	0.00%
MS	0.00%	00.00%	0.00%
Totals	100.00%	100.00%	55.64%

Tax Cuts and Jobs Act of 2017

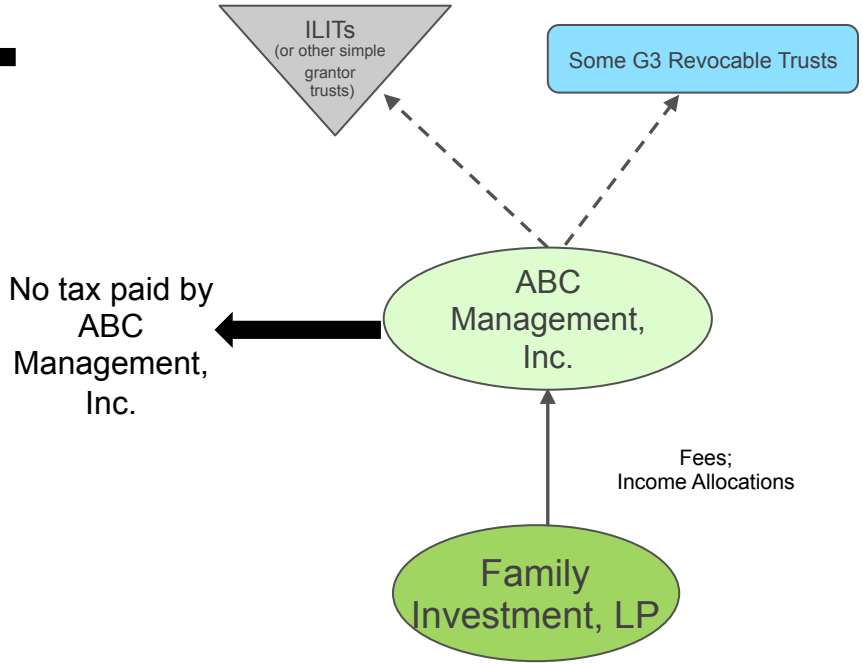
As a result of the Tax Cuts and Jobs Act of 2017:

- The federal corporate income tax rate has been reduced to 21%.
- The maximum federal individual income tax rate remains 23.8%* for dividends and long-term capital gains and has been reduced to 40.8%* for other types of income.
- Capital gains allocated to an S corporation (but not a C corporation) pursuant to a profits interests received in exchange for investment management services are treated as long-term capital gains only to the extent that the assets to which they relate were held for more than 3 years (up from 1 year under prior law).

Taxation of S Corporation (Current)

- 23.8%* tax (when related income earned by Funds) on:
  - Dividends
  - Capital gains via 0.5% or 1.6% ownership of Funds (if holding period > 1 year)
  - Capital gains via 12% profits interests (if holding period > 3 years)
- 40.8%* tax on all other Fund income (when earned by Funds)
- 37% tax on management fees (when earned by ABC Management, Inc.)

S Corporation (23.8 – 40.8% Effective Tax Rate)



Trust income is taxable to the Family Member(s) who created the trusts.

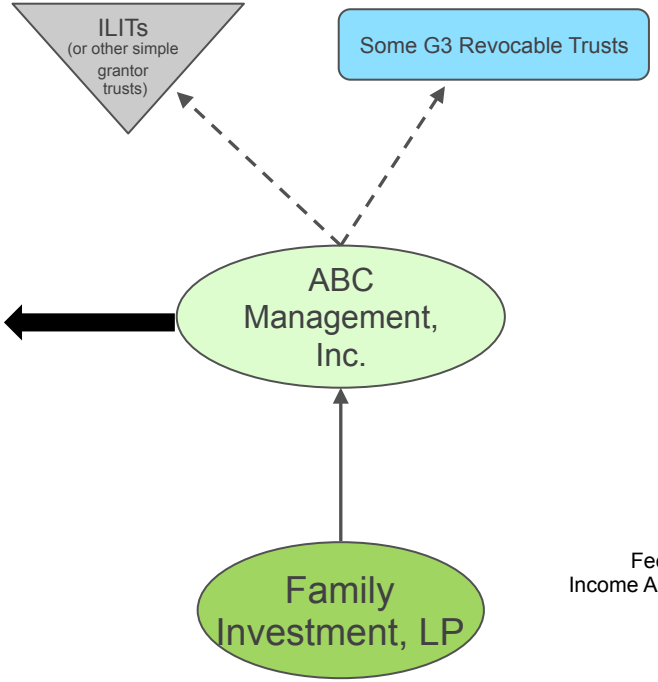
Fund income and management fees are deemed earned by the Family Members (via the shareholder trusts) when earned by the Funds/ABC Management, Inc., even if they are not distributed.

* Includes 3.8% Net Investment Income Tax on dividends, capital gains and certain other passive income.

Taxation of C Corporation (Current)

C Corporation (21% Effective Tax Rate if Income is Retained)

23.8% tax* on dividends (but only if and when paid by ABC Management, Inc.)



Trust income is taxable to the Family Member(s) who created the shareholder trust.

21%** tax on all Fund income (when earned by Funds) and management fees (when earned by ABC Management, Inc.)

ABC Management, Inc.'s income is taxable to Family Members (via shareholder trusts) only when distributed as a dividend.

Fees;
Income Allocations

* Includes 3.8% Net Investment Income Tax on dividends, capital gains and certain other passive income.
** Reflects only federal corporate income tax and no state income tax.

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Retention of Subchapter S Election

If ABC Management, Inc. retains its Subchapter S election:

- Its income will continue to be treated as earned by its shareholders and taxed to the Family Members when earned by ABC Management, Inc. or the Funds.
- Capital gains allocated to ABC Management, Inc. as a result of its 22% profits interests in the Funds may be subject to a 40.8%* federal income tax rate if the assets to which the gains are attributable were not held for more than 3 years.
  - Notably, in addition to the higher tax that may be owed, the administrative burden of tracking and reporting this new class of capital gains may be substantial.
- Dividends, profits interest allocations of capital gains attributable to property held for more than 3 years, and other long-term capital gains remain subject to a 23.8%* individual tax rate.
- If it has excess passive income (gross passive income in excess of 25% of gross receipts), its excess net passive income would be subject to federal tax (sting tax) at a rate of 21% under Section 1375
- Management fees would be subject to a 37% federal tax rate.
- Other income would be subject to a maximum 40.8%* federal tax rate.

* Includes 3.8% Net Investment Income Tax on dividends, capital gains and certain other passive income.

Revocation of Subchapter S Election

If ABC Management, Inc.'s Subchapter S election were instead revoked effective 1/1/2020:

- All income would be subject to a 21%* corporate tax, payable by ABC Management, Inc., when earned by ABC Management, Inc. or the Funds.
  - Each Family Member would cease to be taxed on ABC Management, Inc.'s income, unless a dividend is paid.
- To the extent that the distribution of the income by ABC Management, Inc. is delayed or altogether avoided through, e.g., reinvestment, the time-adjusted cost of any individual tax on the dividend can be decreased or eliminated.
  - If current rates persist, a distribution of the income by ABC Management, Inc. would be subject to a 23.8%** federal individual tax.
- ABC Management should, if possible, distribute the $22 million of AAA during 2019 or 2020 as allowed under the post termination transition period rules of Section 1377(b)(1).
- Accumulated Earnings Tax and Personal Holding Company Tax (both discussed in a later slide) may apply.

* Reflects only federal income tax no state income tax included

** Includes 3.8% Net Investment Income Tax on dividends, capital gains and certain other passive income.

Revocation – Additional Considerations

Revocation of ABC Management, Inc.'s Subchapter S election would require navigation of the following federal taxes (which are applicable to C corporations, but not S corporations):

- Accumulated Earnings Tax – A 20% tax could apply to ABC Management, Inc.'s earnings and profits that are retained beyond its reasonable needs.
  - Demonstrating the reasonableness of any amounts that are retained beyond normal working capital generally requires contemporaneous board documentation of the stated use (e.g., future expansion of operations).
- Personal Holding Company Tax - A 20% tax on undistributed PHC income could apply if 60% or more of ABC Management, Inc.'s income includes certain types of passive "Personal Holding Company Income."
  - Capital gains are disregarded for purposes of the above calculation.
  - Management fees should not be treated as Personal Holding Company Income.

Revocation Process and Conclusion

As a result of the reduced corporate income tax rate and the longer holding period requirement related to ABC Management, Inc.'s profits interests:

- It is likely that the effective tax rate payable on ABC Management, Inc.'s income, if it retains its Subchapter S election, will exceed the 21% corporate income tax rate that would apply if the election were revoked; and
- Accordingly, it would likely be advantageous (assuming that the corporate income tax rate remains at its current level*) to:
  - Distribute ABC Management, Inc.'s AAA account and
  - Revoke ABC Management, Inc.'s Subchapter S election as of January 1, 2019.

* Note that if the corporate income tax rate increases, ABC Management, Inc. could reinstitute its Subchapter S election as early as 2024. However, dispositions of assets held at the time of the election within five years thereafter may be subject to a corporate-level built-in gains tax at the highest corporate income tax rate then in effect, thus maintaining two levels of taxation to at least a limited extent.

4. Case Study: Check-the-Box Election for an LLC

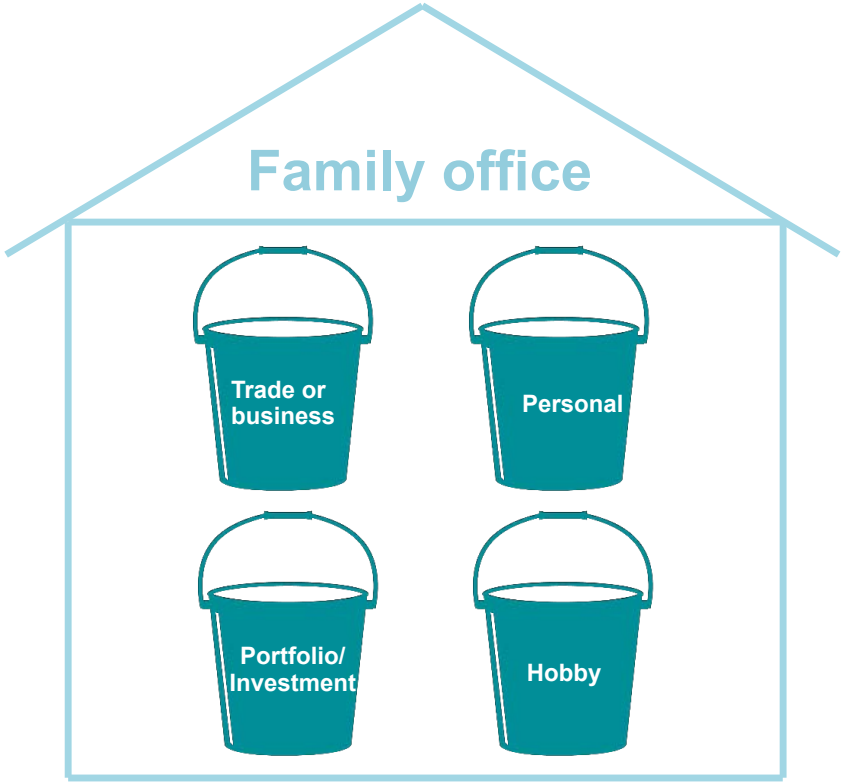
Check-the-Box Election for Doe Investment LLC

- Doe Investment LLC ("Doe Investment") is currently treated as a disregarded entity owned by John Doe for income tax purposes, meaning that its income and expenses are treated as being realized directly by John.
- An income tax benefit may be obtained by electing to have Doe Investment taxed as a corporation:
  - The income of Doe Investment will be ordinary income, which would be subject to a maximum 40.8%* income tax rate if treated as having been earned by an individual or trust.
  - The income of a corporation, on the other hand, is subject to a 21%** income tax rate when earned and a 23.8%* rate when distributed to the corporation's shareholder(s).
    - To the extent that the distribution of income by Doe Investment LLC is delayed or altogether avoided through, e.g., reinvestment, the time-adjusted cost of the tax on the distribution can be decreased or eliminated.
- Although Doe Investment will generate losses for income tax purposes until construction of the related property is finished, such losses likely would not produce a current tax benefit to its owner that would warrant subjecting subsequent income to the higher individual/trust income tax rate. Accordingly, it would be beneficial from an income tax perspective for Doe Investment to be taxed as a corporation and for income to be retained in order to defer the 23.8%* tax on its distribution.

* Note that if the corporate income tax rate increases, ABC Management, Inc. could reinstitute its Subchapter S election as early as 2025. However, dispositions of assets held at the time of the election within five years thereafter may be subject to a corporate-level built-in gains tax at the highest corporate income tax rate then in effect, thus maintaining two levels of taxation to at least a limited extent.

5. Summary and Questions

Typical Family Office Expense Activities



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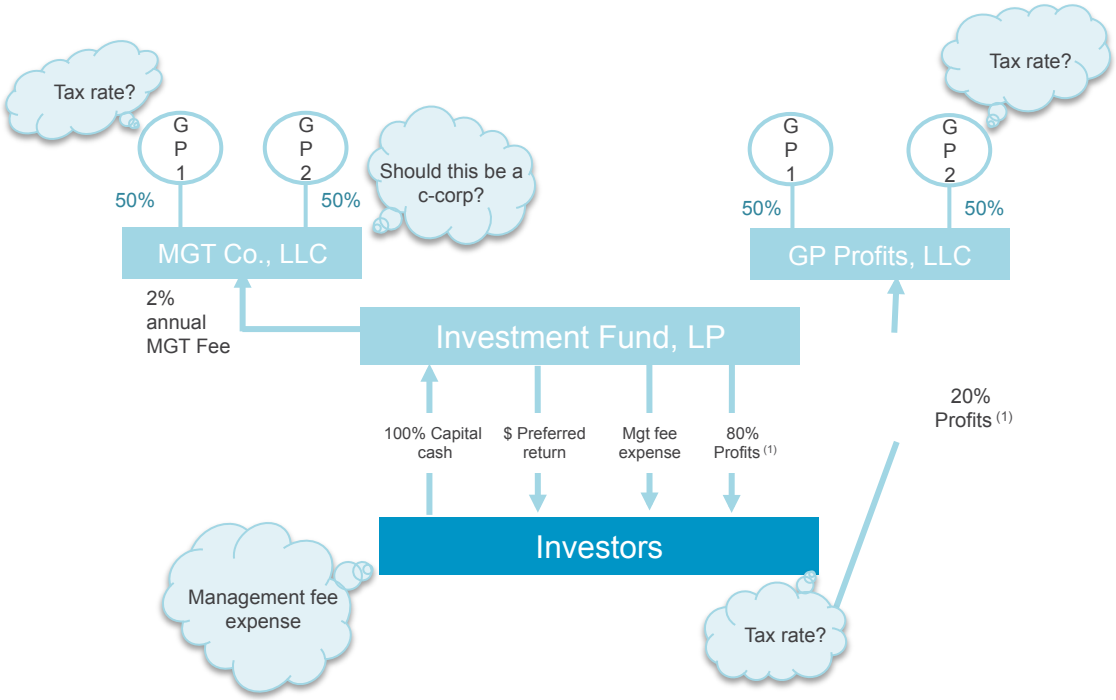
Typical Investment Fund Structure



(1) 80 percent profits are paid only after investors are paid their preferred return (i.e. IRR or model rate).

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Issues to Consider

- Accumulated Earnings Tax
- Personal Holding Company
- Economic Substance of a Transaction/Substance Over Form/Sham Transaction/Step Transaction
- Business Purpose Doctrine
- Assignment of Income Doctrine
- Reportable Transactions/Tax Shelters
- Application of Substantial Underpayment Penalty – 20%
- Lender Management and other cases
- Others…

Questions

Analyzing the Decision in the Wake of the 2017 Tax Act: Family Office Planning

This session will analyze the decision in the wake of the 2017 Tax Act: decreasing tax rates, individual taxes exemptions and deductions, and deduction changes applicable to trusts. The session will review changes to family office investment structures with case study examples.

Mr. Domingo P. Such, III is a partner in the law firm of Perkins Coie LLP based in the Chicago office, focusing his practice on excellence in the delivery of legal advice that is results oriented. He serves as the firmwide chair of Family Office Services, a multi-disciplinary practice representing operating companies, boards of directors, fiduciaries, beneficiaries, and family offices including trust companies and quasi-family office arrangements. A trusted advisor with significant corporate and trusts & estates tax experience, Mr. Such has been cited in various publications including Bloomberg, Business Week, Crain's Business Magazine, The Wall Street Journal, and Worth, and is a frequent author with multiple published law review and magazine articles. He lectures nationally on trust and business planning involving complex estates and trusts which are at times contested in court. Mr. Such received his undergraduate and MBA degrees from Washington University in St. Louis, and his law degree from the Loyola University of Chicago School of Law. He earned his Certificate in Family Business Advising from the Family Firm Institute. He is listed in Who's Who in America and Best Lawyers in America, Super Lawyers and is a fellow of the American College of Trust and Estate Counsel, and the American Bar Foundation reflecting his experience, integrity and recognized professional excellence.

Student Panel Break out session

Tim Kuhman, Moderator
General Counsel
The Kingdom Trust Company
Tim Kuhman serves as the General Counsel for the Kingdom Trust Company and has since its inception in 2010. Having also served as General Counsel to Equity Trust Company, he brings 15 years of experience to our discussion of the Trust Industry in South Dakota. That experience includes helping to build a de novo trust company from the ground up under the laws of South Dakota and staffing an office in the State.

His position requires him to be well-versed in the regulatory regimes that govern both South Dakota Trust Companies and the Self-directed investing world.

He serves as a subject matter expert to the subject matter expert in self-directed retirement accounts and self-directed investing for Kingdom's customer service, operations and business development groups. He is a frequent speaker on webinars and live events covering Self-directed Retirement Accounts and Self-directed Retirement Investing topics.

Tim is a graduate of Southwest Missouri State University (now known as Missouri State University) and the University of Toledo, College of Law. In addition to practicing law, he has taught a variety of business and law related courses at the high school, collegiate and graduate school levels. He has also coached Track and Cross Country at both the high school and intercollegiate levels.

Dr. Todd A. Muehler, JD
Associate Professor of Business Administration and Economics
Keith B. Miller Endowed Chair of Business
Director of Trust Management Program

I began teaching at Dakota Wesleyan University in the Fall of 2017. I had previously been an Assistant Professor at Northern State University where I had taught for four years. Prior to my teaching career, I spent approximately 20 years in the financial services industry working in a variety of sales, management and executive positions for several different financial institutions. These institutions included insurance companies, brokerage firms, and small and large commercial banks. Before my career in the financial services industry, I was engaged in the private practice of law and was a law clerk for a U.S. District Court Judge. I received my undergraduate degree and Doctorate of Jurisprudence from the University of North Dakota in Grand Forks, ND. I am married and have four children.

Michelle Le Herissier
Managing Director, South Dakota
Michelle has nearly 25 years of industry experience and joined JTC in 2015 to head up the company's office in the British Virgin Islands (BVI). Since then her role has significantly diversified and now she has responsibility as managing director for JTC's private wealth operations in Sioux Falls, South Dakota.

Prior to JTC, Michelle was based in Singapore for eight years. She spent four years with Barclays as Managing Director of the Singapore and Hong Kong trust divisions and the other four with CitiTrust, where she set up and ran a similar operation. She has also spent a number of years in the private wealth arena in Switzerland (Zurich) working for Citi and Credit Suisse with a particular focus on the Asian marketplace.

Michelle has been name as one of Citywealth's Power Women in their Leaders List 2016 and 2017 and has also been recognized in Citywealth's IFC Top 200 Powerwomen in both 2017 and 2018.

Robin Aden, JD, CTFA, AEP
Robin Aden is the Wealth Management Director at First Bank & Trust. Her responsibilities include management and growth of the Wealth Division comprised of investment, trust, financial planning, and private banking services. She has over 20 years of experience, primarily in the fiduciary arm of Wealth Management. Aden is a Certified Trust and Financial Advisor (CTFA), Accredited Estate Planner (AEP), and a licensed attorney in South Dakota.

Mike Dea
Mr. Dea has over 30 years of experience in the financial services industry. He has held multiple leadership positions at a number of banking institutions, most notably at Key Bank, where he was Commercial Real Estate Group Managing Director, Chief Financial Officer of the Corporate and Investment Banking Group, and Senior Vice President of Corporate and Investment Banking. Mike earned a BS in Accounting and an MBA from Kent State University.

Tom E. Pruner, CPA, PFS, CFP, AEP
Partner,
Serving Eide Bailly clients since 1982, Tom has extensive tax and accounting experience. He specializes in trust and estate income taxation, estate and gift taxation and financial planning. He oversees the preparation and filing of more than 1,000 trust returns every year.
Tom likes to get to know his clients and their business objectives, so when you work with him you get a partner who will do his homework and have answers ready often before you even realize you have a question. He's also a think outside the box kind of guy who enjoys the challenge of solving his clients' most complex challenges.

He has obtained a Bachelor of Science, Accounting – University of South Dakota, Vermillion
Certified Financial Planner – College for Financial Planning, Denver, Colorado

He is currently a member of the South Dakota CPA Society, American Institute of Certified Public Accountants, Financial Planning Association and the Sioux Falls Estate Planning Council.

Tom as received the following designations: Certified Public Accountant, Personal Financial Specialist,
Certified Financial Planner, Accredited Estate Planner.

He advises clients on estate, gift and trust compliance issues. Consulted clients and their families on matters of estate and gift planning. Provided income tax planning for high income and high net worth individuals.

In addition he has authored articles titled:
A Little Estate Planning Goes a Long Way
Estate planning can be a difficult subject, but avoiding the topic could cause problems down the line. Are you sitting on an outdated plan?

In his community he is involved with the Sioux Falls Area Community Foundation, South Dakota Parent Connection, Sioux Falls Chamber of Commerce, Sioux Falls Area CASA, and Sioux Falls Area Humane Society.

Jennifer Dugas
Jennifer Dugas is Senior Director, Wealth & Trust/Risk & Compliance at the American Bankers Association. In this role, she oversees the ABA Trust Schools and the Wealth Management and Trust Conference. She works closely with advisory boards to develop programming, content and speakers for these events.

Prior to joining ABA , Jennifer worked for the American Bankruptcy Institute, the U.S. Chamber of Commerce and NAPEO. She her undergraduate degree from the University of California, Santa Barbara.

JURISDICTION SHOWDOWN 2019

A DISCUSSION FROM FOUR TRUST, LEGAL AND WEALTH MANAGEMENT PROFESSIONALS COMPARING THE STATE LAW BENEFITS OF SOUTH DAKOTA, DELAWARE, NEVADA AND NEW HAMPSHIRE

The Advantages of Delaware Trust Planning

South Dakota Trust Association Fall Forum

October 17, 2019

By:
Daniel F. Hayward, Esq.
Gordon, Fournaris & Mammarella, P.A.
1925 Lovering Avenue
Wilmington, DE 19806
(302) 652-2900

Fundamental Principles

- Freedom of disposition
  - The lynchpin of Delaware trust law is 12 Del. C. § 3303(a) - "It is the policy of this section to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments"

    "Notwithstanding any other provision of this Code or other law, the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general application to fiduciaries, trusts and trust administration, including, but not limited to, any such laws pertaining to:

    - (1) The rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary's interest for a period of time, as set forth in subsection (c) of this section;
    - (2) The grounds for removal of a fiduciary;
    - (3) The circumstances, if any, in which the fiduciary must diversify investments;
    - (4) The manner in which a fiduciary should invest assets, including whether to engage in 1 or more sustainable or socially responsible investment strategies, in addition to, or in place of, other investment strategies, with or without regard to investment performance; and
    - (5) A fiduciary's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from that instrument;

Protection of Trustees and Fiduciaries

- Standard of liability
  - Fiduciaries can be exculpated for any liability except for wilful misconduct - § 3303(a) "nothing contained in this section shall be construed to permit the exculpation or indemnification of a fiduciary for the fiduciary's own wilful misconduct or preclude a court of competent jurisdiction from removing a fiduciary on account of the fiduciary's wilful misconduct"
  - "Wilful misconduct" is defined as "**intentional wrongdoing**, not mere negligence, gross negligence or recklessness and **'wrongdoing' means malicious conduct or conduct designed to defraud or seek an unconscionable advantage**." – 12 Del. C. § 3301(h)(4)

Protection of Trustees and Fiduciaries

- Statute of Limitations – 12 Del. C. § 3585
  - (a) A person may initiate a proceeding against a trustee for breach of trust or other claim until the first to occur of:
    - (1) One year after the date the person was sent a report that adequately disclosed the facts constituting a claim — provided, however, that if the governing instrument provides that claims shall survive for a period longer than 1 year after such date, then claims shall survive for the period specified in the governing instrument;
    - (2) In the case of any trustee who has resigned, been removed or ceased to serve as trustee for any other reason (including on account of the termination of the trust by reason of liquidation or by reason of a merger or similar transaction described in § 3341 of this title), 120 days after the date the person was sent a report that:
      - a. Notifies the person that the trustee has ceased to serve;
      - b. Adequately discloses the facts constituting a claim; and
      - c. Adequately discloses the time allowed under this section for initiating proceedings against the former trustee; or
    - (3) The date the proceeding was otherwise precluded by adjudication, release, consent, limitation or pursuant to the terms of the governing instrument.
  - If subsection (a) does not apply a judicial proceeding by a person against a trustee for breach of trust or other claim must be commenced within 5 years after the first to occur of (1) the removal, resignation, or death of the trustee; (2) The termination of the person's interest in the trust; or (3) the termination of the trust.

Pre-Mortem Validation of Trusts

- Contesting validity of a trust
  - Pursuant to 12 Del. C. § 3546(a), a judicial proceeding to contest the validly of a trust must be initiated by the first to occur of:
    - 120 days after the date the trustee notified the potential claimant of the existence of the trust, the trustee's name and address, whether the person is a beneficiary and the time allowed for initiating the judicial proceeding to contest the trust
    - 2 years after the trustor's death
    - If the trust was revocable at the trustor's death and the trust is specifically referred to in the trustor's Will, the time in which a petition for review of the Will could be filed in Delaware
      - Generally 6 months after the filing of the (12 Del. C. § 1309(a))
    - The date the potential claimant's right to contest was otherwise precluded by adjudication, consent or other limitation under Delaware law

Pre-Mortem Validation of Trusts

- Pre-mortem validation has gained popularity in recent years
  - A settlor should be permitted to defend an estate plan while alive and mentally alert
  - Delaware has permitted pre-mortem validation since 2003, *i.e.*, 12 Del. C. § 3546(a)
  - The Delaware Supreme Court upheld the pre-mortem validation statute and process in *Matter of Restatement of Declaration of Trust Creating the Survivor's Trust Created Under the Ravet Family Trust Dated Feb. 9, 2012*, No. CIV.A. 7743-VCG, 2014 WL 2538887 (Del. Ch. June 4, 2014), *aff'd sub nom. Ravet v. N. Trust Co. of Delaware*, No. 369, 2014, 2015 WL 631588 (Del. Feb. 12, 2015).
  - Pre-mortem validation also applies to wills (12 Del. C. 1311) and the exercise of powers of appointment (12 Del. C. 1312)
  - Potentially a very valuable and powerful tool to avoid contests post-death of the grantor

Flexible and Favorable Trust Laws

- Small but active Estates and Trusts Section of the DSBA
- Annual housekeeping bill
- Trust Act 2019 has passed the House
- This year:
  - New 3343 of Title 12 will provide a new mechanism to restructure a trust without the need to modify a trust agreement
  - New 3344 will allow grantors of grantor trusts to be reimbursed from income tax liability without the need to modify a trust agreement
  - Revised 3322 will allow the beneficiaries and trustor (if living) to consent to the selection of an agent to carry out delegated Trustee powers, and to exonerate the Trustee for failing to monitor the agent on an ongoing basis

Delaware Court of Chancery

- Trust matters are within the jurisdiction of the Delaware Court of Chancery, with appeals directly to the Delaware Supreme Court
- Court of Chancery is the same court with exclusive jurisdiction over corporate matters – routinely decide cases of national importance.
- Judges (Chancellor or a Vice Chancellor) are appointed, not elected, for 12 year terms.
- Juries do not hear cases.
- Proceedings are timely and efficient.
- Rich case law history for trust matters dating back to the 1800s
- Growing body of modern case law validating modern planning techniques.
  - Duemler v. Wilmington Trust Company (2004) – validated directed trusts
  - Mennen v. Wilmington Trust Company (2015) – validated spendthrift protection

Dynasty Trusts

- Delaware law allows for perpetual trusts
  - Revocation of the Rule Against Perpetuities
    - 25 Del. C. § 503
  - Exception – Real estate
    - 110 year perpetuity period
    - Use of LLCs, partnership, etc.
      - 25 Del. C. § 503(e)
  - Leveraging estate tax and GST tax exemption

Dynasty Trusts

- Grantor Trusts
  - IRC §§ 671-679
    - Treated as the owner for income tax purposes, but not estate tax purposes
    - Common powers
      - Power to substitute assets (IRC § 675(4)(C))
      - Power to borrow without adequate interest or adequate security (IRC § 675(2))
    - Many grantor trusts include a discretionary tax reimbursement clause
      - Revenue Ruling 2004-64 - IRS determined that there would be no inclusion in the gross estate for federal estate tax purposes if the trustee has discretionary authority, under the instrument or applicable local law, to reimburse the grantor for the income tax liability
      - Delaware law – 12 Del. C. § 3536(c) - A trustor's creditors may satisfy their respective claims from the trustor's interest in the trust, but this does not apply to the trustor's right to receive discretionary distributions to reimburse the trustor's income tax liability attributable to the trust
    - Pending legislation – new proposed 12 Del. C. § 3344 – would generally allow income tax reimbursement **even without an express reimbursement provision**

Dynasty Trusts

- Non-Grantor Trusts
  - Used more commonly with grantors in states with high income tax, e.g., New York, California
  - Delaware trusts are allowed a deduction for income accumulate for non-resident beneficiaries
    - Conversion to a Delaware trust prior to sale of highly appreciated assets (30 Del. C. § 1636(a))
      - No return required if all beneficiaries are non-residents (30 Del. C. § 1605(b)(1)a.2)
    - This leads to significant income tax planning opportunities for clients who are residents of high tax jurisdictions
    - It is critical to coordinate with local counsel regarding tax nexus issues relating to that jurisdiction
      - Example: California
  - Delaware does not impose a tax on intangible personal property and there are no franchise or gross receipts taxes applicable to trusts

Directed Trusts

- Delaware law allows for the bifurcation (or more) of trustee duties (12 Del. C. § 3313)
- An "adviser" may direct, consent or disapprove any trustee decision.
- 3313(b) applies to direction advisers
- 3313(c) applies to consent advisers
- When directed the trustee has no duty to (1) monitor an adviser's conduct; (2) provide advice to or consult with an adviser; or (3) warn any beneficiary or third party regarding instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed (12 Del. C. § 3313(e))
- 3313 is an enabling statute. The trust agreement must set forth the desired structure.

Directed Trusts

- Liability Standards
  - When directed and acting in accordance with such direction, then except in cases of wilful misconduct, the trustee "shall not be liable for any loss resulting directly or indirectly from any such act" (12 Del. C. § 3313(b))
    - Willful misconduct is intentional wrongdoing, not mere negligence, gross negligence or recklessness (12 Del. C. § 3301(g))
    - Wrongdoing is "malicious conduct or conduct designed to defraud or seek an unconscionable advantage" (12 Del. C. § 3301(g))

Directed Trusts

- Liability Standards (Cont'd)
  - When the consent of an adviser is required, the standard is reduced to willful misconduct or gross negligence (12 Del. C. § 3313(c)) for actions taken or omitted as a result of an adviser's (1) objection or (2) failure to provide consent.
  - Advisers are deemed to be fiduciaries.
  - Delaware law allows the grantor to determine the liability standard for the adviser, provided an adviser cannot be exculpated or indemnified for willful misconduct (12 Del. C. § 3303(a)). The adviser can be subject to a different standard of liability than the trustee.

Directed Trusts

- Common positions
  - Investment Direction Adviser
    - Used frequently when the trust has a concentrated portfolio, the grantor has a longstanding investment adviser or the grantor wants to continue making the investment decisions
  - Special Holdings Direction Adviser
    - Used frequently with closely-held business interests or other non-marketable trust assets
    - Waiver of Prudent Investor Rule
  - Distribution Adviser
    - Typically someone familiar with beneficiaries and their needs
    - Unusual distribution requests
  - Trust Protector
    - Trust Protector is what you make it. Could direct the trustee to (i) merge trusts, (ii) divide trusts, (iii) change situs or governing law
    - Often an attorney or accountant well versed in trust and tax law
- The direction adviser can be used to completely "bifurcate" trustee duties or to direct transactions on an "as needed" basis
- Reduced fee structure

Excluded Co-Trustees

- In 2017, Delaware adopted 3313A of Title 12
- Similar to directed trust statute (3313) but allows for an allocation of Trustee powers between co-Trustees. In a traditional directed trust, the Trustee still holds all of the Trustee powers but is directed by an adviser to carry them out.
- 3313(A) addresses several aspects of an excluded co-Trustee trust structure:
  - Statute allows a co-Trustee to direct another co-Trustee to exercise Trustee powers.
    - Standard of liability for excluded co-Trustee: Willful misconduct
  - Statute allows a trust agreement to grant Trustee powers exclusively to one co-Trustee, to the exclusion of the others.
    - Standard of liability for excluded co-Trustee: Complete exoneration. Excluded Trustee is not a fiduciary with respect to the Trustee power it does not hold.
  - Excluded Trustees have no duty to monitor the conduct of the co-Trustee, to provide advice to the co-Trustee or consult with or request directions from the co-Trustee, or to notify a beneficiary of an action taken by the co-Trustee.

Excluded Co-Trustees

- Common Positions:
  - Investment Trustee
  - Distribution Trustee
  - Administrative Trustee
- Best Uses Versus a Direction Adviser:
  - Tax Matters
  - Investment Transactions Involving Reps and Warranties
- **NEW STATUTE – 12 Del. C. § 3343**
  - Allows for the appointment of multiple Trustees with different powers as long as there is the ability to appoint additional or successor trustees
  - Allows for directed trusts or excluded co-trustees without the need for modification

Asset Protection Trusts

- Delaware Qualified Dispositions in Trust Act (12 Del. C. § 3570, et. seq.)
- Requirements
  - Disposition by a transferor by a trust instrument
  - Appointment of a qualified trustee
  - The qualified trustee must custody assets in Delaware, maintain trust records, prepare or arrange for the preparation of fiduciary income tax returns, or otherwise materially participate in trust administration
  - The trust instrument must provide that Delaware law governs the validity, construction and administration of the trust
  - The trust must be irrevocable
  - The trust must contain a spend-thrift clause (which should make reference to the Bankruptcy Code)

Asset Protection Trusts

- Prohibited Powers
  - The grantor may not serve as trustee of the trust
  - The grantor may not serve in an advisory position other than investment adviser
  - The grantor may not retain the power to direct distributions
  - The grantor may not demand a return of assets transferred to the trust

Asset Protection Trusts

- Permissible Retained Powers
  - When serving as investment adviser, the right to consent to or direct investment decisions
  - Power to veto distributions of income or principal from the trust
  - Power to appoint advisers who have authority to remove and appoint qualified trustees or trust advisers
  - Power to remove and replace trustees or trust advisers
  - Limited lifetime or testamentary power of appointment
  - Right to receive income or principal pursuant to broad discretion or a standard as determined by Delaware trustees, non-Delaware trustees and/or advisers

Asset Protection Trusts

- Creditor Exceptions
  - A creditor whose claim arose before the creation of the trust, provided the claim is brought within 4 years after the creation of the trust or, if later, within 1year after the creditor discovered (or should have discovered) the trust AND a fraudulent transfer is proven by clear and convincing evidence
  - A creditor whose claim arose after the creation of the trust, provided the claim is brought within 4 years after the creation of the trust AND a fraudulent transfer is proven by clear and convincing evidence
  - A person whose claim arises via agreement or court order for the payment of support or alimony for the grantor's spouse, former spouse or children, or for a division or distribution of property in favor of the grantor's spouse or former spouse
    - Only a spouse who is married to the grantor before the trust was created may avail himself or herself of such right
  - A person who suffers death, personal injury, or property damage on or before the date the trust was created for which the grantor is liable

Asset Protection Trusts

- Completed Gift Asset Protection Trusts
  - Ensure the trust is established in a jurisdiction that allows for self-settled asset protection trusts
    - Deemed retention of dominion and control if a creditor can reach the assets (Rev. Rul. 76-103; Rev. Rul. 77-378; and *Paolozzi v. Commissioner*, 23, T.C. 102 (1954))
    - IRC §§ 2036, 2038 inclusion where the assets are subject to creditor claims (Rev. Rul. 76-103; *Estate of Paxton*, 68 TC 785 (1986))
  - Retained Interest Arguments
    - Rev. Rul. 2004-64
    - PLRs 9837007 & 200944002
    - Acts of Independent Significance
      - Divorce – *Estate of Tully*, 528 F.2d 1401; PLR 9141027)
      - Failure to support/possibility of having children – *Ellis v. Commissioner*, 51 T.C. 182 (1968), judgment aff'd, 437 F.2d 442; Rev. Rul. 80-255

Asset Protection Trusts

- Incomplete Gift Asset Protection Trusts
  - Used when the grantor does not want to use his or her unified credit and wants the assets to receive a basis step-up at death
    - Structured as grantor trusts where state income tax is not a concern, i.e., the grantor is looking only for asset protection
    - Generally set up as non-grantor trusts (DINGs) when the grantor resides in a high state income tax jurisdiction
      - Care must be taken not to trigger grantor trust status under IRC §§ 671-679
        - Distribution committee composed of parties with adverse interests

Asset Protection Trusts

- To structure as an incomplete gift, the grantor should retain
  - Lifetime limited power of appointment limited by a reasonably definitive standard (i.e. health, education, maintenance and support)
  - Testamentary limited power of appointment over the trust
  - Veto power whereby a distribution directed by any one member of the distribution committee must be approved by the grantor (Treas. Reg. § 25.2511-2(b))
- How to structure as a non-grantor trust for income tax purposes (DING trust)
  - Powers of the Distribution Committee
- PLRs 200715005, 200647001, 200637025, 200612002, 200502014, 201310002, and 201550005; IR-2007-127; Rev. Ruls. 76-503 and Rev. Rul. 77-158; CCA 201208026;

Quiet Trusts

- Generally, a Trustee has a duty to inform beneficiaries about a trust and to treat beneficiaries impartially in this regard.
- Delaware's default disclosure requirements are set by *McNeil v. McNeil*, 798 A.2d 503 (Del. 2002)
  - "A trustee has a duty to furnish information to a beneficiary upon reasonable request. Furthermore, even in the absence of a request for information, a trustee must communicate essential facts, such as the existence of the basic terms of the trust. That a person is a current beneficiary of a trust is indeed an essential fact." *Id.* at 510
- 12 Del. C. §§ 3303(a), (c)
  - A trust instrument can eliminate or restrict a beneficiary's right to be informed for a period of time
    - Related to the age of a beneficiary
    - Related to the lifetime of the trustor(s) and/or the trustor's spouse
    - Related to a term of years or specific date
    - Related to a specific event certain to occur

Quiet Trusts

- Common reasons why a grantor might want to restrict or eliminate the provision of information about the trust to beneficiaries:
  - Beneficiaries could lose incentive to pursue work and education - "trust fund" babies
  - Beneficiary has a substance abuse problem
  - Beneficiary is a spendthrift or has a gambling problem
  - Beneficiary could be a victim of abusive spouse or other designing persons
  - Grantor wants to maintain privacy for his lifetime
  - Grantor wants flow of information to be considered on a case by case basis
- Grantor has multiple options for structuring the trust:
  - Waive the Trustee's duty to inform for a period of time and let the Trustee decide when to inform beneficiaries and to what extent.
  - Completely restrict the Trustee from informing beneficiaries about the trust until the selected period of time is over – a true "quiet trust".
  - Grant the power to control the flow of information to someone other than the Trustee – such as a Trust Protector or the Grantor himself.

Quiet Trusts

- Issues in Administration
  - Withdrawal rights – Trust may have Crummey withdrawal powers or set ages at which a beneficiary can withdrawal trust funds. Do the trust provisions conflict?
  - Discretion to withhold information v. mandatory direction
    - If duty to inform is simply waived, a corporate Trustee is likely to inform the beneficiary rather than exercising a discretion to consider the options on a case by case basis
    - If Trustee is restricted from informing beneficiary about the trust, this can hang up trust operations and present difficulties when the Trustee wants to make a distribution
  - No one to receive notice to start statute of limitations
  - Grantor misconception
  - Strained relationship with beneficiary when notice is finally given

Quiet Trusts

- How to address administrative issues: Use Trust Protectors and designated representatives
- The Trustee can be directed as to when and how to inform beneficiaries about the trust by a direction adviser such as a Trust Protector.
- Delaware law provides a tool to enable a quite trust to operate when beneficiary's are not informed about a trust. (12 Del. C. § 3303(d))
- 3303(d) provides that unless the governing instrument provides otherwise, while a beneficiary's right to be informed is restricted or eliminated, the beneficiary may be represented and bound by a "designated representative" for both judicial proceedings and nonjudicial matters.

Quiet Trusts

- A designated representative is deemed to be a fiduciary and must accept his or her appointment in writing and be appointed or authorized to act in one of the following ways:
  - Express appointment as a designated representative or by reference to the applicable section(s) of the Delaware Code in the trust agreement
  - Someone is given the authorization or direction in the trust agreement to represent or bind beneficiaries for purposes of a judicial proceeding and/or nonjudicial matter (whether or not they are expressly identified as a designated representative)
  - Appointment by a person expressly authorized in the trust agreement to appoint the designated representative (or the equivalent)
  - Appointment by a beneficiary to act as his or her designated representative (limited application if the beneficiary's rights to information are restricted or eliminated)
  - Appointment by the settlor to act as a designated representative for the beneficiary(ies) – this can be quite useful. This is a statutory power in the settlor to name a designated representative.

Migrating Trusts to Delaware

- The Peierls cases
  - Part of previously popular "consent Petition" process to move trusts from other jurisdictions to Delaware and simultaneously modify the trusts
  - After the Peierls cases decided by the Delaware Supreme Court in 2013, the Delaware Court of Chancery favors nonjudicial approaches.
  - Concepts from the Peierls cases are now were codified and expanded upon by subsequent legislation:
    - 12 Del. C. § 3332(b) – "Except as otherwise provided by the terms of a court order and notwithstanding a general choice of law provision in the governing instrument of a trust, such as a provision to the effect that the laws of a jurisdiction other than this State shall govern the trust or the administration of the trust, the laws of this State shall govern the administration of the trust while the trust is administered in this State unless the governing instrument expressly provides that the laws of another jurisdiction govern the administration of the trust and further provides that the laws governing the administration of the trust shall not change on account of a change in the place of administration of the trust."
      - Possible exceptions
    - 12 Del. C. § 3340 – "For purposes of this title, a trust shall be deemed to be administered in this State if:
      - (1) The sole trustee is an individual residing in this State or a corporation or other entity having an office for the conduct of trust business in this State;
      - (2) The trust has more than 1 trustee only 1 of which is a corporation or other entity and that corporation or other entity has an office for the conduct of trust business in this State; or
      - (3) The trust has more than 1 trustee all of whom are individuals and 1/2 or more of whom reside in this State.

Trust Modification

- Generally speaking there are 5 ways to modify trusts under Delaware law
  - Consent Petitions
  - Decanting
  - Merger
  - Non-Judicial Settlement Agreements
  - Modification by Consent Agreements

Trust Modification – Consent Petitions

- Governed by Chancery Court Rules 100-104
- Types
  - Modification (prospective)
    - A departure from the original terms of the trust
  - Reformation (retroactive)
    - Allowed in cases of unilateral mistake (*Roos v. Roos*, 203 A.2d 140, 142 (Del. Ch. 1964)
    - When the trust does not reflect the intent of the parties.
- All interested parties, as defined in Chancery Court Rule 101(a)(7), must consent or not object to the relief requested pursuant to the petition
  - Interested parties: trustor (if living), current and presumptive remainder beneficiaries, all serving fiduciaries and other power holders
  - Some or all beneficiaries can be represented by a designated representative, a virtual representative or a guardian ad litem
- Generally available to Trusts administered in Delaware
- Consent petitions to modify trusts are not utilized as often as they once were following the *Peierls* and *Flint* opinions

Trust Modification - Decanting

- Decanting by power granted in the trust agreement
- Decanting by statutory authority (12 Del. C. § 3528)
  - Requirements
    - The first trust cannot expressly prohibit the trustee from distributing assets in further trust for a beneficiary
    - The trustee must have the ability to invade principal and/or income for the benefit of one or more of the beneficiaries of the first trust
    - The decanting may not add new beneficiaries. 12 Del. C. § 3528(a)(1).
    - Generally, the interests of remainder beneficiaries cannot be changed.
    - The second trust must comply with any standard that limits the trustee's authority to make distributions from the first trust. 12 Del. C. § 3528(a).
    - Trust must be administered in the State of Delaware

Trust Modification - Decanting

- Potential Liability of the Trustee
  - Viewed as the exercise of a limited power of appointment (12 Del. C. § 3528(c))
  - An exercise of a discretionary distribution decision, and is difficult to overturn unless the Trustee "abused" its discretion
- No notice or consent requirements
- Releases for Trustee from all interested beneficiaries

Trust Modification - Decanting

- Common Modifications Achieved
  - Bifurcation of trustee responsibilities, e.g., creation of directed trust
  - Addition of quiet trust language
  - Conversion to grantor trust or vice versa
    - Possible recognition of gain with negative basis assets
  - Division of a trust
  - Creation of a general power for basis step-up
    - Expressly allowed under Delaware law (12 Del. C. § 3528(a))
- Circumstances that make decanting more attractive than other modification alternatives:
  - The ability to change beneficial interests of (living and unborn) beneficiaries who are part of the current class of distributes without the participation of a beneficiary
  - The ability to decant back to the same trust
  - Extending a trust for a beneficiary's lifetime without the participation of the beneficiary
  - The availability of the Discretionary Distribution GST Tax safeharbor (Treas. Reg. § 26.2601-1(b)(4)(i)(A))

Trust Modification - Decanting

- Tax Considerations
  - Income Tax
    - Identity of the grantor
    - Continuation of tax attributes
    - Recognition of Gain
  - Estate and Gift Tax
    - Beneficiary consent
      - Taxable transfer or taxable gift

Trust Modification - Decanting

- Tax Considerations (cont'd)
  - GST Tax – 2 Possible Safeharbors
    - Discretionary Distribution Safe Harbor (Treas. Reg. § 26.2601-1(b)(4)(i)(A))
      - Available if the trust instrument or applicable local law authorized the trustee to decant the trust at the time of the trust's creation;
      - Very flexible - The new trust cannot delay the vesting of an interest in the trust beyond a federal perpetuities period
    - Trust Modification Safe Harbor (Treas. Reg. § 26-2601-1(b)(4)(i)(D))
      - The modification cannot shift a beneficial interest in the trust to a beneficiary occupying a lower generation than the persons holding the beneficial interest in the original trust; and
      - The modification cannot extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust

Trust Modification - Merger

- Merger by power granted in the trust agreement
- Merger by statutory authority (12 Del. C. § 3325(29))
  - A trustee is authorized to "merge all or a portion of the trust with or into any other trust or trusts . . . whether or not created by the same trustor and whether or not funded prior to the merger, to be held and administered as a single trust if such a merger *would not result in a material change* in the dispositive terms of the trust defining the nature and extent of any trust beneficiary's interest in the principal or income of the trust." (emphasis added)
  - Merger can be with a newly created empty trust (Delaware may be the only state to allow this)
  - Available if Delaware law governs administration
  - No notice or consent requirements
- Releases for Trustee from all interested beneficiaries
- Exercise of Trustee discretion

Trust Modification - Merger

- Common Modifications Achieved
  - Bifurcation of trustee responsibilities, e.g., creation of directed trust
  - Addition of quiet trust language
- Circumstances that make merger more attractive than other modification alternatives:
  - Only administrative changes are desired, settlor is deceased and Trustee has no discretionary distribution power

Trust Modification

- Non-Judicial Settlement Agreement ("NJSA") (12 Del. C. § 3338)
  - Requires the agreement of all "interested persons" whose consent would be needed to achieve a binding settlement in the Delaware Court of Chancery (12 Del. C. § 3338(a))
    - Interest parties are the trustor (if living), the trustee and other fiduciaries, current and presumptive remainder beneficiaries, and all other having a beneficial interest, e.g., holder of a power of appointment
  - The interested persons may enter into a binding agreement "with respect to *any matter involving a trust…*" (except with respect to charitable trusts and purpose trusts described (12 Del. C. § 3338(b)) (emphasis added)
    - Examples provided by statute: interpretation of a trust instrument, liability of a trustee, granting powers to a trustee, etc. (12 Del. C. § 3338(d))

Trust Modification

- NJSA
  - Limitation
    - A nonjudicial settlement agreement is valid "only to the extent it does not violate a material purpose of the trust, and if applicable, does not change the trust's purpose in a manner that would violate subsection (b) of § 3303 of this chapter if the change was effected by court order; provided, however, that this subsection shall not apply in cases where the trustor is a party to the nonjudicial settlement agreement" (12 Del. C. § 3338(c))

Trust Modification

- Modification by Consent Agreement (12 Del. C. § 3342)
  - Enacted July of 2016
  - Allows a trust to be "modified to include any provision that could have been included in the governing instrument" regardless of "any provision of law or the trust's governing instrument limiting or prohibiting amendment of the trust" (12 Del. C. § 3342(a))
  - **No material purpose requirement**
  - Requires the "**written consent or written nonobjection** of all of the trust's trustors, all then serving fiduciaries and all beneficiaries regardless of whether the modification may violate a material purpose of the trust.
  - A trustor's power to provide a written consent or written nonobjection to a trust's modification may be exercised: (i) by an agent under a power of attorney only to the extent expressly authorized by the power of attorney or the terms of the trust's governing instrument; or (ii) if an agent under a power of attorney is not so authorized, by the guardian of the trustor's property (or similar court-appointed representative) with the approval of the court supervising the guardian (or similar representative).
  - Section applies to any trust administered under the laws of this State.

New Hampshire Trust Law

LEGISLATIVE HISTORY

NEW HAMPSHIRE TRUST LAWS

2003
Enacted unitrust conversion statute

2004
Repealed rule against perpetuities, adopted Uniform Trust Code

2005
Modified trustee's duty to inform & creditor's rights against a beneficiary's interest in a trust

2006
Enacted Trust Modernization & Competitiveness Act

2008
Enacting decanting statute, recognized self-settled spendthrift trusts, expanded virtual represenation, refined rules governing trust advisors & protectors

2010
Enhanced laws governing family trust companies & codified laws into a single chapter

2011
Clarified interest & dividends tax does not apply to accumulated income

2012
Codified no-contest enforceability, rejected benefit-of-the-beneficiaries rule, clarified limitation period for judicial proceedings against trustees, trust advisors and trust protectors for breach of trust

2013
Repealed I&D tax on trusts

Source: New Hampshire Trust Council

NEW HAMPSHIRE TRUST LAW BENEFITS

ASSET PROTECTION	N.H. self-settled spendthrift trusts provide a grantor with the ability to receive distributions while also providing asset protection. Case Law has historically enforced creditor protection (see: In re Goodlander, 161 N.H. 490 (2011). Exception creditors are limited to a divorcing spouse, alimony and child suport. N.H. statutes allow trusts formed outside of N.H. to be converted to N.H. self-settled spendthrift trusts.
TRUST ADMINISTRATION	N.H. trust law provisions provide for efficient and flexible trust admininstration through NJSA's, trustee decanting, trustee modification and virtual representation. N.H directed trusts provide trustee's with protection by allowing for the delegation of trustee duties. N.H. law also provides for the enforcement of a "no-contest" provision and the state has a specialized trust court solely for trust-related matters. N.H. Trust law provisions also provide for quiet trusts and there is no limit on the sealing of trust litigation records.
TAXATION	N.H. does not impose any income tax on nongrantor trusts. Additionally, nonresident beneficiaries are not subject to I&D taxes on distributions and trusts are not subject to I&D tax filing. The state does not impose an estate or gift tax.
SETTLOR INTENT	N.H. case law has a strong history of upholidng settlor intent and the state repudiated the benefit-of-the beneficiaries rule. The state also repealed the rule against perpetuities, allowing settlors to create perpetual trusts.

NEW HAMPSHIRE CASE LAW

SCHEFFEL V. KRUEGER	This case demonstrates N.H.'s courts' long standing commitment to upholding asset protection statutes. The case involved a minor who was assaulted by a pedophile. The parent of the child filed suit to recover assets from a spendthrift trust set up by the defendant's grandparent. Despite mounting pressure stemming from the severity of the crime, the N.H. Supreme Court ruled that the language of the law prevents creditors from recovering assets from a spendthrift trust that is not self-settled or is funded with a fraudulent transfer.
APPEAL OF LOWY 156 NH 57 (2007)	The Lowy case demonstrates N.H. courts' tradition ruling in favor of settlor's intent. The court stated, "When we construe a trust, the intention of a settlor is paramount, and we determine that intent, whenever possible, from the express terms of the trust itself. Moreover, we reject any construction of trust language that would defeat the clear and expressed intention of a settlor."
SHELTON V. TAMPOSI	This decision provided two important rulings for N.H. case law. The N.H. probate court upheld the division of duties between the trustees and the investment directors while also enforcing the no-contest provision following a beneficiary's contest of a trust.
IN RE GOODLANDER, 161 N.H. 490 (2011)	The Goodlander case, the New Hampshire Supre Court reaffirmed that under New Hampshire's Uniform Trust Code, a beneficiary's interest in a trust is an expectancy and should not be reached by a beneficiary's spouse.

CONCORD TRUST
COMPANY

Alliance Trust Company of Nevada offers a non-custodial model for custody of financial assets and securities using a variety of the traditional advisor platforms such as Schwab Institutional, Fidelity Investments, Pershing, TD Ameritrade, and other major brokerage platforms. We are a unique trust company built by former advisors, for advisors, with the goal of providing superior service and flexibility. The Alliance team understands the effect excessive fees have on trust accounts and seeks to maximize the value of services for each client. Clients enjoy the safety of a regulated and independent trust company holding their assets with Securities Investor Protection Corporation (SIPC) coverage for each account. In many cases, these broker-dealer custodians carry private insurance above and beyond the SIPC limit. Advisors can use their preferred custodian for the management of the trust account and do not have to work with inflexible arrangements used by other trust institutions. Because Alliance Trust Company of Nevada is not a subsidiary or affiliate of any brokerage house, insurance company, or bank, we can engage clients and their established teams of professionals without interference or influence. This allows the client the unfettered benefit of the favorable laws in Nevada, one of the best jurisdictions for asset protection with a favorable tax climate.

WHY NEVADA? There is a lot to appreciate about Nevada's laws and regulations concerning estate planning and asset protection – for all U.S. and non-U.S. citizens.

KEY BENEFITS FOR ESTATE PLANNING IN NEVADA

- Nevada allows self-settled spendthrift trusts by statute; these are also known as domestic asset protection trusts or Nevada Asset Protection Trusts. Nevada protects your wealth more than any other state.

- You do not have to live in Nevada to use the Nevada asset protection trust, as long as you have a Nevada resident trustee, like Alliance Trust Company.

- Nevada has no state or corporate income tax. Therefore, income generated from the trust is never taxed on a state level.

- Nevada allows for Dynasty Trusts that can last for 365 years, skipping many generations for estate tax purposes.

KEY BENEFITS FOR NEVADA ASSET PROTCTION

• Nevada has a two-year statute of limitations on asset transfers to self-settled spendthrift trusts, also known as a seasoning period. This is one of the shortest seasoning periods in all the United States.
• There are no exception creditors under Nevada law, which includes claims for spousal and child support, this provision is unique to Nevada.
• There is no prohibition on the settlor's powers over the trust, with the sole exception of making distributions to him or herself.
• Trusts may require a distribution to the settlor and still qualify as self-settled spendthrift trusts, using grantor retained annuity trusts, qualified personal residence trusts, charitable remainder trusts, or income-only distributions.
• The settlor of a Nevada asset protection trust may serve as co-trustee and manage the assets of the trust.
• The settlor can retain a limited power of appointment rendering transfers to the trust incomplete for gift tax purposes.
• Fraudulent conveyance is the only attack allowed on Nevada Asset Protection Trusts and must be proved by clear and convincing evidence as to that particular creditor – a very high burden of proof.
• One of the most common attacks made by creditors to reach assets is to claim "improper dominion and control" over a trust. Evidence of improper dominion and control and alter ego are not admissible according to the Nevada statutes. • Trustees may not be compelled to make discretionary distributions.

By **Terry N. Prendergast** & **Ashley G. Blake**

South Dakota

Legislative, judicial and executive developments

South Dakota trust law has changed over the last few years. Let's focus on the legislative, judicial and executive branch actions that have generally affected trusts and trust companies.

Each year, South Dakota's legislature reviews its trust and trust company law and passes updated legislation. Nineteen years ago, the South Dakota Governor's Task Force on Trust Administration (Governor's Task Force) was created. It meets annually and submits proposals to the legislature to keep trust and trust company laws modern and developed. As most readers know, South Dakota has been traditionally rated as a top tier jurisdiction for its trust laws1 and is recognized for its dynasty trust, asset protection trust and decanting laws. Additionally, South Dakota now has chartered approximately 100 public and private non-depository trust companies, with over $300 billion in assets under management (AUM) (not counting state or national bank trust departments that also have substantial AUM in the state), making the state one of the top for most state-chartered trust companies in the nation.

Legislative Action

On the legislative scene, in 2019, the trust task force bill (SB 51) had fewer substantive changes than previous years. South Dakota had in the last three years added "special spousal" trusts to allow community property trusts (SDCL 55-17, added in 2016), updated and rewritten its virtual representation statutes (codified as SDCL 55-18 in 2017 and updated in 2018) and revamped its laws

to amend its statutes on non-charitable purpose trusts and to include hybrid purpose trusts (SDCL 55-1- 20 to 55-1-22.6 in 2018).

Special spousal trusts (2016). In 2016, the legislature added South Dakota's version of the community property trust, similar to Alaska's, which was first enacted in 1998 (codified as SDCL 55-17).2 By following the statutory provisions, South Dakota now recognizes the validity of the special spousal trust and declared that property conveyed to the trust is "community property" and the trust is "considered a trust established under the community property laws of South Dakota."3 The statutes describe attributes of the property transferred to the trust, including provisions that unless the parties otherwise specifically agree, each spouse is attributed interest in 50% of the special spousal property.

Virtual representation (2017 and 2018). In 2017, the legislature recodified South Dakota virtual representation law (now codified under SDCL 55-18), adding definitions and addressing whether a representative can bind a person subject to a trust and who's excluded from the requirement of service or notice (including unborn persons, unascertained persons, potential appointees of a power of appointment (POA), potential takers in default of a POA, uninterested beneficiaries and persons bound by a representative). For the most part, South Dakota kept intact much of its pre-2017 law, but eliminated, for example, provisions that both parents had to be representatives of a minor. The law now only requires one parent to virtually represent a minor and clarifies that no notice is required for unborn children. Thus, the need for appointment of a guardian ad litem is substantially decreased. The statutes also make clear that persons having substantially identical interests with respect to the matter in question can represent other beneficiaries.

The recodification addressed both judicial and non-judicial proceedings and allows representatives to opt out of being representatives and to represent any number of persons. The new codification also addressed representatives' conflicts of interest and the timely disclosure of any such conflict.4 A representative may, under the new legislation, be entitled to reasonable compensation, and the legislation preserves the court's authority to appoint representatives (court-appointed guardians ad litem for minors) in certain circumstances—although a guardian ad litem won't be required in most cases, and the court would need to exercise this authority only in unusual cases.

The statutes give virtual representatives broad discretion but eliminate liability unless the representative acts dishonestly, with an improper motive, or fails to act if under duty to act. They further provide that the virtual representative isn't a fiduciary unless otherwise ordered by the court or provided in the governing instrument.

The 2017 changes restrict a settlor's right to be a virtual representative if the proposed modification would constitute retained interests or irrevocable transfers under Internal Revenue Code Sections 2036 and 2038. The updated statutes also allow the governing instrument to require additional notifications or consents or to identify those who may not be virtual representatives. Trust protector powers to serve as, designate or remove virtual representatives were also added.

In 2018, certain virtual representation provisions were updated and clarified. If the application of the rules would result in no one being notified (for example, because all of the trust beneficiaries aren't yet born), then someone still must be notified, and the statutes were revised to detail how to provide such notice. Further, out of the laundry list of potential representatives in different situations, it will

often arise that more than one category of representatives can act on behalf of a trust beneficiary. When that occurs, unless otherwise provided, the individual carrying out the notice may exercise discretion in selecting which representative category to use to provide the required notice or obtain the required consent. The procedure for notice on virtual representatives for court proceedings, as well as granting powers of conservators to act as virtual representatives, was also updated. The 2018 changes also clarified that the notice requirements to otherwise defined "qualified beneficiaries" allow notice to a virtual representative.

Purpose trust additions (2018). The 2018 legislative changes to purpose trusts are codified as SDCL 55-1-20 to 55-1-22.6. If a purpose trust fails to qualify as a charitable trust, it's called a "noncharitable purpose trust" under South Dakota law. These aren't enforced by the Attorney General's office; instead, an "enforcer" is named within the trust to enforce the trustee's duties. If the instrument fails to name an enforcer, then a court can appoint one. The 2018 statutes also clarified how noncharitable purpose trusts work and the duties of an enforcer. The statutes designated the enforcer as a fiduciary. The statutes also provided for the removal of an enforcer who's failing to discharge his responsibilities. The updates also clarified how a noncharitable purpose trust works if individual beneficiaries are also named (a hybrid purpose trust) and statutorily recognized such a hybrid purpose trust.

2019 legislative changes. This year, the legislature had fewer changes than usual. All of the 2019 statutory changes took effect July 1, 2019. One of the significant 2019 changes provides procedures for vacation of a trusteeship when a trustee resigns.5 Although the trustee must still use efforts to find a successor trustee, if the beneficiaries, settlor and others interested in the trust have simply abandoned

the trust, the statutes give the trustee a procedure to resign from the trusteeship and serve only as a custodian of the assets or transfer them to the court. A difficult situation can arise for trustees of irrevocable life insurance trusts, for example, when the trust has minimal assets, the policy has little cash value, there's no money to pay premiums and the beneficiaries and settlor have abandoned the trust. Many times in such cases, no successor trustee wants to get involved. The legislation is designed to provide an orderly procedure to fix similar situations while still preserving the rights of the settlor and trust beneficiaries.

The 2019 legislation also clarifies that notice to all fiduciaries is required when a trust is modified or terminated by consent of the beneficiaries and/ or the settlor, to prevent the situation in which the beneficiaries and settlor are modifying the trust by a non-judicial settlement agreement without letting the trustee know.6

Another 2019 change adds a presumption that a trust is irrevocable unless the terms of the trust instrument expressly reserve the power to revoke or modify.7 Although infrequent, there are trusts that don't state whether they're irrevocable or revocable, and certain consequences that flow from those trusts are unclear. The new statutory presumptions can always be overcome by including language rebutting the presumption in the trust instrument. South Dakota law provides that "the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any provisions of general application to trusts and trust administration."8 Legislation also clarifies that with respect to an investment trust advisor, the advisor can be an entity as well as an individual.9 Most practitioners had assumed this to be the case, but the legislation confirms this interpretation.

Recent Judicial Decisions

With respect to judicial decisions, South Dakota statutes are very clear on most trust matters, so there's little litigation on matters set forth in the statutes and very little judicial involvement. One recent case of note, decided May 30, 2017, is *In the Matter of Elizabeth A. Briggs Revocable Living Trust*.10 South Dakota law allows a trustee, trust advisor, trust protector or settlor to send a copy of the trust instrument and a notice informing the recipient of the trust's existence, of the trustee's name and address and that the recipient has 60 days to start a proceeding contesting the validity of the trust.11 In this case, Elizabeth Briggs had twice amended her revocable trusts to expressly omit first her son and then the son's daughter from the disposition of assets on Elizabeth's death. Under SDCL 55-4-57, after Elizabeth's death, the attorney representing her estate sent the descendants the specified notice of 60 days to commence judicial proceedings, and no proceeding was commenced. The son later started an action alleging lack of capacity and undue influence, and the South Dakota Supreme Court, in its first opportunity to address SDCL 55-4- 57, concluded that the son's claims were barred and that SDCL 55-4-57 "operate[s] as a statute of limitations or statute of repose that bar[s] untimely judicial proceedings contesting the valid creation of trusts and trust amendments." The court concluded that the incapacity and undue influence claims were barred as actions to contest the "validity" of the trust.12 While in this case, a post-death notice was provided, it should be noted that SDCL 55-4-57 has no restrictions and may be used to limit contests by giving a pre-death notice to potential beneficiaries who may wish to contest the validity of a trust. Indeed, such cases many times turn on the settlor's capacity and intentions, and a court is in a better position to

judge such capacity and intentions during the settlor's life when the settlor herself can be examined than after her death, when usually only third-party testimony is available.

In addition to the 60 days after notice requirement of SDCL 55-4-57, the statute also provides that if notice isn't given, a claimant has one year after the settlor's death to commence an action to contest the validity of the creation of the trust or amendment thereto. This statute was also held to bar an action to contest a revocable trust that became irrevocable at death in *In re Wintersteen Revocable Trust Agreement*,13 filed Feb. 7, 2018, with the South Dakota Supreme Court, finding the statute operated as a statute of repose that prohibited the relation back doctrine to allow amended pleadings.

In a more recent case, In re Cameron Trust,14 the South Dakota Supreme Court affirmed a trust's spendthrift provisions and refused to give full faith and credit to a California order requiring payment of a child support obligation from the trust. The court, while recognizing the unique facts and 10-year procedural history of the proceedings leading to the California order, affirmed the validity of spendthrift clauses of South Dakota trusts and their prohibition of compelling direct payments to creditors. The court stated:

> Our legislature has placed formidable barriers between creditor claims and trust funds protected by a spendthrift provision (citing SDCL 55-1- 41, 55-1-35) . . . [and] has emphatically rejected even the specter of an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision.15

The court did recognize that a South Dakota domestic asset protection trust (DAPT) grantor couldn't transfer assets into a DAPT to avoid pre-existing child support obligations (SDCL 55-16-15) but stated that wasn't the situation in this case.

Government Commitment

South Dakota is committed to remaining in the top tier of trust jurisdictions, and its legislature and judiciary actions and interpretations help maintain this status. The executive branch is also dedicated to making South Dakota a "welcoming" state. As indicated, part of the framework of South Dakota government is the long time appointment of the Governor's Task Force, which has been continuously renewed over the last 19 years by four governors. The executive branch also strongly emphasizes South Dakota's attributes as a state with no state income tax on individuals, corporations or trusts and as a state with strong fiscal attributes. South Dakota has had a balanced budget every year since statehood in 1889. Both Standard & Poor's Global and Moody's investors have recently reaffirmed South Dakota's AAA bond rating, and the state's public pension retirement system is 100% fully funded.16 Such fiscal responsibility and stability should imply that there's little concern that state revenue decreases will encourage the income taxation of trusts in the future. A provision in the state constitution requires that to impose or increase such taxes, a 2/3 vote of each house of the legislature would be required.

The South Dakota trust industry, including through the South Dakota Trust Association, works with the legislative, judicial and executive branches to continuously improve the experience in the state for trusts and trust companies. Recent developments, including those that were discussed in this article, evidence the successes.

Endnotes

1. Mark Merric and Daniel G. Worthington, “Which Situs is Best in 2018?” Trusts & Estates (January 2018).
2. Terry N. Prendergast, “South Dakota Special Spousal Property Trusts: South Dakota ‘Steps-Up’ to the Plate and Hits a Home Run for Surviving Spouses,” 61 S.D. L. Rev. 431 (2016).
3. SDCL 55-17-5.
4. Thomas E. Simmons, “Conflict of Interest Infected Virtual Representatives and a Cure,” 64 S.D. L. Rev. 1 (2019).
5. SDCL 55-3-16; 55-3-17.1, 21-22-12.
6. SDCL 55-3-24.
7. SDCL 55-3-6.
8. SDCL 55-1-53.
9. SDCL 55-16-5.
10. In the Matter of Elizabeth A. Briggs Revocable Living Trust, 898 N.W.2d 465 (2017).
11. SDCL 55-4-57.
12. The son later attempted to challenge the trust in federal court alleging a claim for tortious interference with inheritance or expected inheritance, but the South Dakota Supreme Court on a certified question didn’t recognize such a cause of action under South Dakota law. Briggs v. Briggs, 2019 S.D. 37 (July 2, 2019).
13. In re Wintersteen Revocable Trust Agreement, 907 N.W.2d 785 (2018).
14. In re Cameron Trust, 2019 S.D. 35 (June 26, 2019).
15. Ibid., Slip. op., at p. 12 (citing SDCL 55-1-25).
16. South Dakota State News, “South Dakota Maintains Highest Credit Rating,” https://news.sd.gov/newsitem.aspx?id=24485; South Dakota Retirement System (SDRS), Comprehensive Annual Financial Report 2018,” https://sdrs. sd.gov/docs/CAFR2018.pdf.

Terry N. Prendergast and **Ashley G. Blake** are attorneys at Davenport Evans, Hurwitz & Smith LLP in Sioux Falls, S.D.

Jurisdiction Showdown Panel

The Jurisdictional Showdown will be an interactive panel of four trust, legal and wealth management professionals from the states of South Dakota, Delaware, Nevada and New Hampshire will discuss and compare their state laws. The group will provide attendees with the jurisdictional information and strategies to take advantage of their unique laws which provide estate planning opportunities for planners and their clients.

Mary Schaefbauer, Moderator
Mary is a Senior Trust Officer/VP with BTC Trust Company of South Dakota. She is an experienced trust professional with demonstrated knowledge in fiduciary administration, trust and estate planning, compliance, wealth management and new business development. Mary specializes in working with ultra-high net worth families, providing specialized high-touch account administration and wealth planning for her clients.

A native of Sioux Falls, Mary holds a BA from the University of SD and a JD from the USD School of Law. For the past 23 years, she has worked at several bank trust departments and trust companies in South Dakota and Arizona
providing trustee and estate settlement services to families. Mary is an active member of the South Dakota Bar Association, the Sioux falls Estate planning Council, a graduate of the Cannon Financial Institute Trust Schools where she earned her CTFA degree and the ABA National Trust School.

Terry N. Prendergast
Davenport Evans Hurwitz & Smith
206 West 14th Street
P.O. Box 1030
Sioux Falls, South Dakota 57101-1030
(605) 336-2880
(605) 357-1229 – Direct Dial e-mail: tprendergast@dehs.com
P R O F E S S I O N A L
Member, Governor's Task Force on Trust Administration Review and Reform, 2010-2018; Member, Lieutenant Governor's Captive Insurance Workgroup; Member, South Dakota Secretary of State's Special Workgroup on Corporate, Business and Trust Companies; Member, Association of College and University Attorneys (Member-Committees on Personal Relations, Tenure and Retirement Programs, Affirmative Action, Liability, Risk Management and Insurance); South Dakota Trial Lawyers Association; American Bar Association (Committees on Science and Technology, Corporation, Banking and Business Law; Real Property, Probate and Trust Law); Past Member Commercial Law League of America; American Inns of Court; Supreme Court Historical Society; American Judicature Society; Member, State Bar of South Dakota; Past

Member, Board of Bar Commissioners, State Bar of South Dakota; Board Member, Public Sector Lawyers' Section, State Bar of South Dakota; Past Chair and Member, Law School Committee, State Bar of South Dakota; Member, Legal Aid-Civil Committee, State Bar of South Dakota; Past Chair and Member, Continuing Legal Education Committee, State Bar of South Dakota; Past Member, Unauthorized Practice of Law Committee, State Bar of South Dakota; Member, Attorneys Task Force on Multistate Regulation, National Council of State Nursing Boards; Past Member, USD Law School Foundation; Service Participant, Retirement Industry Trust Association

C I V I C

Past President and Board of Trustees, Siouxland Heritage Museums; Past President, Secretary-Treasurer and Board Member, Lutheran Social Services of South Dakota; Past President and Board Member, Lutheran Social Services Foundation; Past President and Board Member of Food Service Center, Inc.; Past President and Board Member, Sioux Falls Downtown Kiwanis Club; Past Board Member, Visiting Nurses Association; past Board Member, Sioux Falls Bridge Club; Special Events Chairman, Past President, Past Vice President, Past Secretary and Board Member, Howard Wood Dakota Relays; Past Chairman, Elks Youth Services Committee; South Dakota Historical Society; Past Board Member, Executive Committee Member and Secretary, Kirby Science and Discovery Center; Past Executive Finance Committee Member, Washington Pavillion of Arts and Sciences; Board Member, South Dakota Division of U.S. Olympic Committee; Past Board Member and President, First United Methodist Church Foundation; Member and Past Chair, First United Methodist Church Administrative Board; Member, Investigation Committee, Dakotas Conference, United Methodist Church; Vice President and Board Member, South Dakota School for the Deaf Foundation.

Gregory E. Crawford is the President of Alliance Trust Company of Nevada, responsible for strategy, growth, and overseeing operations. For two decades, Greg has worked with some of the largest institutions in the world designing and implementing asset protection plans for multi-generational families in the United States and abroad.

Greg is a regular speaker on the benefits and advantages of Nevada trust situs at law school conferences around the country. A native of Menlo Park, California, Greg holds a Bachelor of Arts from the University of California, Davis, and a Master of Health Administration from the University of Minnesota. Greg is certified in financial planning by Boston University and is a Registered Trust and Estate Practitioner and a Certified Financial Planner.

Mr. Crawford has regularly been quoted in publications such as The Wall Street Journal, The New York Times, The Financial Times of London, and has appeared as an on-air expert on CNBC, Bloomberg and ABC World News Tonight.

Alliance Trust Company of Nevada works with attorneys, financial advisors, CPAs and insurance professionals around the world to provide flexible trustee services and the benefits of Nevada trust situs. Founded in 2005, Alliance Trust Company of Nevada is fully-independent and 100% employee owned.

Chip Martin
Concord Trust Company
Chip is a co-founder and board member of Concord Trust and he serves as President of the company. His primary responsibilities at CTC include strategic planning, business development and technology platforms.

Prior to CTC, Chip was a member of the senior management team at Bottomline Technologies, a publicly-traded company that provides software solutions to the financial services industry. His banking experience, combined with his extensive general management and business mergers and acquisition experience, helps him lead CTC's growth initiatives and work through the structuring and ownership issues that invariably surface in our clients' complex trusts.

Chip especially enjoys working with the trusted advisors)attorneys, wealth managers, accountants, etc.) of our clients to ensure that trust administration is efficient and effective. He believes that regular and open communications amongst these advisors are critical to the long-term success of multi-participant, directed trust structures.

Chip holds a degree in economics with honors from Dartmouth College and an MBA from Harvard University. An All-American ski racer in college, Chip remains active in the sport as a coach and mentor to many young athletes. He is also a board member of Big Brothers Big Sisters.

Daniel F. Hayward, J.D.

DANIEL F. HAYWARD is a Director at the Wilmington law firm of Gordon, Fournaris & Mammarella, P.A. Daniel graduated with a Bachelor of Science degree in Chemical Engineering from the University of Delaware. He received his law degree from Villanova University School of Law in 2006, and received his LL.M. in Taxation from the Villanova University School of Law in 2015. He is a member of the Delaware Bar Association, and also a member of the Estates and Trusts Section, of which he served as Chair during 2015-2016. He is a Fellow of the American College of Trust and Estate Counsel.

Daniel's practice focuses on the unique aspects of Delaware trust law including directed trusts, dynasty trusts, asset protection trusts and all aspects of the validity, construction and administration of Delaware trusts. Daniel routinely petitions the Delaware Court of Chancery to represent interested parties in the reformation of trusts and to transfer the situs of certain trusts to the State of Delaware. He also drafts, reviews and comments on Delaware trust agreements for local and out of state clients and provides legal opinions on the validity of trusts under Delaware law, including Delaware dynasty trusts and Delaware self-settled asset protection trusts.

Daniel also represents and advises Delaware corporate and individual trustees regarding trust administration and the legal aspects of their fiduciary roles. His practice also frequently includes representation of Delaware trustees in fiduciary litigation matters, in particular actions in the Delaware Court of Chancery seeking construction of trust provisions or instructions from the Court as to various matters of trust administration.

Daniel resides in Hockessin, Delaware with his wife Stephanie and their three children, Charlotte, Lila and Sebastian.

CTFA UPDATE

Jennifer Dugas is Senior Director, Wealth & Trust/Risk & Compliance at the American Bankers Association. In this role, she oversees the ABA Trust Schools and the Wealth Management and Trust Conference. She works closely with advisory boards to develop programming, content and speakers for these events.

Prior to joining ABA, Jennifer worked for the American Bankruptcy Institute, the U.S. Chamber of Commerce and NAPEO. She her undergraduate degree from the University of California, Santa Barbara.

The Behavioral Investor & Factor Investing 101

FORTIS WEALTH

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Explore How Investors are Wired

Look at the Evidence

Provide a Solution

THANK YOU

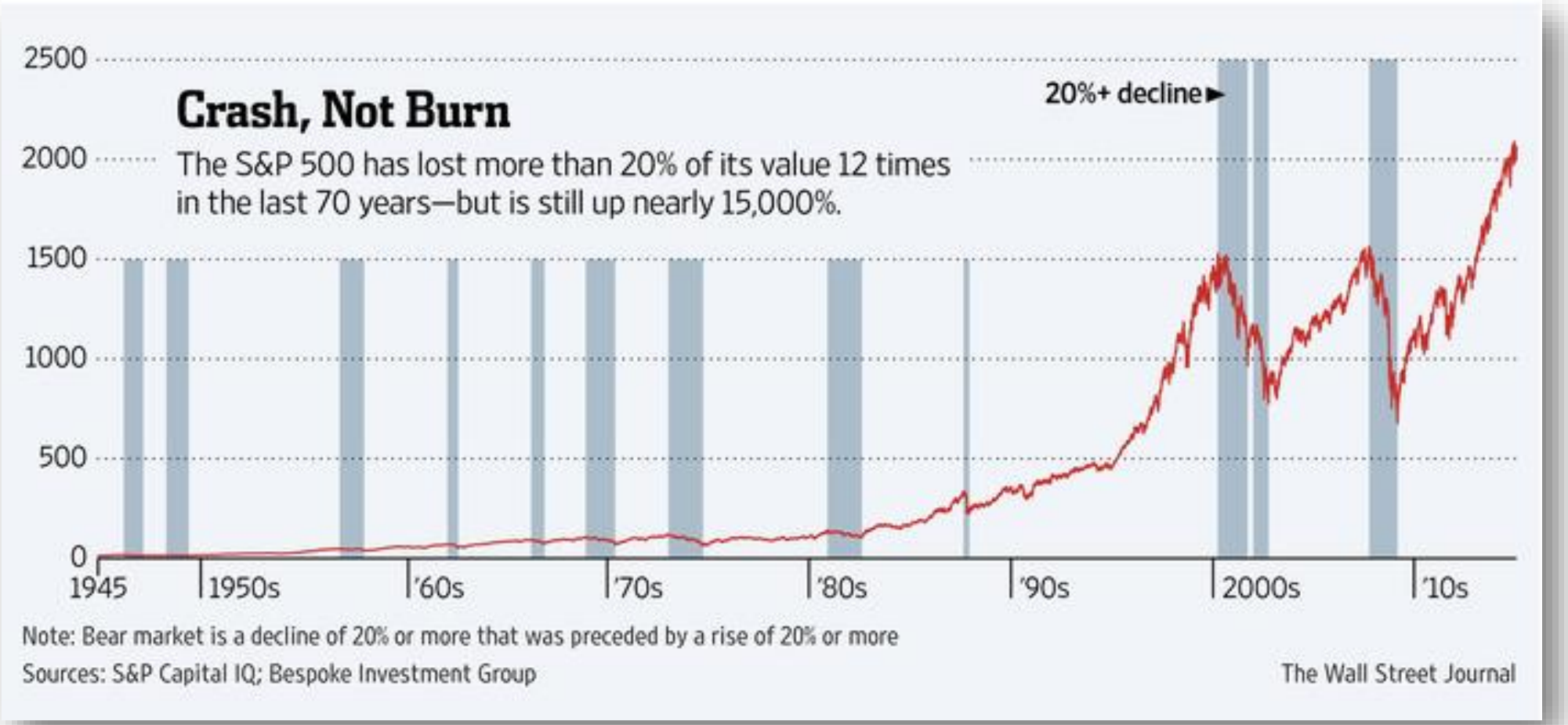
FORTIS WEALTH

Thanks to the
South Dakota Trust Association

Thought Leaders that have Inspired our Philosophy and this Presentation:

- Nobel Laureate, Eugene Famma & his colleague, Ken French
- Nobel Laureate Dick Thaler, Nobel Laureate Danny Kahneman & Amos Tversky
- Andy Berkin & Larry Swedroe
- Wes Gray
- Daniel Crosby
- Andrew Ang

CAPITALISM WORKS



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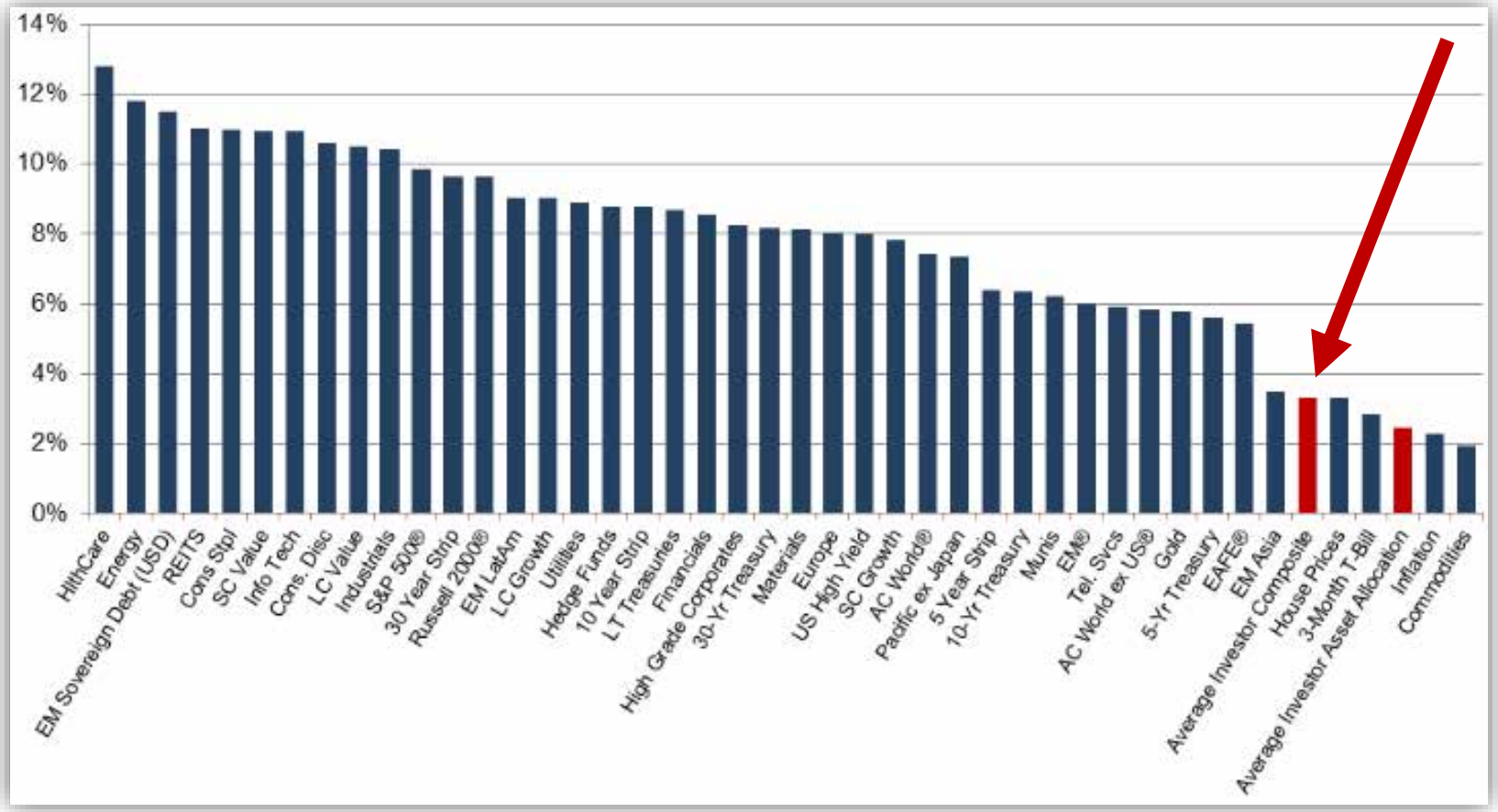
U.S. INVESTOR UNDERPERFORMS ALMOST EVERY ASSET CLASS

Asset Class Returns vs. The "Average Investor"

20 Years Annualized (12/31/1994 – 12/31/2014)



Source: Richard Bernstein Advisors LLC, Bloomberg, MSCI, Standard & Poor's, Russell, HFRI, BofA Merrill Lynch, Dalbar, FHFA, FRB, FTSE. Total Returns in USD. Average Investor returns are represented by Dalbar's Investor returns which represent the change in total mutual fund assets after excluding sales, redemptions and exchanges.

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THE EFFICIENT MARKET HYPOTHESIS

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Asset Prices Fully Reflect Available Information

Stipulate this is True

How we interpret this information is subject to the Human Element which at times eliminates rationality.

Why?

THE HUMAN BRAIN: AN EVOLUTIONARY MIRACLE

Designed Over Thousands of Years

- Quick Reactive Thinking
- Primed for Action
- Searching for Shortcuts

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THROUGHOUT TIME HUMANS PURSUE TWO PATHS

Tug of War

Avoid Pain (Risk)

- Timid
- Protective
- Fearful
- Risk Averse

Seek Reward

- Risk Taking
- Impulsivity
- Physical Arousal
- Increased Dopamine

Problem for Investors is that we seek risk and reward at the exact wrong times.

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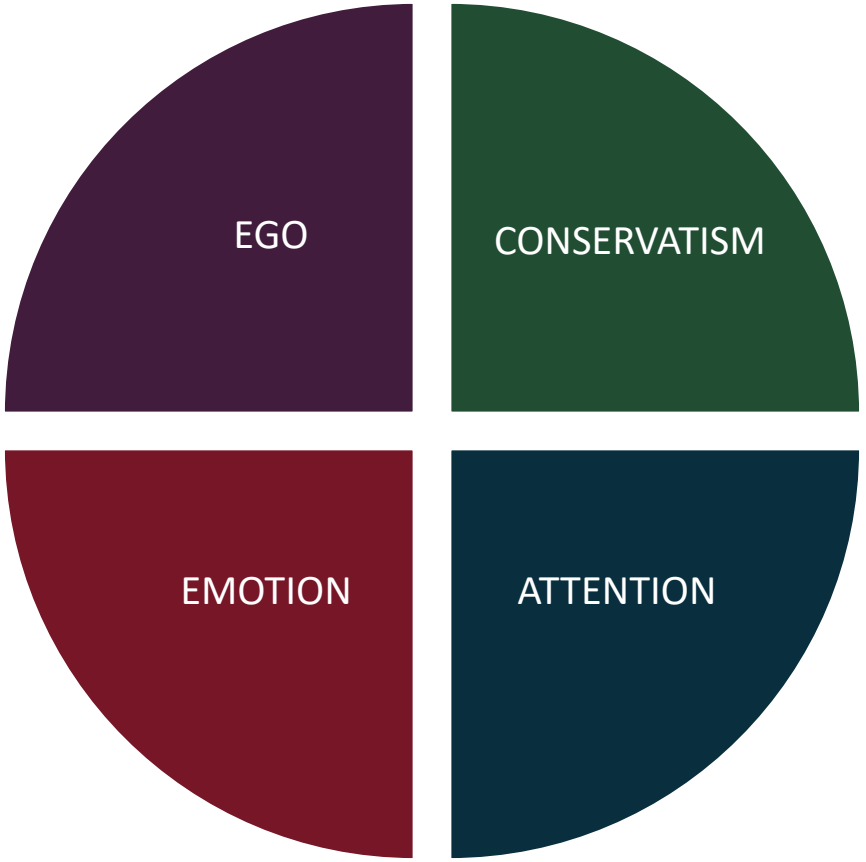
WHY?



Cognitive Biases Cloud Judgement & Impact Behavior

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COGNITIVE BIASES

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

-Mark Twain

OWN OUR MEDIOCRITY

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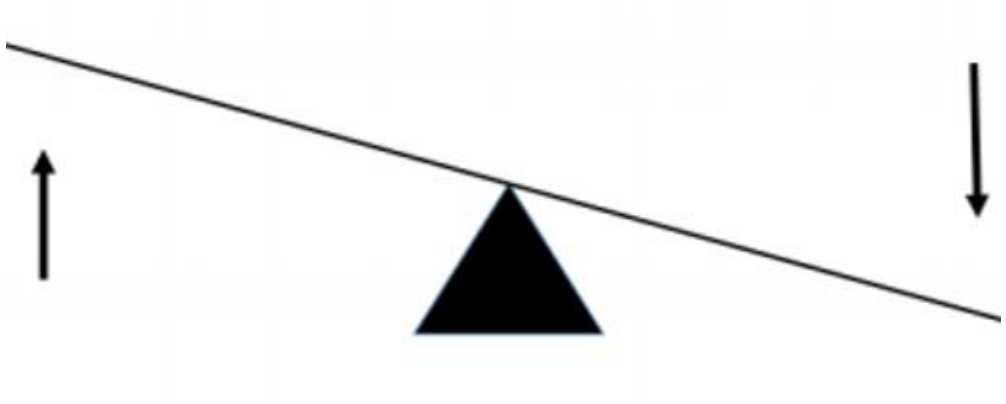
COGNITIVE BIASES

We Prefer Sameness over Change

Achieving Gain



Avoiding Loss

ASYMMETRICAL

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COGNITIVE BIASES

We Rely on Information that is Vivid vs. Factually Accurate

The Power of the Narrative

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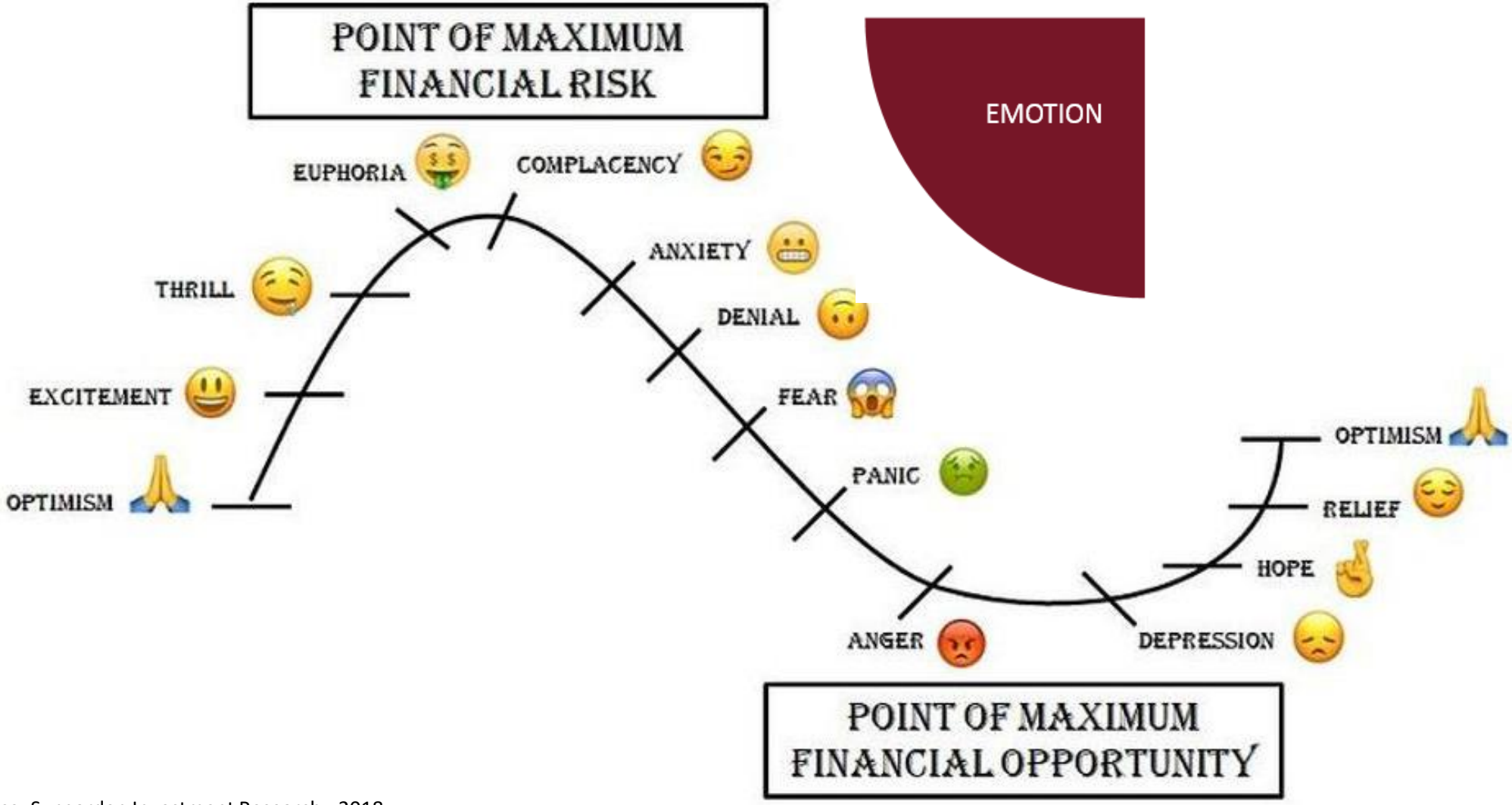
COGNITIVE BIASES



Source: Sungarden Investment Research - 2018

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BEHAVIORAL BIAS OUTCOMES

My Gut is Telling Me…

Ignore Rules

Risk Aversion at the exact wrong time

I know I am Right

Fear

Impulsive

Inaction

Prefer to do nothing over change

Confuse possibility & probability

Reflexive Thinking

Lose Perception of time

Unfamiliar is More Risky

Protective

Greed

Narration over facts

Neural Shortcuts

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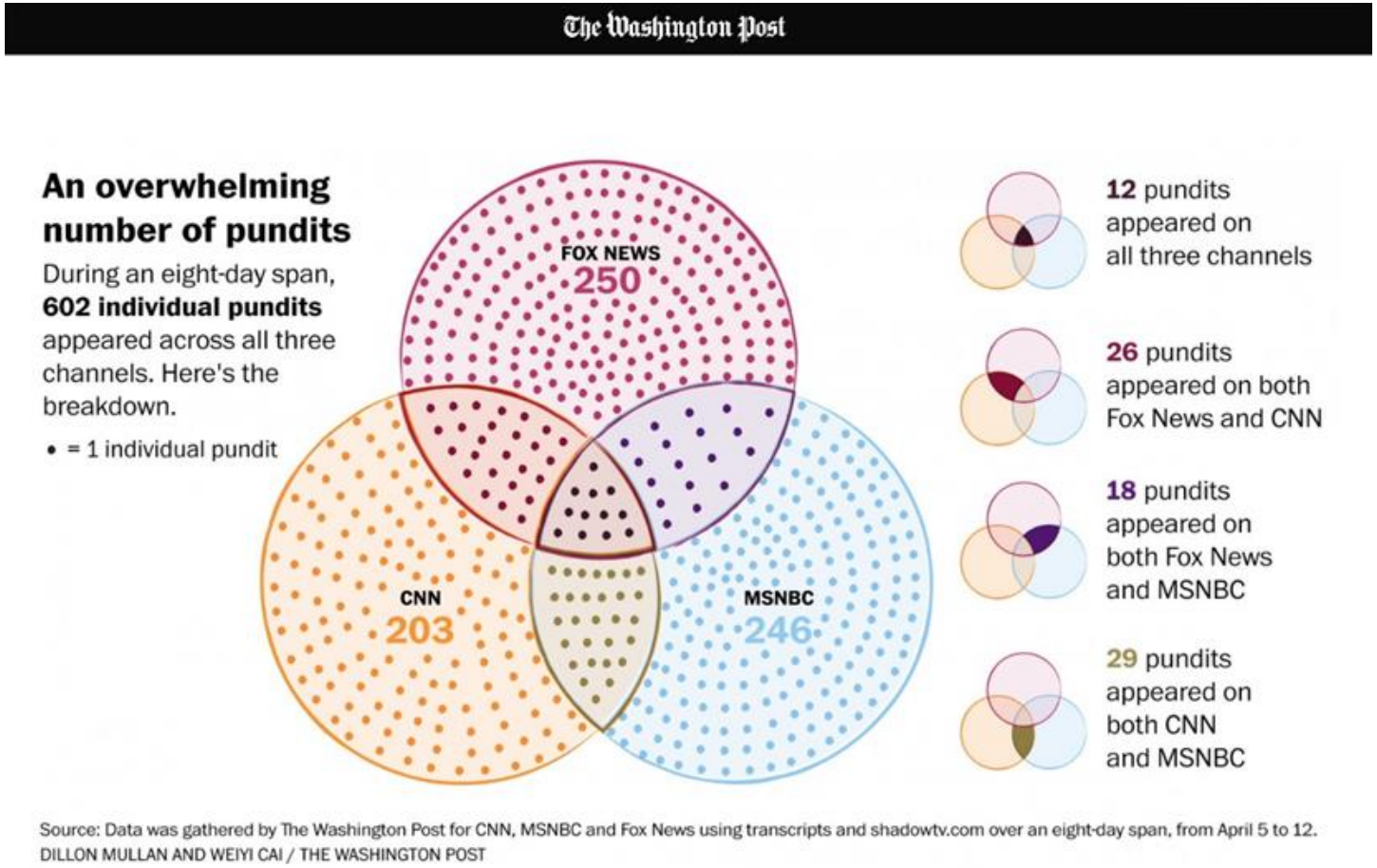
What Does the Evidence Tell Us?

THE MARKETS ARE SO IMPORTANT THAT WE NEED TONS OF EXPERTS

All Doing the Impossible "Predicting the Future"



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INTEREST RATES

Symbol	Index Name	YTD Perf. (%)	04/22/14 - 3/24/15
TNX	10 Year Yield Index	-13.46%	-31.11%
TYX	30 Year Yield Index	-10.29%	-29.60%
FVX	5 Year Yield Index	-17.12%	-19.36%

The returns above are price returns not inclusive of dividends or all potential transaction costs. Past performance is not indicative of future results. Potential for profits is accompanied by possibility of loss.

Source: Wall Street Journal – Market Watch

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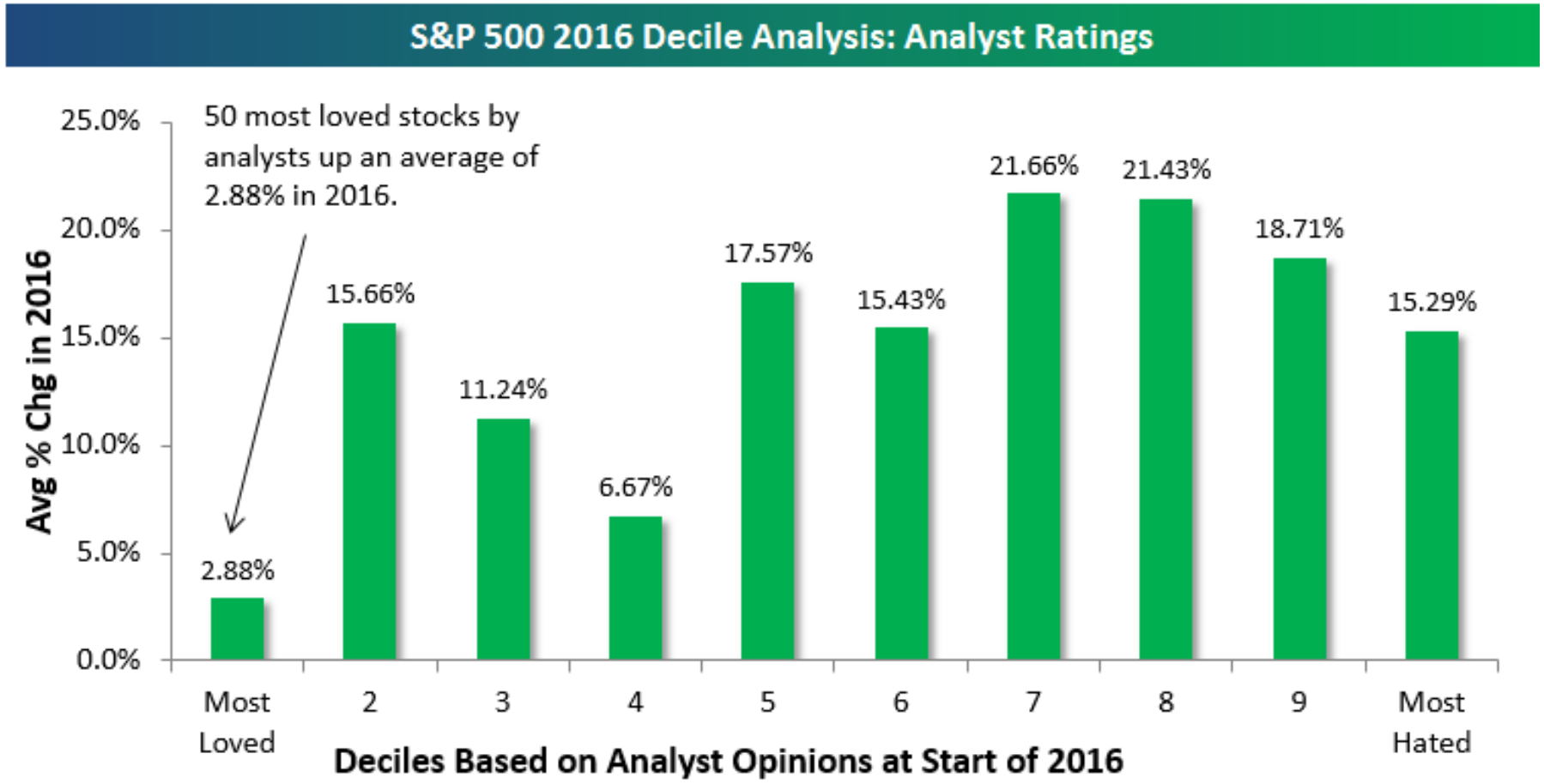
ANALYST EXPERTISE



Source: https://www.bespokepremium.com/think-big-blog/rough-year-for-analysts-most-loved-stocks/

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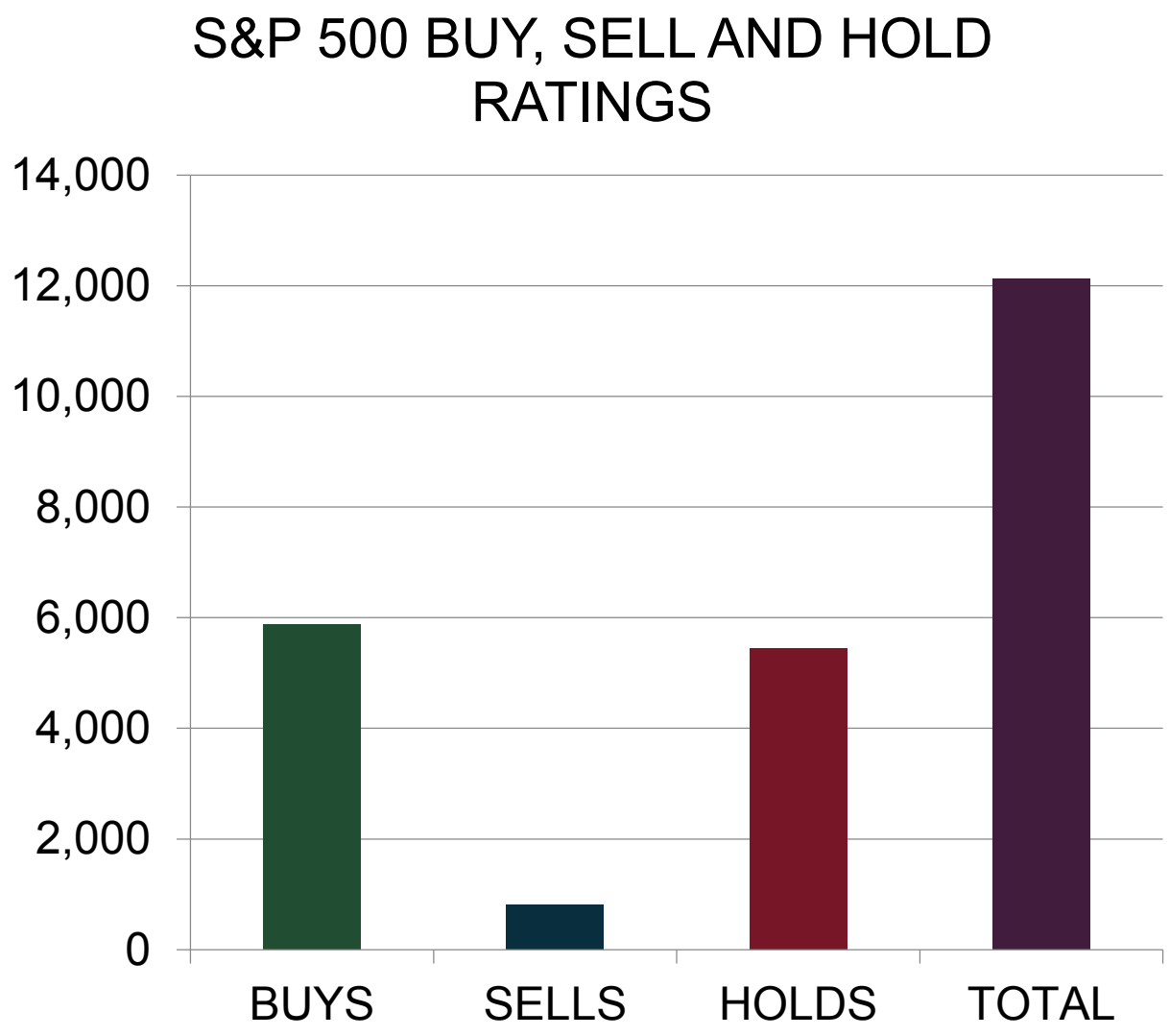
6% WALL STREET RESEARCH SELLS

According to Bespoke Investment Group, there are a total of 12,122 analyst ratings for the 500 stocks in the S&P 500. That's 24.2 ratings per stock. Talk about a glut of coverage.

As shown to the right, 5,871 of those ratings are Buy ratings, 5,443 are Hold ratings, and just 808 are Sell ratings.

Analysts are not usually a very bearish bunch.



Source: Bespoke Investment Group – Think Big Blog
http://www.nytimes.com/2014/07/20/your-money/who-routinely-trounces-the-stock-markt-try-2-out-of-2862-funds.html

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REACTING CAN HURT PERFORMANCE

Missing only a few days of strong returns can drastically impact overall performance.

Source: Dimensional Fund Advisors

Performance of the S&P 500 Index, 1970-2014

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AVERAGE INVESTOR VS. S&P 500

	20 Year Returns of $1,000,000
S&P 500	$4,827,724
Average Investor	$2,491,406
Difference	$2,336,318

Data source: "The Average Investor" Asset Class Returns Over 20 Years 1993-2013" Richard Bernstein Advisors, LLC

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WALL STREET STRATEGIST CONTRA-INDICATOR

Source: BofA Merrill Lynch Global Research US Equity & Quant Strategy

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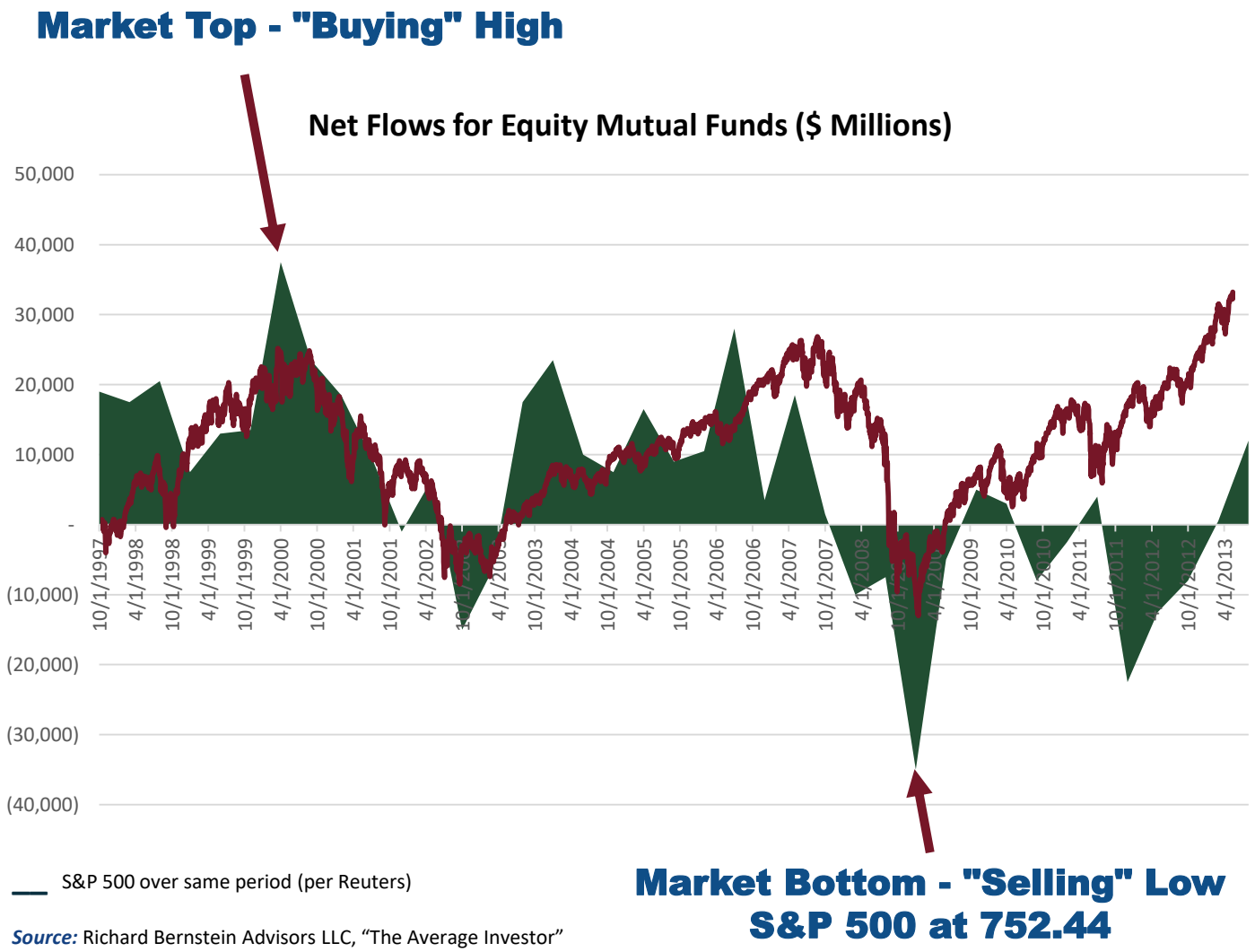
THE EMOTIONAL INVESTOR



Source: Richard Bernstein Advisors LLC, "The Average Investor"

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A Better Way Forward - Replace Human Biases with Factors

FACTOR ZOO – ALL FACTORS ARE NOT CREATED EQUAL

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WHAT ARE FACTORS?

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- A Factor is the "secret sauce", specifically the characteristics of stocks and other securities that explain risk and return.
- A Factor is a quantitative way of expressing a qualitative theme.
- Academic, Nobel Prize winning research has identified factors that have provided premiums above market returns over time.
- Factors rely on scientific priority instead of Wall Street research.
- A Factor must be persistent, pervasive, robust, investable, and intuitive to meet criteria for inclusion.

TRACKING ERROR REGRET: BEHAVIORAL RISKS

Factor tilt premiums over the last 20 years (1995-2015) shows that they went through significant and prolonged drawdowns relative to the S&P 500 Index.

Can we blame investors who gave up on a value tilt after underperforming the market by 31.90%? That relative drawdown, from peak-to-recovery, took 8 years.

None of the factor tilts went unscathed and yet they all were able to generate excess returns over this 20-year period of time. As proponents of momentum investing, it is worth noting that momentum had the highest annualized premium of any of those shown in the article.

	Annualized Premium	Relative Max Drawdown	Max Drawdown Length
Value	2.31%	-33.85%	6 years
Size	0.92%	-31.90%	8 years
Momentum	3.69%	-13.19%	8 years
Minimum Volatility	0.63%	-21.86%	13 years
DividendGrowth	2.45%	-29.52%	6 years

Patience is a Virtue

Source: Kenneth French data library. Analysis by Newfound Research

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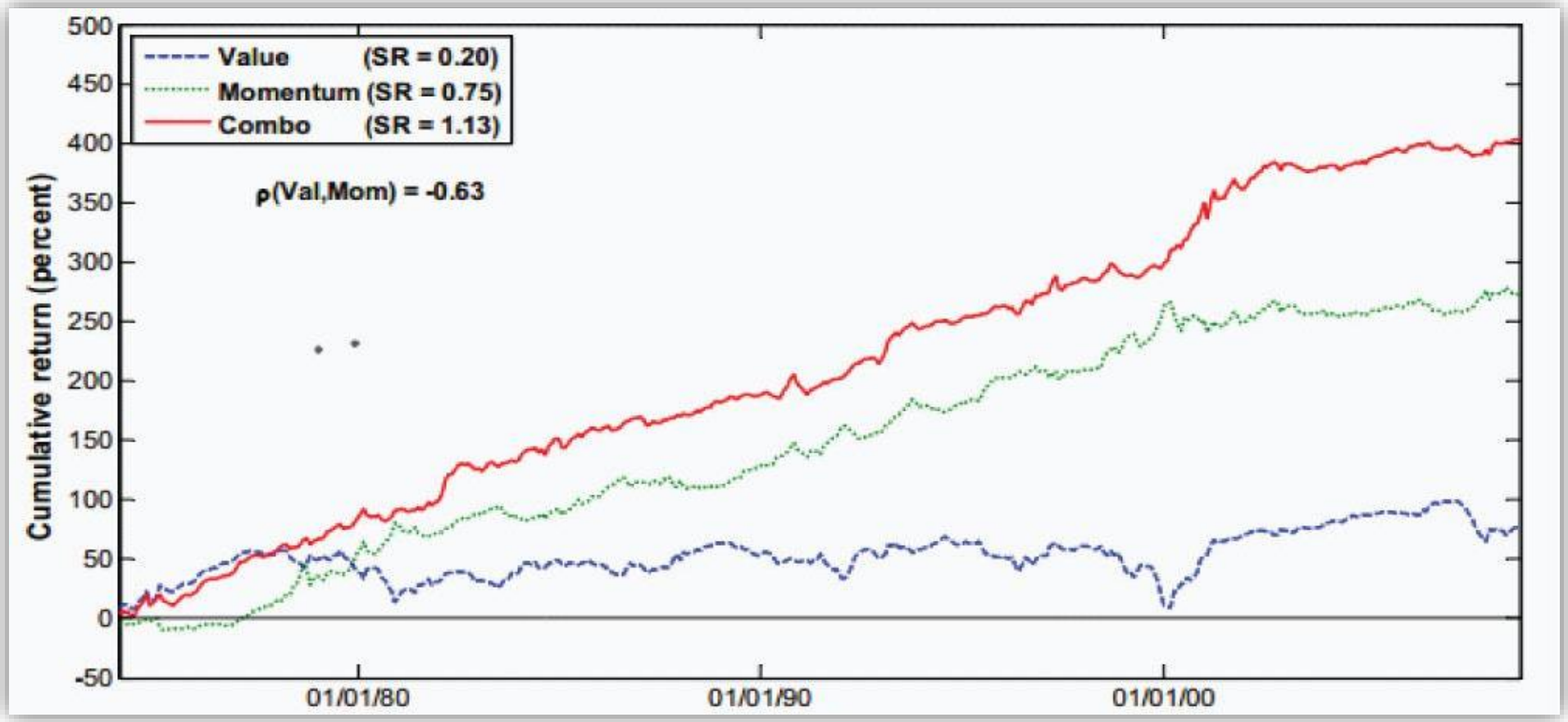
WHY VALUE AND MOMENTUM WORK BEST WHEN COMBINED

- Negative Correlation with each other that reduces or eliminates downside volatility of portfolio. Negative correlation of -.65 (see sharp ratio on chart)

- Combination of strategies outperforms both as stand-alone portfolios

US Stock Selection



Source: https://seekingalpha.com/article/3999827-blending-value-momentum-stock-selection

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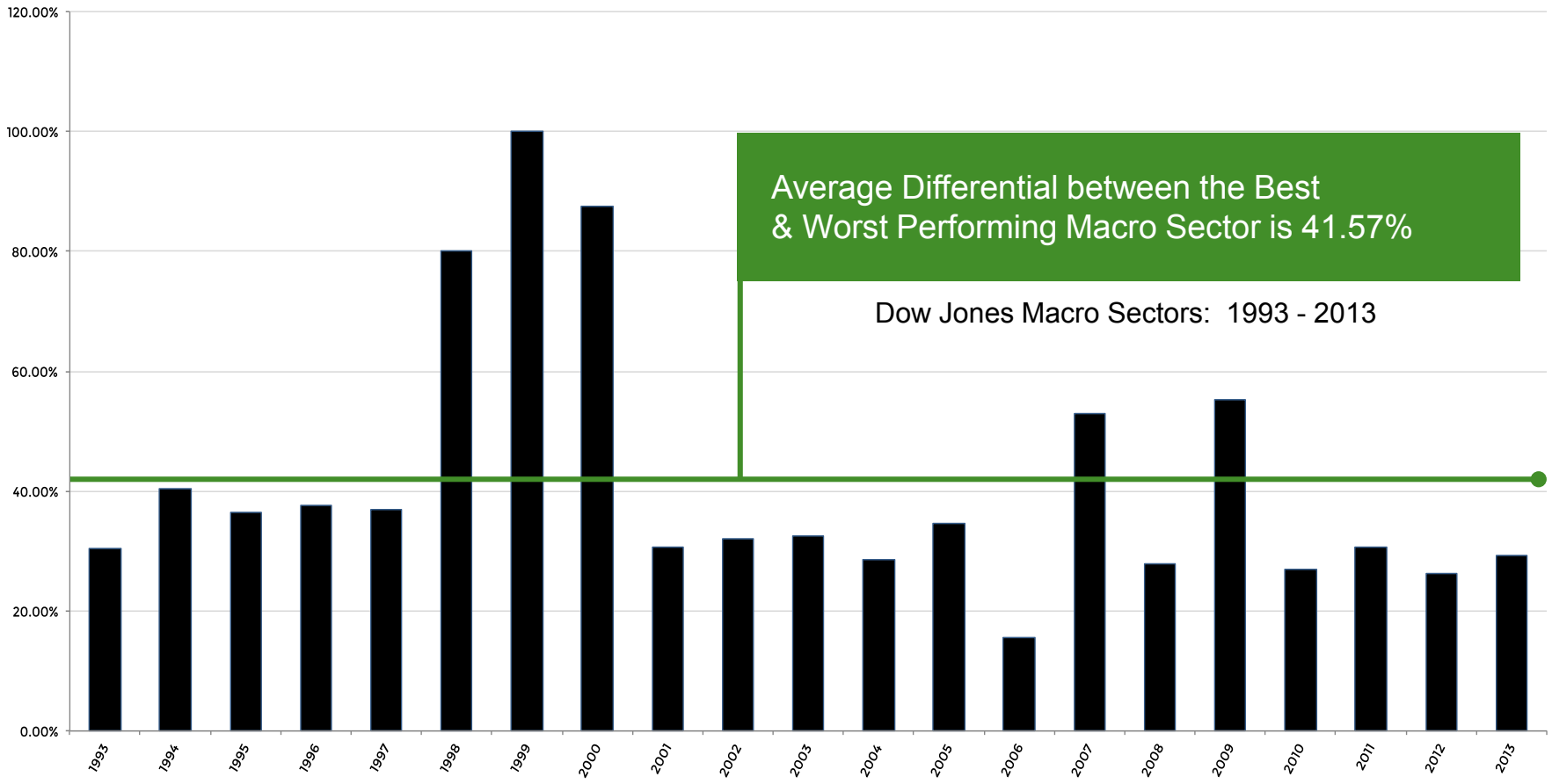
Momentum Discussion

THE KEY TO RELATIVE STRENGTH

The key to relative strength/momentum outperformance
is dispersion among sectors.



Source: Dorsey Wright & Associates. All Performance numbers are based on the performance of non-investable indexes. Investors cannot invest directly in an index. Indexes have no fees. For illustrative purposes only.

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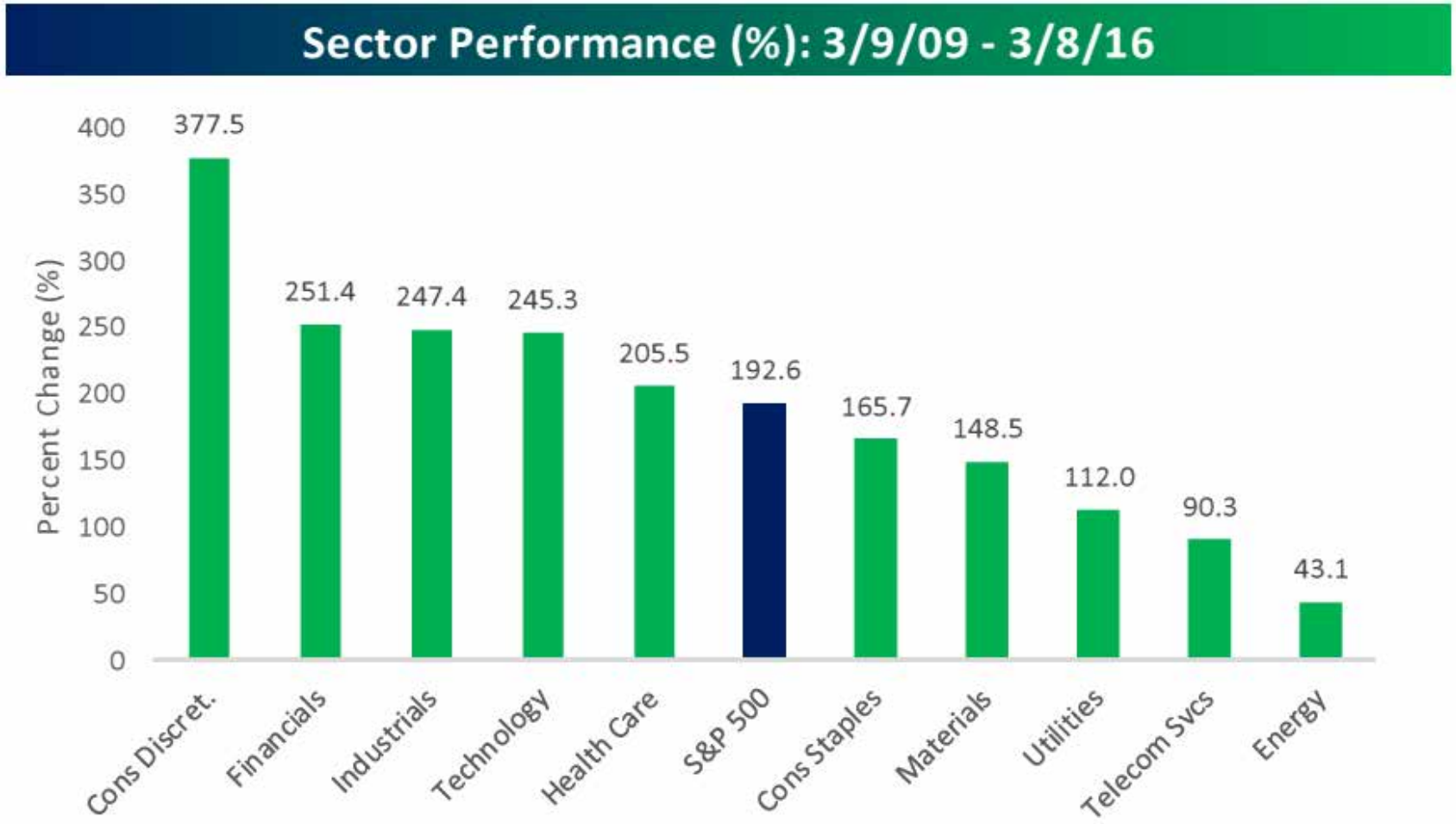
SECTOR PERFORMANCE DURING BULL MARKET



Source: Bespokepremium.com

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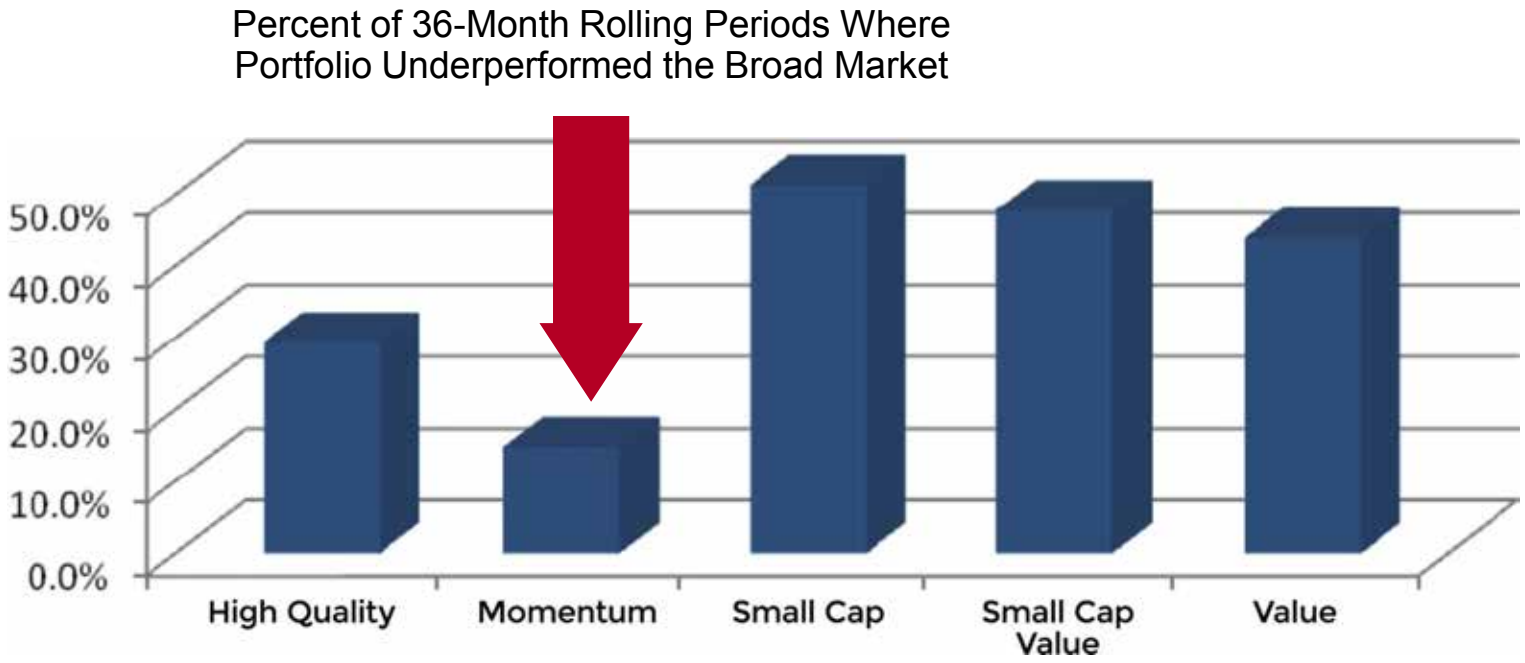
RELATIVE STRENGTH - BEST FACTOR 3 YEAR ROLLING PERIODS

Why factor performance will persist:

Most investors are simply not patient enough to stay invested.

Investors want to outperform all the time.



Source: Advisors Perspective/Tacita Capital based on Morningstar data
http://www.advisorperspectives.com/newsletters13/pdfs/Fantasy_versus_Factors.pdf

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OUTPERFORMANCE CONSISTENT SINCE 1930S

The Performance of Momentum, Value, Growth & the S&P 500 since the 1930s

Summary of Index Performance by Decade	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s	1930-Present
CAGR									
French High Momentum	2.3%	12.9%	23.3%	14.1%	10.3%	18.6%	23.1%	0.6%	13.1%
French Value	-5.8%	17.2%	22.3%	10.7%	12.3%	20.4%	14.3%	4.0%	11.6%
French Growth	1.6%	7.4%	17.5%	8.0%	3.4%	15.8%	20.0%	-1.3%	8.9%
S&P 500	-0.5%	9.0%	19.3%	7.8%	5.9%	17.6%	18.2%	-0.9%	9.4%
Sharpe Ratio									
French High Momentum	0.21	0.73	1.49	0.71	0.29	0.53	1.13	-0.05	0.55
French Value	0.15	0.88	1.23	0.51	0.38	0.75	0.73	0.16	0.41
French Growth	0.19	0.53	1.27	0.35	-0.08	0.42	0.98	-0.17	0.36
S&P 500	0.15	0.59	1.38	0.35	0.04	0.54	0.96	-0.15	0.37

Source: RBC Capital Markets Research, Dr. Kenneth R. French

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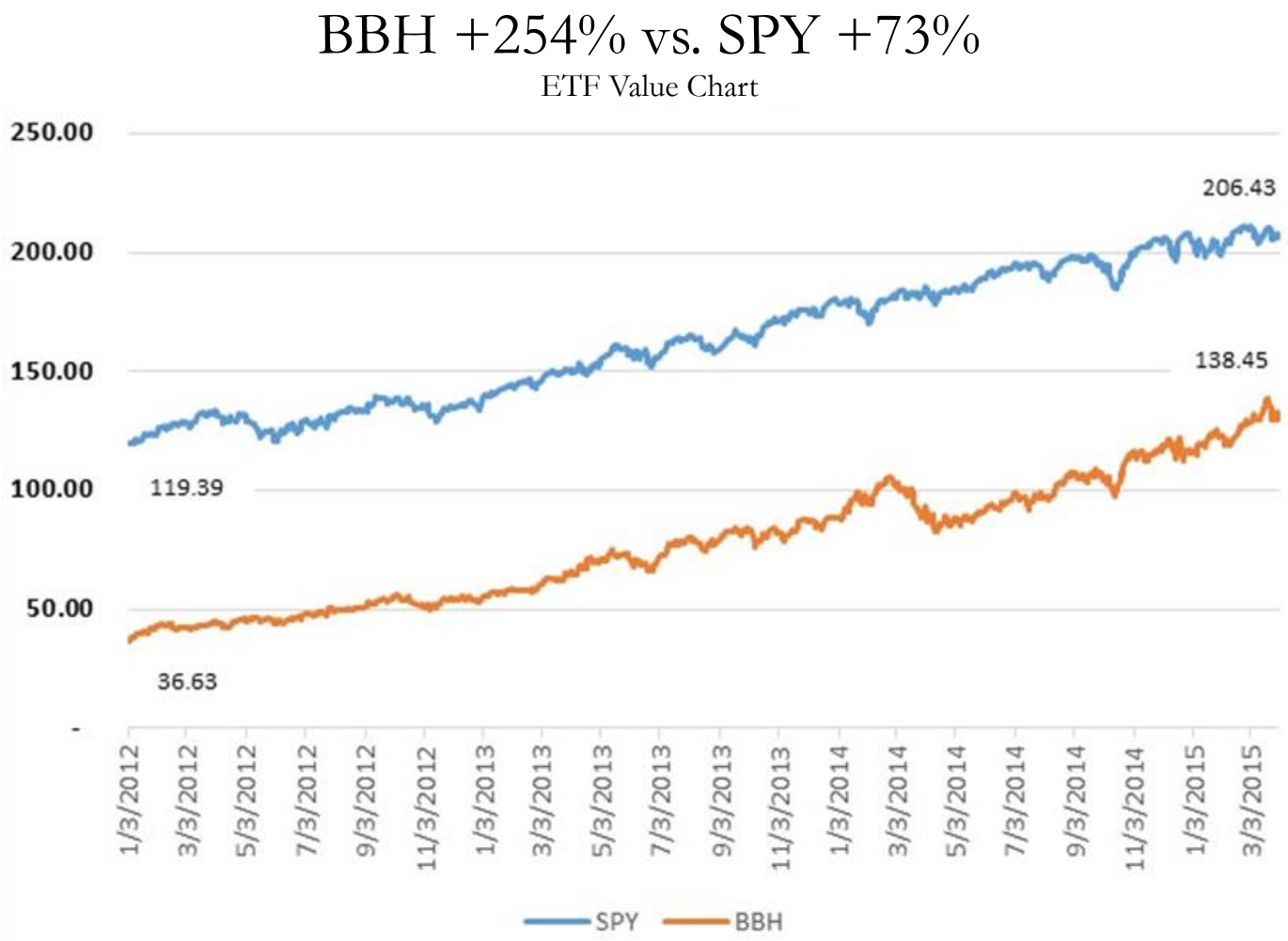
BIOTECH - HIGHEST RANKING SECTOR RS 2012-2015



Source: Morningstar

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TECHNOLOGY – HIGHEST RANKING SECTOR RS 2016-2019

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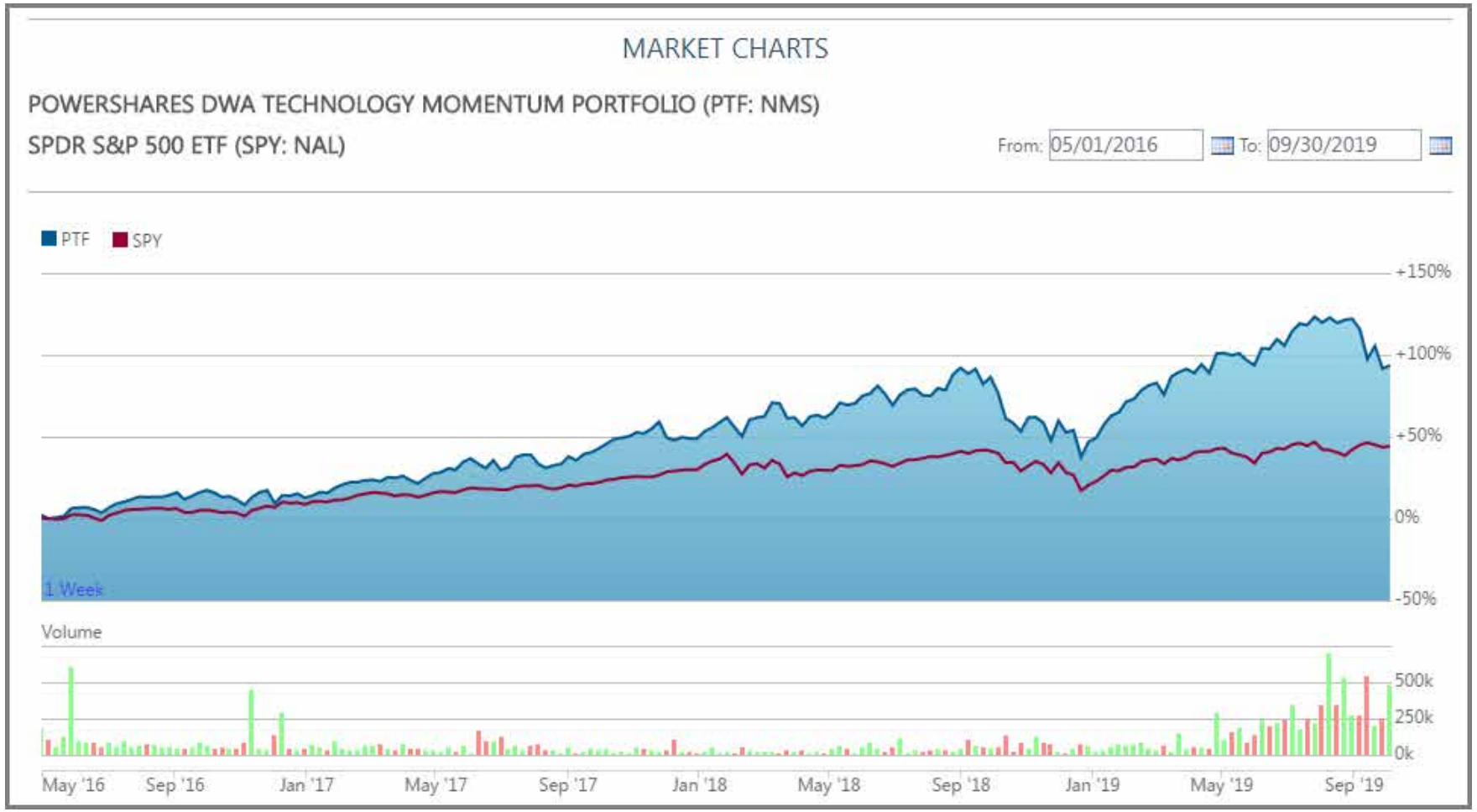
PTF vs SPY 5/1/16 to present (9/30/19)



Value Discussion

VALUE HISTORICAL DATA

An improvement of 46% compared to the S&P Index

Out of these 61 twenty-year periods,
Small Value beat the S&P Index **60 times**.

Criteria	SPX	Small Value Index
Best 20-Year Period	1980-1999 Annual Return 17.9%	1977-1996 Annual 24%
Worst 20-Year Period	1959-1978 Annual Return 6.5%	1955-1976 Annual Return 9.0%
Average Return of the 61	20-Year Periods 11.6%	20-Year Periods 16.7%

Source: Dimensional Fund Advisors

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PORTFOLIOS CAN BE STRUCTURED TO PURSUE FACTORS

Investors can pursue higher expected returns through a low-cost, well-diversified portfolio that targets these factors.

Source: Dimensional Fund Advisors

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PAST PERIODS OF VALUE UNDERPERFORMANCE

Were Followed by Sharp Rises in Alpha

Source: https://blog.thinknewfound.com/2016/02/alpha-not-risk-management-technique/varying-value-

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DIVERSIFICATION OF FACTORS

Why do we combine Value and Momentum?
Role of Fortis Smart Beta Diversification.

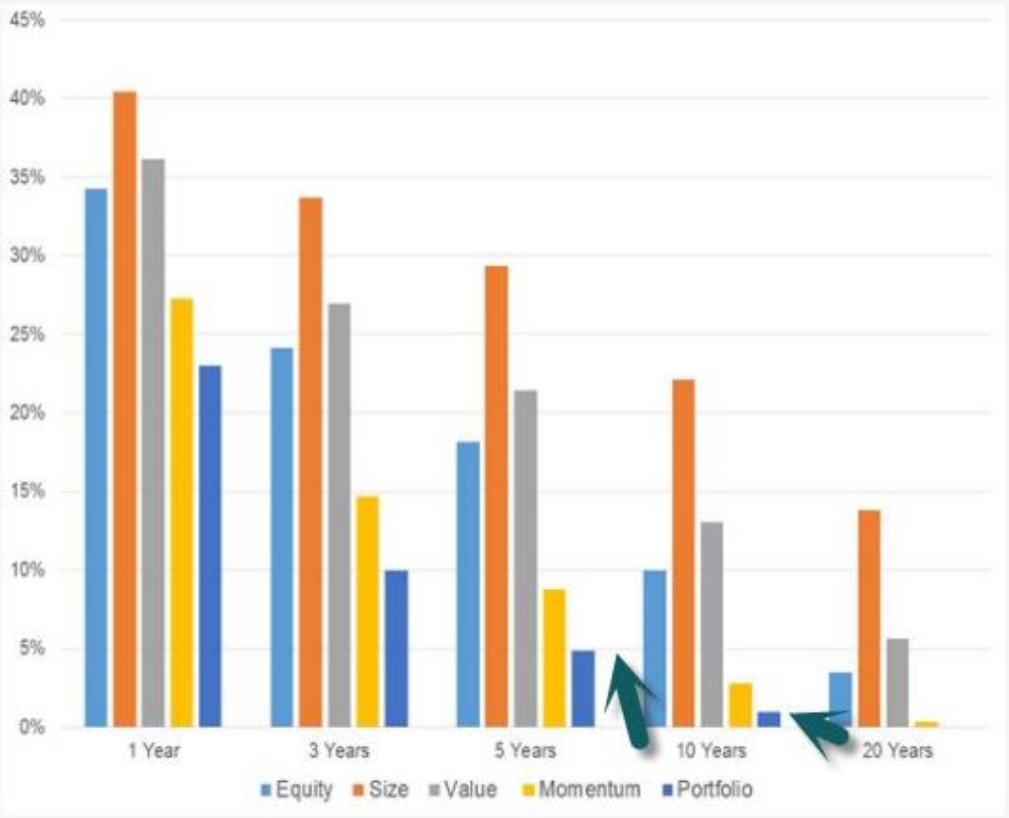
The chart at right illustrates probabilities of underperformance when we combine size, value and momentum into a diversified portfolio. The probability of 5 year underperformance is less than 5%, the chances of trailing on 10 yr. basis is 1-2%.

This is an example of the negative correlation and higher Sharpe Ratios that form the proof of Fortis Smart Beta.

Role Of Diversification

Finally, Kizer examined the importance of diversification in helping to limit the probability of underperformance. As a rough illustration, he built a portfolio allocated 25% to each of the four premiums, then replicated the probability of underperformance from his first graph (keeping the size of each premium at its historical value).

Probabilities of Underperformance



Source: http://www.etf.com/sections/index-investor-corner/swedroe-mystery-vanishing-premiums?nopaging=1

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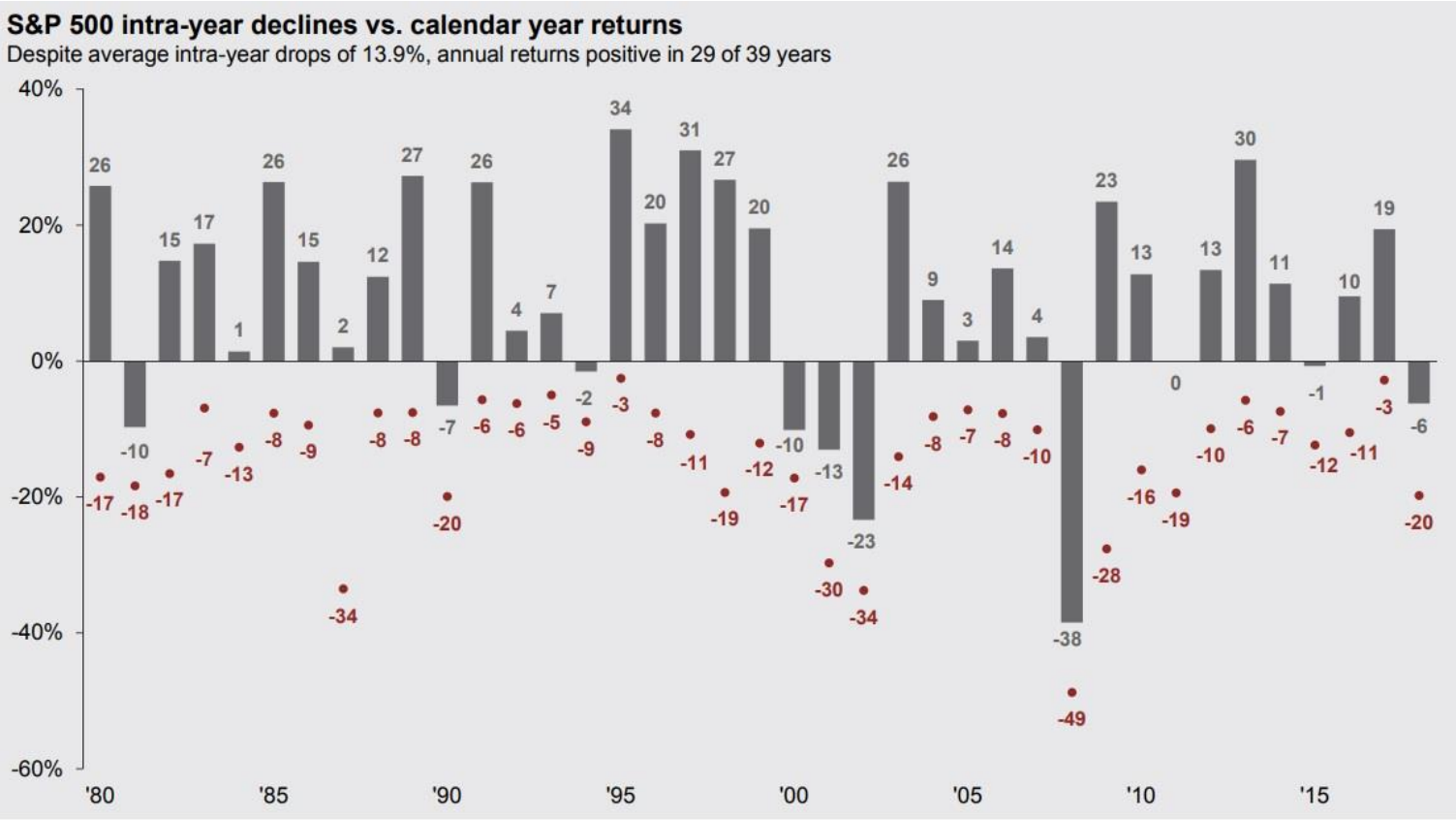
Conclusion

MARKET DECLINES ARE COMMONPLACE



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2018, over which time period the average annual return was 8.4%.
Guide to the Markets – U.S. Data are as of December 31, 2018.

J.P.Morgan
Asset Management

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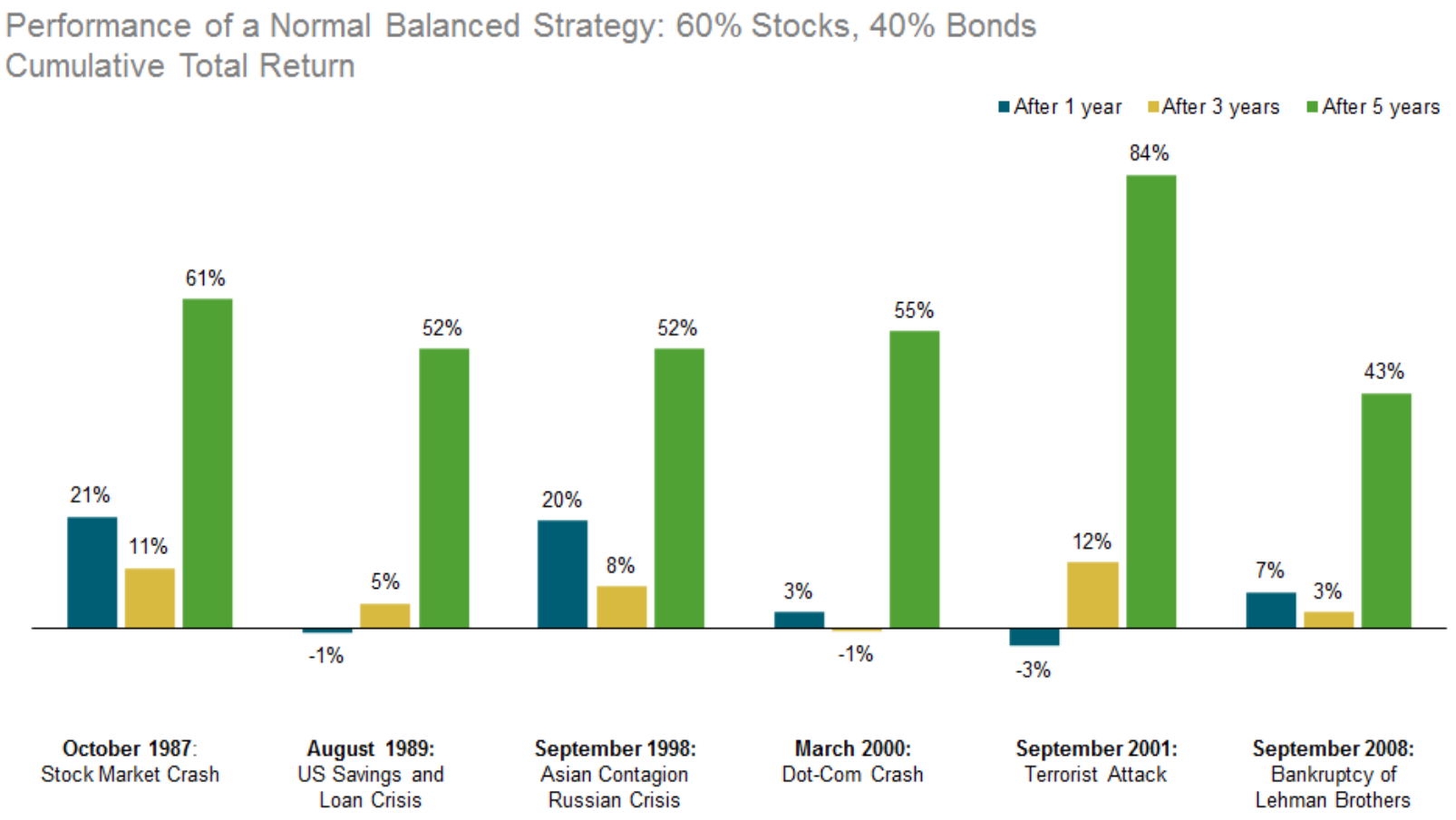
THE MARKET'S RESPONSE TO CRISIS



Balanced Strategy: 7.5% each S&P 500 Index, CRSP 6-10 Index, US Small Value Index, US Large Value Index; 15% each International Value Index, International Small Index; 40% BofA Merrill Lynch One-Year US Treasury Note Index. The S&P data are provided by Standard & Poor's Index Services Group. The Merrill Lynch Indices are used with permission; copyright 2016 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. CRSP data provided by the Center for Research in Security Prices, University of Chicago. US Small Value Index and US Large Value Index provided by Fama/French. International Value Index provided by Fama/French. International Small Cap Index compiled by Dimensional from StyleResearch securities data; includes securities of MSCI EAFE countries in the bottom 10% of market capitalization, excluding the bottom 1%; market-cap weighted; each country capped at 50%; rebalanced monthly.

Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Not to be construed as investment advice. Returns of model portfolios are based on back-tested model allocation mixes designed with the benefit of hindsight and do not represent actual investment performance.

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BONDS BEST PROTECTION AGAINST BEAR MARKET

S&P 500 Bear Markets Since WWII

Peak	Trough	S&P 500	5 Year Treasuries
May 1946	Oct. 1946	-26.6%	0.4%
June 1948	June 1949	-20.6%	1.6%
July 1957	Oct. 1957	-20.7%	1.4%
Jan. 1962	June 1962	-26.4%	2.5%
Feb. 1966	Oct. 1966	-22.2%	1.3%
Nov. 1968	May 1970	-36.1%	8.6%
Jan. 1973	Oct. 1974	-48.2%	4.0%
Sept. 1976	Mar. 1978	-19.4%	7.6%
Nov. 1980	Aug. 1982	-27.1%	28.8%
July 1987	Dec. 1987	-33.5%	-1.8%
July 1990	Oct. 1990	-19.9%	1.8%
July 1998	Aug. 1998	-19.3%	3.0%
Mar. 2000	Oct. 2002	-49.1%	32.7%
Oct. 2007	Mar. 2009	-56.8%	15.0%
Apr. 2011	Oct. 2011	-19.4%	6.1%
Averages		**-29.7%**	**7.5%**

https://www.bloomberg.com/opinion/articles/2017-02-06/be-prepared-for-a-bear-market

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A GOOD ADVISOR SHOULD ADD UP TO 3% TO YOUR RETURNS

Vanguard quantifies the value-add of best practices in wealth management

Vanguard Advisor's Alpha strategy modules	Module number	Value-add relative to "average" client experience (in basis points of return)
Suitable asset allocation using broadly diversified funds/ETFs	I	> 0 bps
Cost-effective implementation (expense ratios)	II	45 bps
Rebalancing	III	35 bps
Behavioral coaching	IV	150 bps
Asset location	V	0 to 75 bps
Spending strategy (withdrawal order)	VI	0 to 70 bps
Total-return versus income investing	VII	> 0 bps
Potential value added		**"About 3%"**

Notes: Return value-add for Modules I and VI was deemed significant but too unique for each investor to quantify. See page 9 for detailed descriptions of each module. Also, for "Potential value added," we did not sum the values because there can be interactions between the strategies. Bps = basis points.

Source: Vanguard.

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STEPS FOR MANAGING OUR PRIMAL BIO-PSYCHO-SOCIAL BEHAVIORS

1. Become Dispassionate
2. Results Matter Less than the Process
3. Slow Down
4. Continue to Learn
5. Recognize When You are Emotional

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DISCLAIMER

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Past Performance is no guarantee of future results.

If you would like to receive a copy of our Form ADV Part 2a or any other information, please contact Matt Topley at mtopley@fortis-wealth.com, or call (610) 313-0910.

Additional information about Fortis Advisors is also available on the SEC's website at www.adviserinfo.sec.gov.

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Title of Presentation: The Behavioral Investor and Factor Investing 101

Overview: Is investing an IQ game or psychology game? Are we better off managing our investments or managing ourselves? Given the vast amount of academic and institutional research over the last few decades how can portfolios pursue such advancements in investment science and technology? In this presentation, Matt Topley, CIO at Fortis Wealth, and Derek Boles, Managing Director at Fortis Wealth and Fortis Family Office, will address these questions and explore methodologies that seek to tilt the odds of market outperformance in the investor's favor.

Speakers:

Matt Topley, Chief Investment Officer, Fortis Wealth

Matt has a unique, global perspective on investing that he gained from nearly two decades on the trading desk and from studying abroad. While doing his graduate work, he had the opportunity to explore the world, studying in Shanghai, Beijing, Toronto and Prague. Matt's desire to make a positive difference, both in his clients' lives and in the community, is evident both in and outside the office. In his free time, Matt is dedicated to many charitable organizations, devoting time and expertise, with a focus on helping inner-city schools and first-generation college students. Matt sits on the Fortis Executive Committee and serves as Chair of the Fortis Investment Committee, overseeing the delivery of investment advice and strategy to clients. A voracious reader and compassionate educator, he has the ability to interpret complex technical financial information and simplify it for the benefit of each of his clients. Matt directs the content of his View From the Top blog (www.matttopley.com), an extension of a daily industry research newsletter he authors, helping clients and teammates stay informed about market trends. Matt holds a Bachelor of Arts from Holy Family University, an MBA from LaSalle University and a Master of Arts in Organizational Leadership from the University of Pennsylvania. He serves on the Board and is Chairman of the Endowment Committee for BLOCS and Holy Family University.

Derek B. Boles, Managing Director, Fortis Wealth and Fortis Family Office

Derek is the Managing Partner and serves as the chair of the Fortis Executive Committee and the Board of Advisors. He is responsible for guiding and growing the organization and setting a course for the future while personally advising many of the firms client engagements. A professional integrating the disciplines of finance, tax and law, Derek's subject matter knowledge and vision are built on a foundation of strong credentials and 20 years of industry experience. Derek earned a B.A. from James Madison University, and both a J.D. and Master of Laws in Taxation from Villanova.

Foreign Trusts

South Dakota Trust Association

October 17, 2019

Elizabeth A. McMorrow Law LLC

Panel Discussion

There has been a growing interest by foreign nationals in creating trusts under South Dakota law. In March 2019, the South Dakota Division of Banking issued Foreign Trust Taxation and Reporting Guidance and Foreign Trust Acceptance and Oversight Guidance. The panel will discuss the goal of the new guidance, practical implementation and obstacles related to the specific aspects of the guidance, best practices, and the Division's view of potential red flags during related examinations.

Panel Biographies

Scott Kelly

Deputy Director of Trust, South Dakota Division of Banking

Scott Kelly was appointed Deputy Director of Trust for the South Dakota Division of Banking in October 2012 after serving as a Bank/Trust Examiner since August 1998. Prior to joining the Division of Banking, he worked as a Sales/Use Tax Auditor for the South Dakota Department of Revenue and as a staff accountant for a South Dakota public accounting firm. He is a graduate of Black Hills State College with a degree in accounting and holds the designation of Certified Fiduciary and Investment Risk Specialist from the Cannon Financial Institute.

Jonathan Sanborn, Esq.

Financial Institution Examiner, South Dakota Division of Banking

Jonathon Sanborn began serving as a Trust Examiner for the South Dakota Division of Banking in June 2015. Prior to joining the Division of Banking, he served in the United States Army rigging parachutes for soldiers of the 82nd Airborne Division. Jonathon is a graduate of the University of South Dakota where he received the degrees of Juris Doctor conferred with Honors, and Master of Business Administration. He holds the designation of Certified Fiduciary and Investment Risk Specialist from Cannon Financial Institute.

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Trust Officer, South Dakota Trust Company
alyssa@sdtrustco.com

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Director - Trust & Fiduciary Services, Trident Trust Company (South Dakota) Inc.
sbridson@tridenttrust.com

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Elizabeth A. McMorrow

Attorney, Elizabeth A. McMorrow Law LLC
elizabeth@elizabethmcmorrowlaw.com

Elizabeth A. McMorrow is an international tax and business attorney providing legal advice and compliance training on Foreign Account Tax Compliance Act (FATCA), Common Reporting Standard (CRS), BSA/KYC/AML, Foreign Corrupt Practices Act (FCPA), U.S. trade controls, the European Union General Data Protection Regulation (GDPR).

Elizabeth also manages legal issues arising from a company's foreign subsidiaries, and oversees U.S. and international outside counsel for small and medium-sized companies across industries including biotech, pharmaceutical, beverage, and consumer goods.

She has a unique combination of international experience having worked as in-house counsel at The Coca-Cola Company and Genzyme Corporation, a member of the Markit|CTI legal advisory team, a Senior Associate with Dewey Ballantine LLP, and a clerk at the U.S. Court of International Trade.

She holds a B.A. in Economics from The College of William and Mary, a J.D. cum laude from Wake Forest University School of Law, and an LL.M. in Taxation from Boston University School of Law. Elizabeth is licensed to practice in New York, Massachusetts, Connecticut, and Washington, D.C.

Beatrice Skyberg, CPA, CFP®, AEP®

Senior Tax Manager @ Eide Bailly LLP
BSkyberg@eidebailly.com

Beatrice has more than 10 years of public accounting experience providing services to a variety of clients. She specializes in domestic and international fiduciary, gift and estate taxation services; assists with compliance, consulting and planning services for a variety of non-profit organizations and private foundations; and provides corporate, partnership and individual taxation services.

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SOUTH DAKOTA
Division of Banking

1601 N. Harrison Ave, Suite 1
Pierre, SD 57501
Phone (605) 773-3421
Fax (866) 326-7504

Foreign Trust Acceptance and Oversight Guidance

Prior to accepting trusts created by and/or for the benefit of foreign nationals, or trusts that hold foreign assets, management must perform and document a thorough review to identify the purpose of the trust, the identity of the customer, and the source of the underlying funds. If management is uncertain about the character of a trust's assets, the U.S. Department of the Treasury (Treasury Department) instructions for Form 8938 provides a description of foreign assets. While there are legitimate reasons for the movement of foreign trusts and assets to and from domestic financial institutions, there is also a risk that these types of trusts are created to conceal the sources and uses of funds, the identity of beneficial and legal owners, or to avoid foreign reporting requirements. Furthermore, trust customers and beneficiaries may try to remain anonymous to move illicit funds or avoid scrutiny or may seek a certain level of anonymity by creating offshore accounts, or other investment entities, that hide the true ownership or beneficial interest of the trust. Therefore, the financial institution must develop pre- and post-acceptance review processes that identify the risk profile of each foreign trust and develop and implement a corresponding initial and ongoing due diligence review program that is commensurate with the level of risk each trust poses. First and foremost, written policies and procedures must be drafted to provide management with comprehensive customer identification and oversight guidance.

Foreign Customer Identification

As with customer identification requirements for domestic customers, financial institutions must collect the name, date of birth, address, and identification number for non-U.S. persons. An identification number for a non-U.S. person is one or more of the following: a taxpayer identification number; a passport number and issuing country; an alien identification card number; or any other unexpired government-issued document evidencing an identification number, nationality or residence, and bearing a photograph or similar safeguard. Additionally, an effective customer identification program (CIP) should provide procedures to evaluate the risk of potential customers.

For purposes of the CIP, financial institutions are not required to search the trust, escrow, or similar accounts to verify the identities of beneficiaries, but instead are required to verify the identity of the customer, which is typically an individual, trust, or a legal entity. With respect to trusts created for the benefit of foreign nationals and their extended families, financial institutions are required to perform enhanced due diligence to identify the customer and source of funds. If the customer is identified as a trust or other legal entity, additional due diligence may be required to identify the beneficial owner(s).

If a trust is identified as the customer, the beneficial owner is the trustee(s) or any other person, such as a grantor or protector, who, in accordance with provisions of the governing document, has effective control of the trust or trust property or has the power to amend the trust or remove/appoint trustees.

If a legal entity is identified as the customer (i.e. a non-U.S. corporation, or, in the case of a trust, if a legal entity created the trust), the financial institution is required to identify the beneficial owner of the entity. A legal entity customer is defined to include the following types of entities: corporations, limited liability companies, general partnerships, limited partnerships, business trusts, other entities created by the filing of a public document with a secretary of state or similar office, or similar entities formed under the laws of a non-

U.S. jurisdiction. Beneficial owner is defined as an individual who owns 25 percent or more of the equity interests of the legal entity customer; a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer or senior manager (e.g. chief executive officer, chief financial officer, chief operating officer, managing member, general partner, president, vice president, or treasurer); or any other individual who regularly performs similar functions (this list of positions is illustrative, not exclusive, as there is significant diversity in how legal entities are structured). Financial institutions can develop internal forms or checklists to document the beneficial owner(s) of legal entity customers or obtain a fillable and non-fillable copy of an optional Certification Regarding Beneficial Owners of Legal Entity Customers available on the Financial Crimes Enforcement Network (FinCEN) website.

If a trust owns directly or indirectly, through any contractual arrangement, understanding, relationship, or otherwise, 25 percent or more of the equity interest of a legal entity customer, the beneficial owner is the trustee(s) or any other individual, such as a grantor or protector, who in accordance with provisions of the trust document has effective control of the trust or trust property, or has the power to amend the trust or remove/appoint trustees. With respect to a directed trust, where the trustee is directed by a trust advisor pursuant to South Dakota Codified Laws Chapter 55-1B, the directed trustee may not be required to inquire into the other ownership interest in said legal entity if the legal entity itself is not the customer.

While the financial institution is required to identify and document the beneficial owner of the customer, the information collected and maintained by the financial institution about the beneficial owner(s) is subject to the confidentiality requirements of law owed by the financial institution towards its customers. To that end, when a financial institution enters banking or investment relationships with third party banks, investment advisors, or asset custodians (Third Parties) through omnibus accounts or otherwise that are in the name of the financial institution, the information that is disclosed to Third Parties is the information about the financial institution itself, and not that of its customers, or their beneficial owners. In this circumstance, disclosure of customer or beneficial owner information by the financial institution may be imprudent.

Customer Risk Rating

Financial institutions should develop a risk-based approach to determine if the foreign trust has a risk profile of low, medium, or high. It is anticipated that most foreign trusts will have a risk profile of medium or high, which will require the development and implementation of an enhanced due diligence review process outlined below. A conclusion regarding the customer risk profile should be based on an evaluation of all pertinent information including but not limited to the purpose of the trust, identity of the customer and its beneficial owner(s), geographical and political characteristics, anticipated account activity, and source of funds. This information, commonly referred to as a customer risk profile, should aid the financial institution in determining the money laundering and terrorist financing risks of its customers. Regulatory guidance acknowledges a spectrum of risks may be identifiable even within the same category of customers, and the assessment of customer risk factors is institution-specific. Given the complexities of foreign trusts, decisions to rate these customers into a risk category that falls outside of the enhanced due diligence review process of the institution should not be commonplace, and any such determination should be well documented.

Enhanced Due Diligence Review Criteria

In addition to standard CIP requirements for domestic individuals, trusts categorized with risk profiles of medium or high will require the review of additional criteria to document the identity, business activity, ownership structure, anticipated or actual volume and types of transactions of a foreign customer and/or

domestic customer with foreign beneficial owners, particularly including those transactions involving higher risk jurisdictions. At acceptance, the following information should be gathered on the foreign customer or beneficial owner:

- Background investigations. Obtain and document a worldwide independent background investigation by an authorized organization (e.g., Refinitiv [formerly Thomson Reuters] World-Check, LexisNexis InstantID International, etc.) on all customers and beneficial owners or document an equivalent background investigation. An equivalent background investigation may be appropriate where the customer or beneficial owner is a public company or a prominent family whose activities are well reported.
- Purpose of the trust. Identify and document the legitimate reason for creating the trust or for transferring the trust from a foreign jurisdiction.
- Proof of compliance with foreign jurisdiction taxation requirements. A sworn statement from the customer or beneficial owner or the customer's or beneficial owner's trustee(s), lawyer(s), wealth manager(s), accountant(s), or banker(s) affirming tax compliance will generally suffice.
- Source of funds. Generally, wealth is derived from inheritance, active business enterprises, former business enterprises, or professional income. Document the source of funds being deposited into the trust. A sworn statement from the customer or beneficial owner or the customer's or beneficial owner's trustee(s), lawyer(s), wealth manager(s), accountant(s), or banker(s) detailing the source of funds may suffice but is not required if the source of funds can be documented from other sources.
- Proof of residence. If the customer or beneficial owner is an individual, obtain invoices that identify the customer's street address, city, and state/country which generally consist of billings for utilities, phone, repair work, television, wireless connectivity, etc.
- Occupation or type of business of the customers and beneficial owners.
- High Risk Only – If the customer or beneficial owner is engaged in business, obtain a description of the primary trade area and whether international transactions are expected to be routine.
- High Risk Only – Determine the expected frequency (weekly/monthly/annually), number, and expected value of transactions that will flow through the trust.

<u>Ongoing Due Diligence Regarding Customer Identification</u>

Customer identification is an ongoing process. The financial institution should establish a risk-based monitoring system to ensure customer profiles are periodically updated. The monitoring system should review and assess each trust's risk profile and update as needed. Best business practices dictate that ongoing due diligence should occur at least annually for trusts that have high risk profiles, at least once every two years for trusts that have medium risk profiles, and at least once every three years for trusts that have low risk profiles. Management must develop, implement, and document a comprehensive ongoing due diligence review process that at minimum encompasses the following criteria:

- Review and assess annually the financial institution's CIP risk assessment (i.e. the likelihood the trusts could be used for money laundering or to finance terrorism); this function can be performed separate from the account-level review process (i.e. internal/external audits, independent assessments, etc.).
- Review trust opening documentation, including the enhanced CIP, to ensure that adequate due diligence has been performed and that appropriate records are maintained.
- Identify any unusual or suspicious activity, ensuring the timely filing of suspicious activity reports.

- Conduct periodic FinCEN searches of the customers and beneficial owners on all trusts.
- Conduct periodic checks of the customers and beneficial owners on all trusts against the Specially Designated Nationals list of the Office of Foreign Assets Control of the Treasury Department.
- Conduct periodic reviews of the beneficial owners of the legal entity and the individual with responsibility to control the legal entity.
- High Risk Only - Conduct an internet search of the customers and beneficial owners.
- High Risk Only - Review account statements and, as necessary, specific transaction details. Compare expected transactions with actual activity.
- High Risk Only - Determine whether actual activity is consistent with the nature of the customer's or beneficial owner's business and the stated purpose of the trust.
- High Risk Only - Require explanations for changes in trust activity. For directed trusts, a letter from the trust advisor with the direction may satisfy this requirement.

The ongoing due diligence can be a function of the trust company's internal audit program or a function of personnel/committees appointed by management.

SOUTH DAKOTA
Division of Banking

1601 N. Harrison Ave, Suite 1
Pierre, SD 57501
Phone (605) 773-3421
Fax (866) 326-7504

Foreign Trust Taxation and Reporting Guidance

The taxation and reporting requirements associated with foreign trust management are complex and require specific expertise from knowledgeable parties. The intent of this guidance is to provide South Dakota-chartered financial institutions with a general summary of foreign trust taxation and reporting requirements to alert them to areas of concern. Specific taxation and reporting requirements are beyond the scope of the South Dakota Division of Banking's regulatory oversight duties and responsibilities.

South Dakota has experienced extensive growth in the foreign trust market resulting in large part from the implementation of the Foreign Account Tax Compliance Act (FATCA) and automatic exchanges of information under the Organisation for Economic Co-operation and Development proposed common reporting standards (CRS). FATCA is one of the U.S. Government's primary tools to combat international tax fraud and evasion by uncovering hidden and secret foreign bank accounts, financial accounts, income producing assets, and underreported foreign income. CRS, often referred to as the global version of FATCA, or "GATCA," is an information exchange of customer data between various countries on a global scale. The goal of CRS is similar to FATCA, which is to track overseas information regarding individuals who may have hidden or be attempting to hide assets to avoid paying taxes. Although the U.S. is not a CRS partner jurisdiction, U.S. trustees must provide CRS self-certification to non-U.S. financial institutions upon their request. Additionally, the Internal Revenue Service (IRS) and Financial Crimes Enforcement Network (FinCEN) have imposed rigorous reporting requirements with respect to foreign trusts and assets.

Prior to accepting trusts created by and for the benefit of foreign nationals, or trusts that hold foreign assets, financial institutions must possess, or have access to, the expertise needed to ensure compliance with all applicable reporting requirements, including but not limited to, those of FATCA, CRS, the IRS, and FinCEN. The U.S. Department of the Treasury (Treasury Department) instructions for Form 8938 provides a description of foreign assets. The financial institution must develop and implement comprehensive written guidance to address compliance with foreign trust taxation and reporting requirements. Financial institutions should consider the maintenance of a matrix for tracking filing due dates and oversight responsibilities with respect to pertinent reporting requirements.

Foreign Account Tax Compliance Act

FATCA requires every financial institution to classify every account holder. The financial institution is generally required to have on file a Form W-9 or a Form in the W-8 series to support such classification of the account holder. Financial institutions are expected to have a current form on file for each account holder. The classification process, in part, consists of identifying whether a trust is a foreign trust or a domestic trust for U.S. tax reporting purposes. The regulations used to classify trusts are contained in the Treasury Department Regulations 26 CFR § 301.7701-7.

FATCA imposes certain reporting obligations on foreign financial institutions (FFIs); the definition of an FFI includes an investment entity. The regulations define an investment entity as an entity that either (1) conducts a

business of investing, reinvesting, or trading in financial assets or otherwise investing, administering, or managing funds, money, or financial assets for customers, and receives 50 percent or more of its gross income during a "relevant period" from such investment entity activities; or (2) is managed by another financial institution and receives more than 50 percent of its gross income during a "relevant period" from investment entity activities (the regulation defines the "relevant period" as the three prior calendar years for the entity or the duration of the entity's existence, whichever is shorter). As defined by the regulations, a foreign trust, both directed and discretionary, is generally an investment entity, and thus an FFI. This FATCA status applies to a foreign trust that is professionally managed by a South Dakota-chartered financial institution if the trust meets the gross income test.

FFIs are required to register with the IRS and obtain a Global Intermediary Identification Number (GIIN); the FFI reports using the GIIN. A foreign trust holding assets professionally managed by an asset manager is an FFI unless exempted by an intergovernmental agreement. It is important to note that many foreign trust structures are composed of various underlying entities, a FATCA classification must be determined for all non-U.S. entities. These underlying entities include, but are not limited to, foreign corporations, foreign partnerships, or other foreign trusts. Some of them might be classified as FFIs, while others might be passive non-financial foreign entities (Passive NFFEs), which are also subject to FATCA withholding unless reporting requirements are satisfied. A non-financial foreign entity (NFFE) is a non-U.S. company, partnership, trust, foundation, or any other legal entity that can't be defined as an FFI.

If the foreign trust is resident in a country that has entered into a Model I FATCA intergovernmental agreement with the U.S., the foreign trust files its FATCA reports through its home country tax or regulatory authority. If the foreign trust is resident in a country that has entered into a Model II FATCA intergovernmental agreement with the U.S., the foreign trust files its FATCA reports directly with the IRS. If the foreign trust is not resident in a country that has entered into a FATCA intergovernmental agreement with the U.S., the foreign trust files its FATCA reports directly with the IRS. A list of countries that have entered into intergovernmental agreements with the U.S. can be found on the Treasury Department website.

Written policies and procedures should address IRS filing requirements, steps for identifying and classifying any foreign account that may be an FFI, and the corresponding FATCA reporting requirements and timelines. Failure to comply with FATCA reporting requirements could subject the financial institution and its customers to reputational risks, severe civil penalties, and possibly criminal punishment.

Valid documents to support FATCA compliance (as well as withholding requirements) include confidential and sensitive personal information. South Dakota-chartered financial institutions should take extra precautions to safeguard clients' information. The typical documents to support FATCA classification include but are not limited to the following:

- Form W-8BEN, Certificate of Foreign Status of Beneficial Owner of U.S. Tax Withholding and Reporting (Individuals)

- Form W-8BEN-E, Certificate of Status of Beneficial Owner of U.S. Tax Withholding and Reporting (Entities)
- Form W-8ECI, Certificate of Foreign Person's Claim that Income is Effectively Connected with the Conduct of a Trade
- Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for U.S. Tax Withholding and Reporting or Business in the U.S.
- Form W-9, Request for Taxpayer Identification Number and Certification

Additional Reporting Requirements

Additional reporting may be required by a U.S. person who creates a foreign trust, transfers any money or property to a foreign trust, receives a distribution from a foreign trust, is treated as the U.S. owner of a foreign trust, or maintains custody of assets owned by a foreign entity such as an FFI. Tax consequences generally apply to the grantor, the beneficiary, and the foreign trust. The following are examples of IRS forms that are routinely filed for foreign trusts. Management, or their contracted accounting or tax advisors, should be familiar with any that are applicable to the trusts under management:

- Form 926, Return by a U.S Transferor of Property to a Foreign Corporation.
- Form 1040NR, U.S. Nonresident Alien Income Tax Return.
- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.
- Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding.
- Form 3520, Annual Return to Report Transactions with Foreign Trust and Receipt of Certain Foreign Gifts.
- Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner.
- Form 5471, Information Returns of U.S. Persons with Respect to Certain Foreign Corporations.
- Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.
- Form 5713, International Boycott Report.
- Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Person of U.S. Real Property Interests.
- Form 8288-A, Statement of Withholding on Disposition by Foreign Persons of U.S. Real Property Interests.
- Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.
- Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b).
- Form 8858, Information Return of U.S. Persons with Respect to Foreign Disregarded Entities.
- Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships.
- Form 8938, Statement of Specified Foreign Financial Assets.

In addition to these IRS Forms, FinCEN requires the electronic filing of a Report of Foreign Bank and Financial Accounts (FinCEN Form 114 “FBAR”) with FinCEN to report any financial interest in, or signatory authority over, a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account exceeding certain thresholds. Please note that federal tax definition of a U.S. person is not applicable for FinCEN reporting, thus, both U.S. and foreign trusts could be subject to FinCEN filings. FinCEN is a bureau of the Treasury Department.

Guidance on Foreign Trusts

There has been a growing interest by foreign nationals in creating trusts under South Dakota law. In March 2019, the South Dakota Division of Banking issued Foreign Trust Taxation and Reporting Guidance and Foreign Trust Acceptance and Oversight Guidance. The panel will discuss the goal of the new guidance, practical implementation and obstacles related to the specific aspects of the guidance, best practices, and the Division's view of potential red flags during related examinations.

Elizabeth A. McMorrow, Moderator

Attorney, Elizabeth A. McMorrow Law LLC

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Beatrice Skyberg, CPA, CFP®, AEP®
Senior Tax Manager @ Eide Bailly LLP

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GUNDERSON | PALMER | NELSON | ASHMORE LLP
506 Sixth Street
Rapid City, South Dakota 57701
(605) 342-1078
gpna.com

SOUTH DAKOTA TRUST LAW UPDATE - 2019 Edition

Patrick G. Goetzinger - patrick@gpna.com[1]

Beginning July 1, 2019, several new laws affecting South Dakota trust companies and South Dakota trusts will become effective. During my testimony on trust legislation during the 2019 Legislative Session, I likened the process of updating South Dakota's trust statutes to weeding the garden to keep it healthy and productive. The annual package of legislative updates resulting from the work of the Governor's Task Force on Trust Administration & Reform ("TTF") along with the revisions drafted by the South Dakota Division of Banking ("DOB") yields the statutory equivalent of a healthy and productive garden for families, fiduciaries and other folks to enjoy in helping them achieve their objectives.

Two Bills were enacted this past session affecting South Dakota trusts and trust companies. House Bill 1033, authored by the DOB, represents the regulatory piece impacting South Dakota trust companies. Senate Bill 51, authored by the TTF, represents the trust industry piece that impacts South Dakota trusts. Though not directly related to trusts, also notable was passage of blockchain technology legislation, House Bill 1196. All three Bills are summarized in this memo.

<u>Notable items in House Bill 1033 (the DOB's regulatory legislation) include:</u>

- Revisions to SDCL 51A-6A-19.2 give the Director discretion to increase a trust company's pledge of assets to the Division in the event the company presents a unique or excessive risk to the Division. A hearing procedure is established in the event the company disagrees with the pledge requirement.

- Revisions to SDCL 51A-6A-24 streamline the process of retiring a trust company's preferred shares.

- Revisions to SDCL 51A-6A-27 & 28 modify the restriction on funding trust company dividends with surplus capital, with the Director's approval. The change authorizes using surplus capital to fund dividend distributions if the company is in compliance with its minimum capital requirements and the Director pre-approves the dividend distribution.

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[1] Patrick G. Goetzinger is a partner in the Rapid City law firm Gunderson, Palmer, Nelson & Ashmore, LLP where he leads the firm's Business and Estate Planning Group. Pat is a member of the American Bar Association Board of Governors, past president of the South Dakota State Bar Association, past president and current director of the South Dakota State Bar Foundation, Fellow in the American College of Trust and Estate Counsel (currently South Dakota State Chair), Fellow in the American College of Real Estate Lawyers, a member of the Governor's Task Force on Trust Administration, Review and Reform and a Director of the South Dakota Trust Association. He is listed among the Best Lawyers in America, Super Lawyers and in Chambers USA, America's leading Lawyers for Business in the categories of Corporate/Commercial Law and Real Estate Law, and Private Wealth Law.

Notable items in Senate Bill 51 (the TTF legislation) include:

- SDCL Chap. 55-3 was revised by adding a new statutory mechanism for trustees to resign when the governing instrument is either silent or ineffective in adequately securing a resignation. Resignation from both revocable and irrevocable trusts are addressed. This guidance is helpful by providing trustees a path to resign when the governing instrument is silent or vague.

- SDCL 21-22-12 was amended to provide a trustee a method to transfer trust assets when a trustee resigns and the office of trustee is vacated as well as trustee protection for availing themselves of the procedure set forth in the new law. This is companion legislation to the revisions discussed in SDCL Chap. 55-3, above. Both are significant changes resulting from a multi-year study of these issues by the TTF. They are welcome guidance for trustees presented with unique issues on certain trusts.

- SDCL 55-3-6 now states, "Unless the terms of a trust expressly reserve a power to the settlor to revoke or modify a trust, a trust shall be irrevocable."

- South Dakota's trust modification statute, SDCL 55-3-24, was amended to add a notice requirement. Written notice must now be provided to all fiduciaries prior to when the trust modification or termination becomes effective. The notice requirement can be waived by the fiduciaries.

- South Dakota's new and improved Virtual Representation statute continues to be well received in the trust planning community. SDCL 55-18-1 was revised to provide further guidance on when a material conflict of interest may exist between a representative and another interested beneficiary.

Marking the first instance the South Dakota legislature addressed blockchain technology legislation, House Bill 1196 was introduced this past Legislative Session. It added a definition of blockchain technology to South Dakota's Uniform Electronic Transmissions Act. SDCL 53-12-1 now acknowledges blockchain technology and confirms blockchain transmissions are in fact statutorily recognized electronic transmissions under South Dakota law. The definition does not require the use of blockchain, but merely expressly indicates blockchain transactions are permitted electronic transmissions. This is an important addition to our state law and provides comfort to trustees holding blockchain assets in South Dakota trusts.

There you have it. Another eventful Legislative Session is now in the books. Planning is already under way for the next Legislative Session. If you have any recommendations for legislation or need additional information on 2019 legislation, please don't hesitate to contact me.

Patrick G. Goetzinger
Senior Partner
(605) 342-1078
Patrick@gpna.com

Student Panel Break out session

Tim Kuhman, Moderator
General Counsel
The Kingdom Trust Company
Tim Kuhman serves as the General Counsel for the Kingdom Trust Company and has since its inception in 2010. Having also served as General Counsel to Equity Trust Company, he brings 15 years of experience to our discussion of the Trust Industry in South Dakota. That experience includes helping to build a de novo trust company from the ground up under the laws of South Dakota and staffing an office in the State.

His position requires him to be well-versed in the regulatory regimes that govern both South Dakota Trust Companies and the Self-directed investing world.

He serves as a subject matter expert to the subject matter expert in self-directed retirement accounts and self-directed investing for Kingdom's customer service, operations and business development groups. He is a frequent speaker on webinars and live events covering Self-directed Retirement Accounts and Self-directed Retirement Investing topics.

Tim is a graduate of Southwest Missouri State University (now known as Missouri State University) and the University of Toledo, College of Law. In addition to practicing law, he has taught a variety of business and law related courses at the high school, collegiate and graduate school levels. He has also coached Track and Cross Country at both the high school and intercollegiate levels.

Dr. Todd A. Muehler, JD
Associate Professor of Business Administration and Economics
Keith B. Miller Endowed Chair of Business
Director of Trust Management Program

I began teaching at Dakota Wesleyan University in the Fall of 2017. I had previously been an Assistant Professor at Northern State University where I had taught for four years. Prior to my teaching career, I spent approximately 20 years in the financial services industry working in a variety of sales, management and executive positions for several different financial institutions. These institutions included insurance companies, brokerage firms, and small and large commercial banks. Before my career in the financial services industry, I was engaged in the private practice of law and was a law clerk for a U.S. District Court Judge. I received my undergraduate degree and Doctorate of Jurisprudence from the University of North Dakota in Grand Forks, ND. I am married and have four children.

Michelle Le Herissier
Managing Director, South Dakota
Michelle has nearly 25 years of industry experience and joined JTC in 2015 to head up the company's office in the British Virgin Islands (BVI). Since then her role has significantly diversified and now she has responsibility as managing director for JTC's private wealth operations in Sioux Falls, South Dakota.

Prior to JTC, Michelle was based in Singapore for eight years. She spent four years with Barclays as Managing Director of the Singapore and Hong Kong trust divisions and the other four with CitiTrust, where she set up and ran a similar operation. She has also spent a number of years in the private wealth arena in Switzerland (Zurich) working for Citi and Credit Suisse with a particular focus on the Asian marketplace.

Michelle has been name as one of Citywealth's Power Women in their Leaders List 2016 and 2017 and has also been recognized in Citywealth's IFC Top 200 Powerwomen in both 2017 and 2018.

Robin Aden, JD, CTFA, AEP
Robin Aden is the Wealth Management Director at First Bank & Trust. Her responsibilities include management and growth of the Wealth Division comprised of investment, trust, financial planning, and private banking services. She has over 20 years of experience, primarily in the fiduciary arm of Wealth Management. Aden is a Certified Trust and Financial Advisor (CTFA), Accredited Estate Planner (AEP), and a licensed attorney in South Dakota.

Mike Dea
Mr. Dea has over 30 years of experience in the financial services industry. He has held multiple leadership positions at a number of banking institutions, most notably at Key Bank, where he was Commercial Real Estate Group Managing Director, Chief Financial Officer of the Corporate and Investment Banking Group, and Senior Vice President of Corporate and Investment Banking. Mike earned a BS in Accounting and an MBA from Kent State University.

Tom E. Pruner, CPA, PFS, CFP, AEP
Partner,
Serving Eide Bailly clients since 1982, Tom has extensive tax and accounting experience. He specializes in trust and estate income taxation, estate and gift taxation and financial planning. He oversees the preparation and filing of more than 1,000 trust returns every year.
Tom likes to get to know his clients and their business objectives, so when you work with him you get a partner who will do his homework and have answers ready often before you even realize you have a question. He's also a think outside the box kind of guy who enjoys the challenge of solving his clients' most complex challenges.

He has obtained a Bachelor of Science, Accounting – University of South Dakota, Vermillion
Certified Financial Planner – College for Financial Planning, Denver, Colorado

He is currently a member of the South Dakota CPA Society, American Institute of Certified Public Accountants, Financial Planning Association and the Sioux Falls Estate Planning Council.

Tom as received the following designations: Certified Public Accountant, Personal Financial Specialist,
Certified Financial Planner, Accredited Estate Planner.

He advises clients on estate, gift and trust compliance issues. Consulted clients and their families on matters of estate and gift planning. Provided income tax planning for high income and high net worth individuals.

In addition he has authored articles titled:
A Little Estate Planning Goes a Long Way
Estate planning can be a difficult subject, but avoiding the topic could cause problems down the line. Are you sitting on an outdated plan?

In his community he is involved with the Sioux Falls Area Community Foundation, South Dakota Parent Connection, Sioux Falls Chamber of Commerce, Sioux Falls Area CASA, and Sioux Falls Area Humane Society.

Jennifer Dugas
Jennifer Dugas is Senior Director, Wealth & Trust/Risk & Compliance at the American Bankers Association. In this role, she oversees the ABA Trust Schools and the Wealth Management and Trust Conference. She works closely with advisory boards to develop programming, content and speakers for these events.

Prior to joining ABA , Jennifer worked for the American Bankruptcy Institute, the U.S. Chamber of Commerce and NAPEO. She her undergraduate degree from the University of California, Santa Barbara.