Special Report for Wealth Managers

Directed Trusts 2.0

A guide to enhanced advisor-controlled features with fixed trustee fee advantage

Douglas Blattmachr
Founder of Alaska Trust Company.
Author or co-author of 10 articles
on estate planning and investments.

ALASKA TRUST COMPANY
Complete Trust & Investment Solutions™

Table of Contents

Executive Summary

Competition among wealth managers for high-wealth clients is fierce. In order to attract and retain such clients, wealth managers must now offer a wide range of sophisticated services.

For years, two of these services — trust administration and investment management — came as a joint package. When a client came to a bank and was referred to its trust department, services were offered in the form of a trustee who would retain decisions about asset choice, arguing that both services were not wise to divide.

Now, as a wealth advisor, you can furnish the very powerful tool of a directed trust to allow your client to retain the services of an independent trustee and maintain full dominion over investment decisions and the management of client assets.

Directed trusts have been around for over ten years. As their popularity increase since the creation of the Uniform Prudent Investor Act (UPIA), trustees are having a hard time arguing they still offer the best investment options for a client.

This report brings the directed trust technology to its most updated and evolved stage.

Thanks to new advisor-controlled features and a fixed trustee fee, your clients are given the greatest possible advantage.

Directed Trusts 2.0

What is a directed trust? In the simplest sense it removes investment management responsibility from the trustee. The individual or institution responsible for administering the trust then follows the investment choices of an outside advisor decided by the trust grantor or settlor.

This in effect splits responsibilities; the trust company or the trustee administers the trust but the client's financial advisor keeps dominion over investment choices and assets.

What is new, discussed in this report, is the amount of control that an advisor may have. In the past, directed trust arrangements have harnessed the advisor into a level of responsibility that requires review and oversight by the trustee or the trust company administering the trust.

Through the use of a limited liability company owned by the trust, the arrangements offered through Alaska Trust Company permit a previously unimaginable degree of bifurcation or splitting of the trust responsibilities.

In addition, Directed Trust 2.0 explains the benefit of a fixed trustee fee that preserves client assets from needless costs that would otherwise be based on a percentage of assets managed.

Advisors at Risk

Generations of advisors had only two options when it came to integrating trust services into their practice. One of these options was better for clients and third-party vendors than the other, but neither was exactly an attractive outcome for the advisors themselves.

Directed trust arrangements finally bring a third option to the table and let the advisor stay in the game:

OPTION ONE. You can simply *refuse* to help your clients set up a trust, even though it may obviously make sense for estate planning, asset protection, or other purposes. This is rarely the best choice, but many advisors make it all the time, simply because they don't want to risk introducing their best clients to a competitor. But your best clients are the very ones who want help setting up trusts — and if they have to go to another advisor for that help, it only weakens your position at the center of their financial lives.

Prognosis: Negative.

OPTION TWO. You can refer your clients to a bank or third-party trust company that will take over the management of the trust assets as well as the chores of running the trust itself. Many advisors shun this option because at best, it effectively removes this money

— and the associated management fees — from their control and gives it to a competitor. At worst, the trust company or an affiliate will then try to use their new relationship with your client to prospect for an even bigger share of that household's wealth, squeezing you out of the picture entirely.

Prognosis: Dangerous at best.

OPTION THREE. You can suggest that your clients create a directed trust. In this kind of arrangement, you retain control over how the assets in a trust are invested, but hand off the responsibility for administering the trust itself. Since the trust company has no vested interest in managing the money, you remain the primary point of contact with your most valued clients, ensuring that the time and effort you put into building the relationship in the first place is not wasted or impaired.

Prognosis: Positive.

The Directed Trust: Advisors and Clients Win

The evolution of many trust companies into broad-based wealth management firms has put financial advisors serving the high-net-worth market in the unenviable position of having to cede control of a portion or all of their clients' assets to a competitor whenever they suggest that a trust be created.

But with the advent of directed trusts, the grantor can *direct* the trust company to follow the investment choices of an outside advisor. In these arrangements, control over the assets (and the investment fees they generate) remains with the advisor, while the trustee administers the trust itself.

Since both trustee and investment advisor are thus free to do what they do best, this aligns the interest of all parties with the grantors and beneficiaries themselves, while minimizing potential conflicts.

The key point to remember about directed trusts is that someone other than the trustee manages the underlying assets. In a traditional common law trust, the trustee is responsible for both the administration of the property held in trust and how it is invested. In a directed trust, these functions are split up between the trustee, the advisor, and possibly other professionals.

The practice of directed trust began with the Uniform Prudent Investor Act of 1994, and the first families to benefit from these arrangements used them as a vehicle to consolidate control over various family-held business entities.

Since the family had much greater understanding of how the business operated than any outside trustee could ever achieve, directed trust arrangements allowed them to form a family LLP or LLC and transfer the ownership units into the trust. A trust company served as trustee while the manager of the partnership maintained control over the enterprise. Everyone won.

Over the last few decades, the directed trust concept has expanded to focus on more conventional asset classes such as stocks, bonds, cash, or other marketable securities.

As before, the person managing that wealth — the legacy advisor — is logically the best positioned to go on managing it. Again, a trust company serves as trustee, but the advisor continues running the investments and everyone wins.

Advisors like having a partner who can handle the transactions and administrative duties at a flat rate of usually less than what a traditional bank would charge. And there is no fear of a stranger getting in the way of painstakingly built client relationships because the paperwork still moves through the advisor.

As a financial advisor, you already work hand in hand with your clients' attorneys and other trusted professionals, so you are keenly aware of the need to work in teams in order to create customized solutions for complex financial situations. This works the same way. We have our job and you continue doing yours.

Enter the Directed Trust Company

In the last 15 years, a vibrant industry of independent trust companies like Alaska Trust Company has emerged as specialized directed trust vendors.

The best directed trust companies support custody platforms that are truly open in architecture. They can support their trust clients' portfolios across the universe of asset classes — cash, stocks, individual bonds, mutual funds, ETFs, and exotic instruments — all, of course, as you direct.

Fees for administration and custody at directed trust companies are typically in the 0.50% to 0.80% range for the first $1 million, which is roughly half the normal fee that all-inclusive firms tend to charge for bundled wealth management plus trust administration. As with any other financial service, fees vary widely and the tradeoff between value and expense can be precarious. Advisors should be prepared to shop around on behalf of their clients.

Naturally, the investment manager directing the way the trust assets are invested retains the right to set his or her own management fee and, where appropriate, performance fees as well.

While full-service trust companies normally adjust their fees to pass on the cost of working with unusually complex or non-liquid assets, directed trust companies can avoid this surcharge because they are passing on the responsibility (and liability) for managing those exotic investments.

Choosing the Right State

Location is everything. Various U.S. jurisdictions support over 50 types of trusts and dozens of legal codes that determine what protection your clients are entitled to receive — and what your rights as directing advisor are. Many states do not allow directed trusts at all.

Fortunately, there are no rules forcing wealthy families to work with a trust company in their own state. Many cross state lines in order to get the strongest protection available, and many advisors are there helping them make the best choice.

Family office providers generally begin by narrowing their search to a favorable state or group of states, then look further to find a good fit among the trust companies doing business there.

Even if a particular tax benefit or class of protection is not required as yet, these advisors know that their clients' situations or needs may change. Since multiple generations may be part of the equation, the trust must be able to evolve with the family's needs.

Many advisors look for some combination of the following factors when searching for a trust company:

1. **Perpetuities.** Perpetual trusts, or dynasty trusts, are very popular techniques used by planners and clients today. Alaska, for example, allows property to remain in trust in perpetuity, whereas most other states limit the effective life of the trust to 90 years after the last original beneficiary dies.
2. **Avoidance of State Income Taxes.** Avoiding state income tax is another key objective for planners to achieve for their clients. Alaska does not impose an income tax on trusts.
3. **Avoidance of Capital Gains Taxes.** Many trusts are created in states, such as Alaska, which do not have an income tax on accumulated trust income or capital gains.
4. **Asset Protection.** Some states offer varying degrees of protection for locally domiciled trusts from the trust creator's creditors. The language can be vague in some jurisdictions that theoretically support these "asset protection" trusts. However, in other states, like Alaska, statutes designed to explain exactly how long assets need to be in trust before a hostile claim is made, what kinds of claims (if any) are exempted from the protection, and other key matters.
5. **Total Return Trusts and Power to Adjust.** Many states have enacted total return trust or power-to-adjust statutes. Trustees in these states can now invest based on a total return approach and satisfy beneficiaries who receive either a share of current income or the principal at a later date. Most states with total return trust legislation have the ability to

convert a trust to a unitrust percentage between 3% and 5%.

6. **Delegation.** Directed trusts are common today where a third party investment advisor manages the assets of the trust. It is important to review state statutes permitting segregation of duties. Trustees who delegate investment management to an outside investment advisor may still be responsible since the trustee selected the investment manager.
7. **Privacy.** Most states have methods for insuring that fiduciary matters will not be a matter of public record, although some are stronger than others. However, state laws do differ on beneficiaries' entitlement to trust information and only a few states allow a trust instrument to delay or prohibit disclosure of trust information to future beneficiaries.

The Directed Trust that YOU Control

Most states force trustees to play an active role in how their clients invest their money, or at least watch over the directing advisor's shoulder to ensure that all investments are suitable, free from vested conflicts of interest, and appropriate to the wishes of the original grantor.

Alaska takes a very different approach. Our trust companies have the legal right to trust the advisors who direct the investment choices.

This gives outside financial advisors **full control** over how the underlying assets are invested. Any asset class, any securities, any style, without a whiff of outside interference. As long as the person who establishes the trust has faith in you and your abilities and it is clear in the trust agreement to be the Grantor's intention, we are satisfied.

The Alaska trust code gives them the freedom to trust you to know what you're doing — after all, you have plenty of compliance issues of your own to deal with as it is — and they pass that freedom on to you.

You will find that Alaskan trust companies understand that there are no "one size fits all" solutions that fit every client and advisor. Instead, we are willing to think outside the box — after all, thinking outside the box was how the entire Alaskan trust industry was came about.

While Alaskan trust companies are flexible, innovative, and resilient, they also offer the service that wealthy families in the "Lower 48" and their advisors expect and demand. Technology makes it possible for local trust officers to be "on the ground" remotely wherever you or your clients happen to be, regardless of distance or time zone differential. We are here when you need us.

One Flat Fee for All Clients

Similar to fee-based advisors who charge a sliding fee based on the amount of money they manage, most companies that support directed trust arrangements collect an administration fee tied to the size of the trusts they work with.

These fees vary widely, but industry surveys indicate that they average around 75 basis points a year. This means a trust that owns $500,000 in property can historically expect to pay the trust company $3,750 a year — and this fee will rise as the trust's underlying wealth grows.

However, there are a few trust companies bucking this trend by instituting a flat fee for all accounts, large or small. The benefits to most trusts are obvious, and they get even better as your clients get wealthier.

Working with a trust company that charges a flat $3,500 charge, for example, saves your clients — and ultimately their families — $1,750 a year on a trust that's worth $750,000, compared to what a company that charges 70 basis points a year would charge.

As more wealth is transferred into the trust, the economics of this new type of arrangement favor your clients even more. A trust worth $5 million, for example, would recoup $31,500 a year by going to a vendor that charges a flat fee. And in almost all scenarios, there are no distribution charges, "alternative asset administration fees", trading fees, lock-up fees, or any other nuisance expenses buried in the contracts.

How can the flat fee trust companies do this? It is simply a matter of providing value to the advisors and families they choose to work with. If that means leaving a little money on the table for your clients to enjoy, so be it.

While every trust company reserves the right to shift extremely onerous relationships to an hourly billing schedule, this almost never happens in directed trust situations — after all, you are the primary point of contact with your clients, so the directed trust company will remain almost entirely hands-off.

Alaska Asset Protection

Alaskan laws were the first to give U.S. citizens the same kind of protection that they would ordinarily receive from an offshore institution. Domestic trusts are in many cases now preferable to offshore trusts because they allow an individual to keep their assets in the United States.

In fact, self-settled spendthrift trusts and domestic asset protection trusts have become known as "Alaska Trusts". Now, over a decade after the Alaska Trust Act was passed, the state remains at the forefront in updating and improving its statutes to provide favorable protections for individuals, families, and family-owned entities.

While many people perceive asset protection as the sole reason for asset protection trusts, these vehicles also give individuals a new way to approach passing money to future generations. For example, estate planning attorneys have for years recommended wealthy clients gift significant amounts to their children, rather than passing it on at death.

However, some balk at the idea of gifting large sums without knowing what the future would bring. Alaska lets people establish a trust for their own benefit without having the assets considered part of their estates. If the money is needed later, the trustee can provide the funds as a trust distribution.

It is also common for trusts to be combined with other estate planning and asset protection tools. For example, Alaska trusts can be established to hold interests in family limited partnerships, which reduces estate taxes while maintaining control of family assets.

Because of this, Alaska has become one of the top states of choice for the location of trusts and family limited liability companies. These partnerships can either be a single family limited liability corporation or a limited liability corporation with members representing a number of different families. In these situations, an individual typically only gives a portion of his or her wealth to a trust.

And the Alaska trust advantage remains as fresh as it was — if not more so — over a decade ago. A few unique recent innovations:

- Alaska has some of the strongest asset protection laws in the country. Alaska bars all creditors from attaching the trust assets before distributions are made to a beneficiary. This includes, but is not limited to, claims by tort, creditors, and ex-spouses for alimony or child support.
- In 1998, Alaska made another major improvement to its trust laws by allowing married individuals to choose a community property structure for their assets. The act also gave out-of-state couples the ability to set up a community property trust in Alaska, even if their home state does not recognize community property.
- State law provides for the dissolution of a partnership or limited liability company only if a court determines it is impossible for the enterprise to continue to operate. An Alaskan court can not simply dissolve a partnership for any "equitable" reason and expose its underlying assets to litigation, as is the case in other states.
- The trust incontestibility clause provides a trust provision

"penalizing" a beneficiary for taking certain actions, such as contesting the trust or the decedent's will or suing another member. Enforcement will occur even if probable cause exists.

- Because trust court filings are not required, Alaska law provides a high degree of confidentiality to grantors and beneficiaries of a trust.
- No trustee can be held liable to beneficiaries or others associated with the trust for any actions of any other trustee. This allows different trustees to have different responsibilities without anyone having to worry about the others.

But what about those offshore trusts? Modern trust creators prefer to keep trustees and their assets in the United States, which entitles them to the protection of U.S. courts.

"Offshore" asset protection trusts in a foreign country, on the other hand, by definition operate in legal gray areas. Their very nature continues to draw attention from the IRS and other enforcement entities.

Directed Trust: Planning Tips

Regardless of where it is established, a directed trust must meet three major requirements to provide effective protection for your clients' assets:

1. It must be *irrevocable* or unchangeable.
2. It must have a *trustee* who has the legal right to guide its administration.
3. It needs a "spendthrift clause", which limits any involuntary or voluntary transfer of a beneficiary's interest in any trust property before that property is actually distributed to a beneficiary.

The benefits of an asset protection trust can be many. Chiefly, because these assets are now the trust's property, the grantor may protect those assets against any claims made by future creditors of the grantor.

Also, a grantor can create a self-settled trust, which lets him or her retain a beneficial interest in the trust while protecting future assets. The most important thing to remember about these trusts is that their primary goal is to shield wealth from litigation — a fear for almost half of all high-net-worth families!

Lawsuits are a fact of life in the United States, with estimates now putting the country's lawsuit rate at one every 30 seconds. Higher jury awards, expanding legal theories, and unpredictable judges have many worried that they will one day find themselves on "the wrong side of the law" through no direct fault of their own.

Given this trend, asset protection is on the minds of everyone today, including financial advisors and their clients. It is important to remember, however, that the goal of asset protection is not only to guard against a damaging legal judgment, but to prevent litigation in the first place.

Ultimately, asset protection is about protecting assets in the most prudent way for a specific client. While this can be as simple as joint property ownership or the gifting of assets, more complex techniques like domestic asset protection trusts permit people to protect their assets and retain a level of control not possible otherwise.

Asset protection can be strengthened by combining a directed asset protection trust with an LLC established under the laws of an asset protection state that makes a charging order against the owner of an LLC interest the creditor's sole remedy to collect the judgment.

In effect, combining an LLC with a directed asset protection trust provides two walls of defense against creditor claims that might otherwise seem insurmountable. This is obviously an area in which Alaska trust companies shine, given our expertise in working with LLCs, asset protection, and directed trust structures.

How To Gather More AUM with Alaska Full Control Directed Trust

Remember, trusts give wealthy families:

- Control over disposition of assets.
- Effective tax planning.
- Protection from lawsuits.
- Flexibility to respond to changing family need.

Every single one of your clients — not to mention the clients of competing advisors — would like to achieve at least one of these goals, if not all of them.

In other words, an advisor who can help set up trusts has a key differentiating factor that all clients and prospects appreciate.

And like any other differentiator, trust services can be used as either a competitive weapon to capture clients and assets held elsewhere, as a defensive moat to keep your clients from straying, or both:

- Highlight your expertise in this area in your brochure, website, and other marketing materials.
- Prospect your existing book by reviewing client documents for trust assets that could be moved or "decanted" into a directed trust under your management.
- Remind all clients that you will effectively be "fired" when they die unless their trust documents name you as the ongoing advisor of record.
- Network with estate planning attorneys. You are a valuable referral source for them and, in return, many are actively searching for investment advisors to suggest to their own clientele who are contemplating a directed trust arrangement.

The ideal time to raise the issue is during a regular client review meeting or when new estate planning concerns arise. Simply lay out how directed trusts work and how they allow you to keep providing the same level of service you currently offer your client — even after the wealth moves into the trust.

Be ready to describe the advantages that all forms of trust provide wealthy individuals and families, as well as the differences between directed trusts and traditional trust arrangements. Not all trusts are created equal.

Finally, mention that you would be happy to assist in the search for the right directed trust relationship.

The Asset Protection Conversation

You probably routinely work with business owners concerned about maximizing their asset protection. Your clients are seeking the best way to protect their assets and preserve them, not only for themselves, but for future generations.

There are also a variety of advantages for small business owners. Physicians traditionally look to these trusts to protect them from the potential that legal liabilities may exceed their insurance coverage. Instead of buying more insurance, the practice's assets can simply be placed in a domestic asset protection trust to shield the doctor from liability.

These same arguments would work for virtually any small business owner. Best of all, they stand to benefit tremendously from the ability that a direct asset protection trust provides them to gift a part of the business, while still retaining control of the assets, if needed.

Finally, while asset protection gives advisors a natural opportunity to open a conversation about the near-term benefits of trusts, it is important to at least touch on the importance of locking in these benefits sooner, rather than later.

Given the unsettled estate tax environment, it would be foolish for many families to neglect the opportunity to transfer wealth out of their estates before the rules change again.

Certainly, up to $5 million in individual assets (or $10 million for married couples) are exempt from the federal estate tax today. But what about in 2013?

When discussing trusts with your clients, make sure to touch upon the key impact points:

- Trusts help business owners shield their business and other assets from the threat of creditor claims.
- Trusts are not an all or nothing proposition, providing both flexibility and control.
- The long-term planning benefits should not be underestimated.
- Shifting tax policy means the opportunity to move money into trust may never be better or more attractive.

Top Reasons to Move Your Clients' Money to Alaska

Alaska law offers an unbeatable combination of trust provisions.

1. **Full control directed trust.** Alaskan trust companies know that clients already have financial advisors, legal advisors, and tax advisors. Directing those advisors to oversee the investment side of a trust ensures that these relationships continue.
2. **Tax treatment**. Clients of Alaskan trust companies get the full benefits of favorable IRS rulings regarding trusts established in the state.
3. **Asset protection.** Alaska was the first state to establish self-settled spendthrift trusts, which are not subject to creditor claims on either the grantor or any other beneficiary.
4. **No state taxes.** Trust beneficiaries can take advantage of the fact that Alaska has no state income tax on trust income.
5. **Dynastic planning.** Perpetual trusts can significantly increase wealth passed to others using generational transfers, while avoiding unnecessary estate, gift, and other taxes. In Alaska, trusts can last forever; however, if a beneficiary exercises a special power of appointment, the trust is limited to 1,000 years.
6. **Flexibility**. In Alaska, the grantor may retain an interest in a number of different trust types and have protection from creditor claims:
   - Charitable Remainder Trust
   - Total Return Trust
   - Grantor Retained Annuity Trust
   - Grantor Retained Unitrust
   - Qualified Personal Residence Trust
7. **IRA protection.** Alaska gives affluent families a unique benefit in the form of Alaska Creditor Protected IRAs. Alaska law permits an individual whose IRA is not protected from creditor claims in their state of residence to use Alaska law instead.
8. **Out-of-state community property.** Alaska is also the only state that allows both resident and non-resident couples to "opt into" all or some of the assets of an Alaska Community Property Trust, which can provide unique income and estate tax savings.
9. **Portability.** Trusts must move to Alaska to reap the benefits provided by state law. Alaska also has the most powerful decanting law, which is one way to do this.
10. **Alaska probate.** Non-residents of Alaska can also have their will probated under Alaska's flexible probate rules. This can help the estate avoid state and local income tax during probate administration, as well as statutory executor/personal representative fees or attorney costs.

About the Author

Douglas Blattmachr founded Alaska Trust Company in 1997. Since 1997, Douglas has been President & CEO, Shareholder, and Director of Alaska Trust Company. He brings with him over 30 years of trust and investment management experience. Prior to starting Alaska Trust Company, he was Senior Vice President and Chief Investment Officer for a $5 billion trust division, President & CEO of Neuberger & Berman Trust Company, and headed up the D.A. Davidson Trust Company.

About Alaska Trust Company

Alaska Trust Company was founded in 1997 by the financial and estate planning experts who helped create Alaska's advantageous and liberating trust laws. Since that time, thousands of people from across the country have entrusted the company with over $4 billion in assets. Alaska Trust gives you access to the friendliest trust laws in the United States no matter where you live. You do not have to be an Alaskan resident, or even ever visit the state, to benefit.

ALASKA TRUST COMPANY
Complete Trust & Investment Solutions™

Alaska Trust Company
1029 W 3rd Ave # 400, Anchorage, AK 99501
Phone (907) 278-6775, Website: http://www.alaskatrust.com