Directed Trusts

PEAK TRUST COMPANY

Elevated Trust & Wealth Management Solutions

Directed trusts have been around for nearly 20 years. As their popularity has increased since the creation of the Uniform Prudent Investor Act (UPIA), trustees are having a hard time justifying they still offer the best investment options for a client.

Executive Summary

Competition among wealth managers for high net-worth 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 control over investment decisions and the management of client assets. Directed trusts are not new, they have been around for nearly 20 years.

As their popularity has increased since the creation of the Uniform Prudent Investor Act (UPIA), traditional trustees are having a hard time justifying they still offer the best investment options for a client.

This report brings the directed trust concept to its most up-dated and evolved stage.

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 control over investment choices and assets.

What is different is the amount of control that an advisor may have. Other trust companies' directed trust arrangements can force 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 Peak Trust Company permit a previously unimaginable degree of bifurcation or splitting of the trust responsibilities.

Advisors at Risk

Generations of advisors had only two options when it came to integrating trust services into their practice(s). 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 lets the advisor continue to play an important role in managing their clients' financial affairs.

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, simply because you don't want to risk introducing your best clients to a competitor. Your best, high-net-worth clients are the ones who need and want help setting up trusts to protect their wealth and wishes. If you do not provide that, they will find someone that does. This weakens your position, or eliminates it entirely.

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 chore 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.

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 trusts 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 rate that is 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 20 years, a vibrant industry of independent trust companies like Peak Trust Company have 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, exchange-traded funds, 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 trade off 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 assets.

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.

Since multiple generations may be part of the equation, the trust must be able to evolve with the family's needs.

Even if a particular tax benefit or class of protection is not required as of 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, Nevada can continue for 365 years.
2. **Avoidance of State Income Taxes.** Avoiding state income tax is another key objective for planners to achieve for their clients. Alaska and Nevada do not impose an income tax on trusts.
3. **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. Nevada and Alaska, however, specifically state how long assets must be in trust before they become protected from creditors and what claims may be exempted from protection.
4. **Total Return Trusts and Power to Adjust.** Many states have enacted total return trust or power-to-adjust statutes. Trustees in these states can 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%.
5. **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.
6. **Privacy.** Most states have methods for insuring that fiduciary matters will not be a matter of public record, although some are stronger than others. Alaska and Nevada both provide for a high degree of confidentiality to grantors and trust beneficiaries (e.g.. grantors can elect to keep the trusts existence confidential form beneficiaries for a pre-determined period of time.)

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 directed 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 and Nevada take a 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 hint 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 and Nevada trust statutes give your clients 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.

While Peak Trust Company is flexible, innovative, and resilient, we also offer the service that wealthy families 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.

Asset Protection

Asset Protection laws give U.S. citizens the same kind of protection that they would ordinarily receive from an offshore institution without some of the headaches. Foreign Trusts ar heavily scrutinized by the government, and generally are much more expensive to create and maintain. Domestic trusts are in many cases now preferable to offshore trusts because they allow an individual to keep their assets in the United States.

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 and Nevada statutes let 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 and Nevada trusts can be established to hold interests in family limited partnerships or LLC's, which reduces estate taxes while maintaining control of family assets. Because of this, Alaska and Nevada have become the top states of choice for the location of trusts and family LLCs or FLP's. These partnerships can either be a single family LLC or an LLC 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.

Self Settled Spendthrift Trusts (DAPT-Domestic Asset Protection Trusts): Planning Tips:

Regardless of where it is established, a self-settled trust or DAPT 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 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!

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

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.

Trusts help business owners shield their business and other assets from the threat of creditor claims.

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. Currently, up to $5.45 million in individual assets (or $10.9 million for married couples) are exempt from the federal estate tax today. But what about in the future?

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 than the present.

Top Reasons to Move Your Clients' Trust to Peak Trust Company

Alaska and Nevada laws offer an unbeatable combination of trust provisions.

1. **Full control directed trust.** Peak Trust Company knows 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 Peak Trust Company get the full benefits of favorable IRS rulings regarding trusts established in Nevada and Alaska.
3. **Asset protection.** Alaska and Nevada Statutes allow self-settled spendthrift trusts, which are not subject to creditor claims on either the grantor or any other beneficiary, after certain conditions have been met.
4. **No state taxes.** Trust beneficiaries can take advantage of the fact that Alaska and Nevada have 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 and in Nevada the trust can go for 365 years.
6. **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.
7. **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.
8. **Portability.** Trusts must move to Alaska or Nevada to reap the benefits provided by state law. They both have powerful decanting laws, which under certain conditions allow you to "pour" (decant) the assets of one trust into another (irrevocable). This allows you to change situs (state) and possibly update the old trust into a new, more current one that reflects

For more information, visit the Peak Trust Company website at www.PeakTrust.com or contact one of our knowledgeable team members at (844) 391-2789.