Spring 2016
Vol. 12 No. 2

# On the Menu

# PPLI

## A New Day for Private Placement Life Insurance Planning in Delaware

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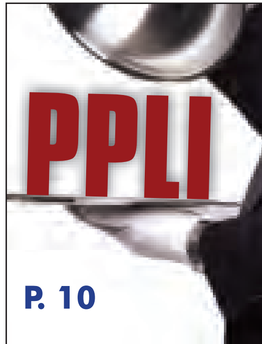
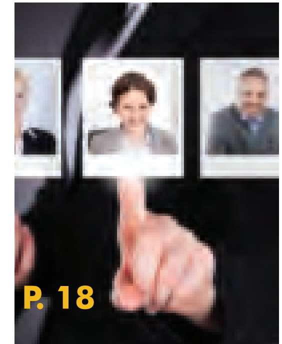
**Spring 2016**
**Vol. 12, No. 2**

**The Quarterly Publication of the Delaware Bankers Association**



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# View from the Chair

by
Rodger Levenson
Executive Vice President and CFO
WSFS Bank

Chairman
Delaware Bankers Association

***"It's been an eventful, exciting two years..."***

When I first took the helm as the chairman of the Delaware Bankers Association, I wrote in this column that my predecessor, Dave Gillan, cautioned that the year as chairman goes quickly. Funny, but now that my term is over it almost seems like two years! I'm being facetious, of course. It has been two years…two very busy, and hopefully productive years.

In the past two years our association has faced such challenges as: the continued explosion in the digital banking area, and the increased cyber threats those advances bring; the imbalance of responsibility in the area of data breaches; regulatory issues with non-bank competitors; and regulatory reform; just to name a handful.

We've said a fond farewell to our association president, David Bakerian, and welcomed our new president, Sarah Long. There have also been many constructive meetings with our Congressional delegation, during two annual Washington Visits along with meetings in state. We've met with members of the Delaware legislature at two editions of our Legislative Reception.

Within the association we've continued our commitment to financial literacy with 17th and 18th editions of the DBA's Teach Children to Save Day, while investigating new ways to educate and serve through elder financial exploitation awareness. The association has also been working to re-invigorate our committees in a way that addresses members' needs in a way that is both relevant and convenient. I'm happy to report that the CyberSecurity and Community Relations groups are already well on their way in this process of revitalization.

There have been two editions of the annual Delaware Trust Conference, the ninth and tenth. In 2015, after several years of straining the capacity at the Hotel du Pont, the conference moved to larger quarters at the Chase Center on the Riverfront. The first year at the Chase Center was a success and will allow the conference to become a truly national event that will attract a wider base of attendees to experience the unique advantages of Delaware's trust product.

Also in the area of trusts, your association has been working with the University of Delaware to create a minor in Trust and Wealth Management. This initiative will be one of the first of its kind in the nation and will help train the best talent for our trust companies and wealth management firms, while further enhancing the State's reputation in that field.

As always, over the past twenty-four months, we have stressed the importance of our industry to the community. Banking is an important part of every community across the country, but even more so in the State of Delaware. This fact is even more true than in the past as the number of bank employees grows and previous stalwarts of the state's economy contract. Ours really is a profession of which to be proud.

It's been an eventful, exciting two years, but now, the time has come to hand over the reins of this fine Association. I wish all the best to Mark Graham as he becomes chairman. And, as always, all the best to the fine men and women of Delaware's banks.

# THE POWER OF FOCUS

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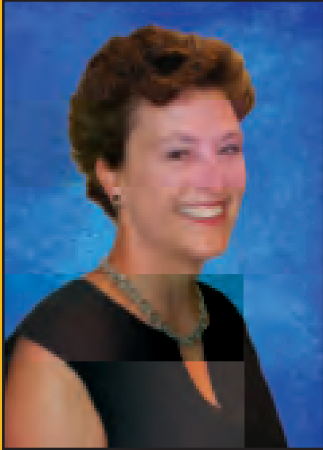
# President's Report



by
Sarah A. Long
President, CEO & Treasurer
Delaware Bankers Association

***"The DBA proudly serves as the unified voice of banks and trust companies to legislators and regulatory agencies alike. "***

In Lewis Carroll's *Alice in Wonderland*, Alice asks the Cheshire Cat for directions.

*"Would you tell me, please, which way I ought to go from here?"*
*"That depends a good deal on where you want to get to," said the Cat.*
*"I don't much care where—" said Alice.*
*"Then it doesn't matter which way you go," said the Cat*
*"—so long as I get somewhere," Alice added as an explanation.*
*"Oh, you're sure to do that,' said the Cat, 'if you only walk long enough."*

Direction is vital, much more so to an industry, than to a girl wandering in a Wonderland. For over 120 years, the Delaware Bankers Association has represented the collective interests of the Financial Services Industry in our state. The DBA proudly serves as the unified voice of banks and trust companies to legislators and regulatory agencies alike. And, along with our members, the Association participates in drafting, monitoring and supporting legislation beneficial to the banking and trust business in Delaware. Through advocacy, we solidify Delaware's standing as the pre-eminent state for financial services.

But our mission is not confined to advocacy. Our industry is at a crossroad, and we, like Alice, find ourselves confronted with issues as complex as the logic of the Cheshire Cat. In an environment marked by rapid change, shifting consumer behaviors, evolving technologies, and the relentless burden of regulatory oversight, banking in Delaware must remain focused, agile, dynamic and relevant. So must our Association. Over the past year, the Board of Directors and the DBA Staff have been working to meet those challenges.

As one of the foremost states for financial services, Delaware has the opportunity to shape the future of the industry. To do so effectively, the DBA must have both member engagement and financial stability. We must be bold in supporting workforce readiness initiatives. And we must continue to deepen our engagement in the community.

**Growing the Association -** Active and engaged members are critical to the overall growth and sustainability of the DBA. Positive experiences of members matter. Providing members with value is essential to long-term success. Sponsoring valuable networking events, and establishing relevant, forward thinking committees are just the beginning.

**Enabling Financial Stability** - Meaningful programs and positive member experiences are essential to the financial wellbeing of the Association. An alliance-friendly Association can muster the strength of all of our resources for the benefit of all of our members. Diversification will guard against the inevitable ebbs and flows of the Association through active engagement and partnership with similarly purposed Associations on initiatives and programs.

**Supporting Workforce Readiness** - Timely, relevant and accessible education and training is a key element of workforce readiness. Educational offerings cover a variety of topics that members need to effectively manage and lead their organizations. We must invest in opportunities that develop the financial services leaders of tomorrow and we should have a place at the table in regards to state policy decisions that impact the Financial Services Industry such as the Governor's Cybersecurity Advisory Council and the State of Delaware Taskforce on Financial Literacy.

**Engaging in the Community** - Banks and Trust Companies are deeply rooted in the community, and are well positioned to educate and mobilize individuals around the issues that matter. Through the DBA, we can pool funds and expertise for greater community impact. This includes improving the financial wellbeing for all through education on topics that impact overall financial capability, of which financial literacy is a fundamental pillar.

Delaware's financial services industry continues on its journey. If, as an association we remain focused, agile, dynamic and relevant, we will be not only get somewhere, but it will be somewhere worthwhile.

Sarah

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# What's New at the DBA

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## 2016 Legislative Reception

The Delaware Bankers Association hosted its sixth annual Legislative Reception for members of the Delaware General Assembly, April 21st, at Dover Downs. DBA Chairman, **Rodger Levenson**, Executive Vice President and CFO, **WSFS Bank**, joined other prominent bankers from across the State in welcoming the law makers. The reception was made possible by the generous sponsorship of the following members: **Bank of America; Barclays; Bessemer Trust Company of Delaware; The Bryn Mawr Trust Company of Delaware; Capital One; Charles Schwab Trust Company of Delaware; Comenity Bank; Commonwealth Trust Company; Community Bank Delaware; County Bank; Discover Bank; Fulton Bank; M&T Bank; MidCoast Community Bank; U.S. Trust Company; Wilmington Trust;** and, **WSFS Bank**.

(l. to r.) Representative Bryon H. Short, Chairman House Economic Development/Banking/Insurance/Commerce Committee; Rodger Levenson, DBA Chairman, Executive Vice President and CFO, WSFS Bank; Sarah A. Long, DBA President; Senator Bryan Townsend, Chairman Senate Banking and Business Committee; and, Robert A. Glen, Delaware State Bank Commissioner, at the DBA Legislative Reception.

## DBA CyberSecurity Committee

Over 20 security and IT professionals attended the "re-boot" of the Delaware Bankers Association's CyberSecurity Committee. The group met for a CyberSecurity Roundtable on April 7th at the University &Whist Club in Wilmington. Committee chair **Deborah Hornbeck**, IS Professional Senior Group Manager, **Citibank**, led a wide-ranging discussion on the cybersecurity issues facing Delaware's banks, along with suggestions for agenda topics for future meetings. **Diane Rogerson**, Technology Director, **JPMorgan Chase** and member of the Delaware CyberSecurity Advisory Council provided an update on the council's activities.

## ABA Emerging Leaders Forum

(l. to r.) Chris Milone, Director, Digital Marketing, Barclaycard US, Sarah Long, President, Delaware Bankers Association; Amy Walls, Assistant CRA Director, Discover Bank; and Ryan Dougherty, Site Operations Manager, Capital One, at the ABA Emerging Leaders Forum, March 14th in Washington D.C. The Forum provided a great opportunity for new leaders in banking to share challenges and strategies, network with peers from across the country and gain new perspectives on leadership.

## DBA Senior Washington Visit

Attendees of the 2016 DBA Senior Washington Visit in the historic Federal Reserve Board Room

The Delaware Bankers Association conducted their annual DBA Senior Washington Visit, March 2nd through March 4th. The 2016 Washington Visit provided members the opportunity to meet with key regulators at the FDIC, the OCC, the Federal Reserve and the CFPB. The group also met with **Senator Tom Carper**, **Senator Chris Coons**, and **Representative John Carney**. The DBA thanks all their generous sponsors including: Platinum Sponsor **- The Federal Home Loan Bank of Pittsburgh**; Reception Sponsors **- Brooks Courier Service, Inc.**; **Buchanan Ingersoll Rooney PC**; **FIS™ Risk, Information Security and Compliance (RISC) Solutions**, and **Richards, Layton & Finger**; and, Bus Sponsor **- Glenmede**.

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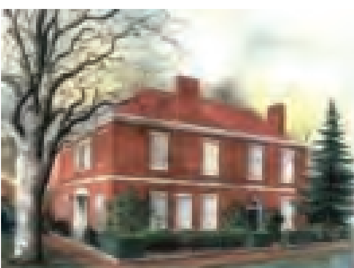

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# Yes PPLlease!

## A New Day for Private Placement Life Insurance Planning in Delaware

by
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Delaware's House and Senate have recently passed a bill that amends Section 702 of Title 18, which pertains to the State's premium tax on life insurance policies issued in Delaware. The bill adds new Subsection 702(c)(3) to the Section, providing that the premium tax on private placement life insurance ("PPLI") policies delivered in the State of Delaware shall be 2.0% on the first $100,000 of net premiums, and shall be 0.0% on net premiums exceeding $100,000. House Bill number 237 is currently awaiting the Governor's signature at the time this article is being written. This change to Delaware's PPLI premium tax makes Delaware much more competitive with other jurisdictions that have historically attracted virtually all of the PPLI trust planning business.

### PPLI

PPLI is a rapidly growing market in which life insurance policies are used as sophisticated, and flexible investment vehicles designed to enhance the performance and tax-efficiency of certain investments. PPLI is only offered to owners who are qualified purchasers and accredited investors and the annual premium payments generally range between $1 million to $5 million. PPLI death benefits are generally quite large, often in the tens of millions of dollars. As a

life insurance product, a key advantage of PPLI is that it permits income tax-deferred buildup of the investments maintained inside the insurance product during the insured's lifetime and provides an income tax-free death benefit. The tax benefits of PPLI are heightened when the investments held as a part of the policy are the types of investments that are tax-inefficient, such as certain mutual funds, hedge funds and investment partnerships that spin off taxable income. Unlike other types of life insurance that include an investment component, such as variable, universal and whole life policies, PPLI offers the policy owner the flexibility to change investment fund managers to take advantage of different investment styles and allocations within the policy to adjust to the insured's investment objectives and risk tolerance. There are complicated rules that prevent the owner of a PPLI policy from having control over the investments and he or she cannot dictate investment decisions. However, the policy owner can choose a fund manager and make adjustments to that choice based upon the asset manager's investment allocations and philosophy. As the current tax environment has made income tax planning even more important to investors, tax deferral and tax efficient investment planning such as that available with PPLI is becoming a higher priority for high net worth clients.

Often, PPLI policies are held in a trust structure. A properly designed trust can provide creditor protection as well gift, estate and GST tax planning opportunities. A policy owner may also use a trust as the owner of PPLI because the policy owner wants to take advantage of the lowest premium tax law environment and holding the PPLI in a revocable trust whose situs is in a low tax jurisdiction can trigger the application of that state's tax laws. The selection of a trust situs is based on many decisions, but all things being equal, the administrative cost savings available in a jurisdiction that has a favorable state premium tax is the strongest driver.

Delaware has historically been a far less attractive option than jurisdictions such as South Dakota and Alaska for PPLI planning. The Delaware tax rate on premiums has been 2%. The current premium tax rate in South Dakota is 0.08% on annual premiums in excess of $100,000. Alaska also has a very attractive tax rate of 0.10%. Consequently, most sophisticated planners looking to design life insurance trusts holding PPLI have turned to South Dakota or Alaska, and not Delaware, and Delaware has attracted little or no PPLI trust business in the past. The repeal of the PPLI premium tax in Delaware on net premiums over $100,000, combined with the many other well-known advantages of using Delaware trusts for such planning, should attract new PPLI trust business to Delaware. And because these policies are so large, the assets under administration in Delaware, particularly after the death benefit is paid, could be substantial.

### Delaware Advantages

One key aspect of Delaware law that makes it among the most attractive jurisdictions in the country for trust settlors is the ability to create a directed trust. Because a life insurance trust holds a concentrated position in a single asset (i.e. the life insurance policy) it often makes sense to use a directed trust and limit fiduciary duties to diversity in the trust agreement, so

*(Continued on p. 12)*

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that the trustee is not pressured to liquidate the insurance policy under common law duties to diversify. Section 3313 of Title 12 of the Delaware Code, and Delaware's well-developed trust law on the subject, has made Delaware the leading jurisdiction for direct trusts.

Additionally, Section 3302(d) of Title 12 of the Delaware Code provides trustees with a special set of rules applicable to life insurance held in trust on the life of the settlor or the settlor's spouse. It provides that when the trust agreement references that statute, the trustee may acquire or retain a contract of life insurance upon the life of the trustor or the trustor's spouse, without liability for a loss arising from the trustee's failure to: (1) determine whether the life insurance contract is or remains a proper investment; (2) investigate the financial strength or changes in the financial strength of the life insurance company; (3) make a determination of whether to exercise any policy option available under the life insurance contract; (4) make a decision of whether to diversify life insurance contacts relative to one another or to other assets, administered by the trustee; or (5) inquire about changes in the health or financial condition of the insured or insureds relative to any life insurance contract. This allows the express provisions of the Delaware trust agreement to carry out the settlor's intentions with respect to a life insurance trust: that the trustee simply hold the life insurance policy and pay the premiums, without being forced to sell it or diversify.

Another advantage of Delaware trust planning that applies to a Delaware life insurance trust is that Delaware does not impose any state income tax on Delaware resident trusts that have no Delaware resident beneficiaries. Delaware trust's are entitled to a distributable net income deduction for income distributed to beneficiaries similar to that provided for under Federal law. Additionally, under Section 1636 of Title 30 of the Delaware Code, Delaware resident trusts are entitled to a non-resident beneficiary deduction for income accumulated for beneficiaries who are not residents of the State of Delaware. The effect of these two deductions is that Delaware trusts that have no Delaware resident beneficiaries do not pay any Delaware state income tax on the income of the trust. When the life insurance trust becomes a non-grantor trust for Federal income tax purposes, the trust could benefit from state income tax savings.

## Strategies

One planning strategy for PPLI is to use a dynasty trust for wealth transfer planning. Such a trust may be useful as an estate planning strategy because the trust assets would not be included in the settlor's taxable estate and would be exempt from generation skipping transfer tax. However, if the insured's objectives for the PPLI include withdrawal of investment proceeds as a tax-deferral strategy, then a traditional dynasty trust is not an appropriate vehicle because the assets of the trust would not be available for distribution to the settlor. There are some more sophisticated planning options that might be available to accomplish the estate planning goals in addition to permitting the settlor to get access to trust distributions, such as a completed gift asset protection trust or a spousal lead access trust (which is generally a very similar structure to a traditional irrevocable life insurance trust).

Alternatively, in cases where a primary motivation for the PPLI is income tax savings and deferral of investment-related income, the insured may want the flexibility of accessing funds held in the policy during his or her lifetime. Access to investment returns within PPLI is done in a way that is similar to what is common with other forms of life insurance that include an investment component, like variable, universal and whole life policies. To achieve this goal when PPLI is held in a trust, the insured will need to have access to distributions from the trust holding the PPLI. The trust could be structured as a revocable trust with a Delaware trustee in order to take advantage of the state's favorable premium tax. The settlor can essentially withdrawal assets from a revocable trust at any time. The trust could also be structured as an irrevocable Delaware asset protection trust to achieve creditor protection. Of course, if an asset protection trust is used, trust distributions could only be made in the trustee's sole discretion, and the settlor would not have the ability to directly access the assets.

This new change to Delaware's PPLI premium tax could present a big opportunity for the Delaware trust industry to attract a new area of large asset trust business to the State of Delaware that was not otherwise coming to the state.

*Todd Flubacher works with national and local clients on the creation, migration, modification and administration of Delaware trusts. He represents Delaware trustees, beneficiaries, law firms and individuals throughout the country on all matters involving Delaware trusts and estates. Todd is a Fellow of the American College of Trust and Estate Counsel (ACTEC) and holds the designation of Accredited Estate Planner® (AEP®) by the National Association of Estate Planners & Councils. He is included in The Best Lawyers in America (2014-2016) and AV-rated by his peers in Martindale-Hubbell. Todd is a past-chair of both the Estates & Trusts and Tax Sections of the Delaware State Bar Association. Todd is a nationally recognized author on Delaware trust law and his articles have appeared in notable publications such as Trusts & Estates magazine and Estate Planning magazine, among others.*

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# Possible Privilege Pitfalls

## The Fiduciary Exception to the Attorney-Client Privilege

by
Scott E. Swenson
Connolly Gallagher LLP

Managing risk requires relying upon the advice of counsel. Although the attorney-client privilege protects the confidential communications between lawyer and client made in the course of legal representation,[1] its protections are not absolute. Professional fiduciaries are at particular risk of the disclosure of their presumed confidential communications with counsel under what is known as the "fiduciary exception" to the attorney-client privilege. Understanding the fiduciary exception is critical to avoiding its grasp.

### *Riggs* and the Rise of the Fiduciary Exception

Although the notion of the fiduciary exception to the attorney-client privilege did not arise in Delaware,[2] the seminal case on its application to trustees of common law trusts came from our own Delaware Court of Chancery. In the 1976 case *Riggs National Bank of Washington D.C. v. Zimmer*,[3] which the U.S. Supreme Court in 2011 called "the leading American case on the fiduciary exception,"[4] the Court of Chancery weighed a claim by trust beneficiaries to surcharge the trustees for alleged breaches of trust with respect to certain tax matters. In the prosecution of their claim, the beneficiaries sought a legal memorandum prepared by the trustees' outside

counsel on this topic.[5] The trustees resisted this request on the basis that the memorandum was the product of confidential communications between the trustee and his attorneys for the purpose of securing legal assistance, and thus was protected by the attorney-client privilege. Because the memo constituted the work product of their attorney prepared in contemplation of potential tax litigation with the State of Delaware, the trustees argued, it was entitled to work-product immunity.[6]

The Court rejected both contentions, finding instead that the memorandum was prepared ultimately for the benefit of the beneficiaries of the trust and *not* for the purpose of the trustees' own defense in any litigation.[7] The Court reasoned that the attorney-client privilege did not apply to shield the communication from the beneficiaries because, as a fiduciary representative for the beneficiaries, the trustee was not the real client in the sense that the trustee's personal interests were being served by the advice rendered.[8] Rather, the Court found that the very intention of the memorandum was to aid the beneficiaries, and it thus could not be protected from them.[9]

In a somewhat closer call, the Court declined to extend attorney work-product protection to the memorandum, holding that the beneficiaries, rather than the trustees, were the attorney's ultimate clients because the advice was for the ultimate benefit of the beneficiaries rather than the trustees themselves.[10] The purpose of the work product doctrine is not to protect the client, but rather, the attorney. The underlying policy is to protect the privacy of lawyers in their work and encourage the freedom of lawyers from interference in the task of preparing their clients' cases for trial.[11] The work product doctrine is not absolute, and can be overcome where the party seeking such documents demonstrates a "substantial need" for their production that could not otherwise be satisfied without undue hardship.[12] Here, the Court found that the beneficiaries had substantial need of the memorandum, and the trustees were ordered to turn it over.[13]

Tellingly, the *Riggs* court focused on who paid the lawyers. That they were paid from the trust was "a significant factor, not only in weighing ultimately whether the beneficiaries ought to have access to the document, but also it is in itself a strong indication of precisely who the real clients were."[14] As counsel fees came from the trust, the Court noted, the beneficiaries effectively paid for the memorandum, and if it were indeed prepared for the benefit of the trustees, charging the trust may have been improper.[15]

### *Mennen* and the Current State of the Fiduciary Exception

Delaware courts had little to say on the fiduciary exception until its return to the forefront in *Mennen v. Wilmington Trust Co.*,[16] in which the beneficiaries sought to compel the trustees to produce all of the institutional trustee's communications with counsel related to an earlier action where the institutional trustee had petitioned the Court for instructions and for the removal of the individual trustee. The beneficiaries also sought "production of legal 'advice and documents related to [the institutional trustee's] duties and powers' under the Trust agreement."[17] The beneficiaries argued that these documents were prepared for their ultimate benefit, rather than the trustees' benefit, and were thus subject to the fiduciary exception to the attorney-client privilege under *Riggs*.[18]

Over the trustees' objections, the Court determined that *Riggs* remains good law in Delaware,[19] and helpfully distilled the *Riggs* holding, and the subsequent federal cases discussing it, into several factors for courts to consider in determining whether the fiduciary exception should apply. These include: (i) the purpose of the legal advice; (ii) whether litigation was pending or threatened between the trustee and the beneficiaries when the advice was obtained; and (iii) the source from which the fees for the legal advice were paid.[20]

Evaluating the circumstances of the *Mennen* case in light of these factors, the Court ruled that the documents relating to the earlier petition for instructions by the institutional trustee were largely protected, whereas documents relating to the trustee's powers and responsibilities were not.[21]

The Court's analysis in finding that the bank trustee need not disclose documents relating to the earlier petition is instructive to all trustees. Applying the first factor, the Court agreed with the institutional trustee that it sought the advice on its own behalf and not on behalf of the beneficiaries.[22] The trustee acted foremost in its own interests, and any potential benefit conferred upon the beneficiaries through its actions was ancillary.

Second, the Court concluded that the institutional trustee reasonably anticipated a threat of litigation with the beneficiaries.[23] As the Third Circuit explained, the *Riggs* court, in finding that the advice in question was for the ultimate benefit of the beneficiaries, placed significance on the fact that the trustee lacked "a legitimate personal interest in the legal advice obtained."[24] A finding that the trustee had a legitimate personal interest in legal advice does not require pending litigation against the trustee, according to the Court in *Mennen*; rather, the determination must be made in light of all of the facts at hand, which seems to include the trustee's reasonable anticipation of litigation with the beneficiaries.[25] In this case, that occurred when the company comprising the trust's largest investment went bankrupt.[26]

Third, the institutional trustee paid for the legal advice in these matters rather than charging it to the trust. Under *Riggs*, each of these three factors weighs in favor of a finding that the trustee was the real client and that the privilege should therefore be preserved. The Court accordingly denied the beneficiaries' motion to compel with respect to privileged documents pertaining to the trustee's exposure or prepared in connection with or in anticipation of litigation, including the earlier action.[27] However, the Court ordered the disclosure of otherwise privileged documents pertaining to the trustees' powers and responsibilities under the terms of the trust unless prepared in connection with litigation, finding that, under *Riggs*, "[a] beneficiary is entitled to inspect opinions of counsel procured by the trustee to guide him in the administration of the trust" and that beneficiaries must have "knowledge of the affairs and mechanics of the trust management" in order for them to hold the trustee to the proper standards of care and honesty.[28]

*(continued on p. 16)*

# Trust

(continued from p. 15)

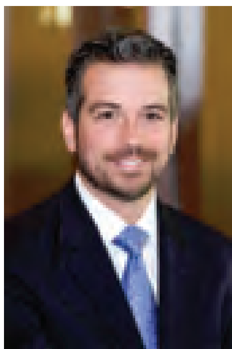
### Takeaways for Trustees

a. Look out for your own interests.

It may seem counter-intuitive, but by openly acting in its own interests in seeking the advice of counsel, an institutional trustee may be afforded the protection of the attorney-client privilege to shield its communications with counsel. Cynical though it may sound, a trustee should consider the possibility of conflict with one or more beneficiaries in every action it takes and anticipate claims by those beneficiaries. Where possible, a trustee should frame even actions ostensibly taken on behalf of the beneficiaries as being in the trustee's best interest – after all, the failure to take action for the good of the beneficiaries could expose the trustee to liability at the hands of the beneficiaries. Otherwise, even the most altruistic trustee could find itself on the receiving end of a suit in which the very beneficiaries it sought to benefit may use the trustee's own communications with counsel against it. No good deed goes unpunished.

b. Where appropriate, foot the bill.

The third factor in the *Riggs* test is not dispositive, and in fact Delaware law con-firms that a trustee's retention of counsel, and its payment of counsel's fees out of trust funds, does not alone operate as a waiver of the attorney-client privilege.[29] However, where the trustee's conduct is at issue, the trustee may be wise to pay costs of legal counsel out of its own pocket rather than from the trust, and the reasons extend beyond strengthening the trustee's claim to privilege under the *Riggs* test. For instance, it may be politically expedient in order to avoid further riling already aggrieved beneficiaries, or to show deference to the tribunal, which has ultimate authority over the payment of attorneys' fees in trust actions.[30] A trustee can always later seek to have its attorneys' fees reimbursed from the trust if the situation warrants.



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*Notes:*

1- See Delaware Uniform Rule of Evidence 502(b) for Delaware's statement of the attorney-client privilege. This bedrock principle of the common law system is designed to promote candor and allow clients to obtain legal advice, assessing both strengths and weaknesses, without fear of compelled disclosure. *See generally* Hazard, Jr., Geoffrey C., *An Historical Perspective on the Lawyer-Client Privilege*, 66 CAL. L. REV. 1061, 1069-91 (1978).

2- *See, e.g., Garner v. Wolfinbarger*, 430 F.2d 1093, 1103-04 (5th Cir. 1970) (holding that "where the corporation is in suit against its stockholder on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance").

3- 355 A.2d 709 (Del. Ch. 1976) (Chancellor William T. Quillen).

4- *United States v. Jicarilla Apache Nation*, 131 S. Ct. 2313, 2321 (2011).

5- *Id*. at 710.

6- *Id*.

7- *Id*. at 711.

8- *Id*. at 713.

9- *Id*. at 713-14.

10- *Id*. at 716.

11- *Id*. at 714-15 (citing *Hickman v. Taylor*, 329 U.S. 495, (1947); *Duplan Corp. v. Moulinage et Retorderie de Chavanoz*, 487 F. 2d 480 (4th Cir. 1973); *Republic Gear Co. v. Borg-Warner Corp*., 381 F.2d 551 (2d Cir. 1967)).

12- See Ct. Ch. R. 26(b)(3).

13- *Riggs*, 355 A.2d 709 at 716.

14- *Id*. at 712.

15- *Id*.

16- *Mennen v. Wilmington Trust Co.*, 2013 WL 4083852 (Del. Ch. July 25, 2013) (Master's Final Report, adopted by Order dated August 12, 2013).

17- *Id*. at *2.

18- *Supra*, note 5.

19- The trustees had asserted that the Delaware Supreme Court's adoption of Rule 502 of the Delaware Uniform Rules of Evidence and its statement of the attorney-client privilege abrogated the common law exception in *Riggs*, a contention the Court dismissed. *Mennen*, 2013 WL 4083852, at *3.

20- *Id.* at *4 (citing *Riggs*, 355 A.2d at 711–12; *Jicarilla*, 131 S. Ct. 2313, 2322 (2011) (listing these three factors as the basis for the determination of who the "real client" was in *Riggs*); *Wachtel v. Health Net, Inc.*, 482 F.3d 225, 232 (3d Cir. 2007) (listing the same three factors)).

21- *Mennen*, 2013 WL 4083852, at *10.

22- *Id*. at *4-5.

23- *Id*. at *5.

24- *Id*. (citing *Wachtel*, 482 F.3d at 232).

25- *Mennen*, 2013 WL 4083852 at *5.

26- *Id*.

27- *Id*. at *10.

28- *Id*. at *7.

29- *Id*. at *5 (citing 12 *Del. C*. § 3333).

30- 12 *Del. C*. § 3584 ("In a judicial proceeding involving a trust, the court, as justice and equity may require, may award costs and expenses, including reasonable attorneys' fees, to any party, to be paid by another party or from the trust that is the subject of the controversy").

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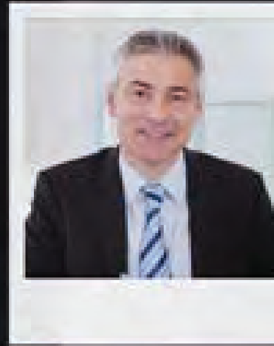

# What To Look For in Your Next CEO

by Alan J. Kaplan, Founder & CEO
Kaplan Partners

Selecting a new CEO for your institution is the single most important responsibility of a bank Board of Directors. Everything flows from this decision: strategy, reputation, leadership that sets the "tone at the top", the ability to attract critical talent, investor and employee confidence, and the credibility of the board itself. The list is endless. Moreover, selecting an underprepared or inadequate leader—no matter how well liked or how long employed—can quickly send a bank in the wrong direction.

## Banking Industry Skills

The list of optimal banking industry skills required in a CEO today could easily include dozens of items.. Below are ten which, based on our firm's experience successfully conducting over fifty CEO search and succession assignments, are commonly viewed as "must haves".

**Experience Working with Regulators**
A decade ago regulatory relations were barely on the radar screen for bank leaders, unless the bank was in trouble. However, in today's paradigm-shifted regulatory climate, the ability to forge a positive working relationship with a bank's varied regulators has become a vital ingredient for success.

**Balance Sheet Management Experience**
The low interest rate environment which seems to have become a semi-permanent condition (rates are going up soon, right?) has put pressure on bank spreads like never before. With interest rate risk and margin pressures on the front burner, CEOs need to understand the construction of their balance sheet, including capital strategy, more deeply than before.

**Commercial Credit Skills**
You can never have too much credit skill in a bank in our opinion. There's no quicker way to turn a good bank into

an underperformer than via credit quality issues. The path to the CEO chair still goes through the commercial lending area more often than any other area.

**Experience with Corporate Governance**
Boards of Directors are under more scrutiny from investors, customers, regulators, communities and even employees than ever before. CEOs need to appreciate the pressures facing Directors (even for privately held and mutual institutions), respect the ongoing challenges facing the Board, and help navigate the path.

**Technology Savvy, Including Evolving Channels**
Everyone knows that technology in banking has moved from the back office to the front lines. Understanding how the rapidly shifting technology landscape is impacting the industry—and how to respond in real time—has become a vital ingredient for ongoing success.

**A New Perspective on Risk Management**
In the good old days risk meant credit, fraud or plain old liability for things like slip-and-fall. Nowadays, this category has broadened to include cyber security, counterparty risk, compliance issues, legal challenges and more. Being able to identify and triage the bank's risk factors is more important than ever.

**Marketing and Social Media Knowledge**
As mentioned, technology has become a front-line channel for growth. The integration of social media with technology has changed how many banks must go to market, build brand awareness, drive engagement and respond to customer needs. CEOs need to be plugged into these shifts, even if they are not yet active themselves on social media (though they should be).

**Exposure to Fee-Based Lines of Business**
With the decline of the margin business, boosting fee revenue appears to be on almost every bank's strategic planning agenda. Even for banks with a low percentage of fee-driven revenue, CEOs going forward will need to explore alternative ways to grow the top line.

**Transaction and Integration Experience**
Many banks which had never previously considered a transaction are now exploring all options, including acquisitions, mergers of equals, branch sales and purchases, fee business acquisitions, etc. Exposure to the transactional arena has become more critical, as has the ability to successfully integrate post-transaction. Otherwise, the value derived from "doing a deal" may not be achieved.

**Strategic Planning Skills** Everyone seems to have a plan, but how real and achievable is that plan? The CEOs ability to craft a meaningful path forward and drive the plan's execution has become a differentiator for successful banks.

## Leadership Attributes

Here we will emphasize ten leadership competencies and attributes which we have found to have proven vital for bank CEOs. They may appear to some as classic "soft" skills, but they are not simple qualities to develop and can lead to "hard" performance results.

**Leadership and Vision**
As the late great management guru Peter Drucker famously stated "management is doing things right; leadership is doing the right things". Setting the proper course for an institution by outlining the company vision, and creating "followership" among the employees, may be the first step on the path to superior performance. CEOs must have this ability.

**Broad-based Communication Skills and Executive Presence**
This may be stating obvious qualities which every board member desires in a CEO, but they can't be taken for granted. Today's CEO must communicate through a broader array of channels than ever before, and to a wider audience beyond just customers, employees and communities. When you add investors and regulators to the mix, the presence and style of communication become more important than ever.

**Cultural Agility**
The U.S. today is a bigger melting pot than ever. As a result, a bank's customers and employees become ever more diverse. Most new businesses in America are started by women and minorities as well, so the agility to appreciate a more varied constituency is critical for banks that want to grow.

**The Ability to Assess and Attract Top Talent**
This may be one of the most underappreciated yet important element of successful leaders. Stars want to work with stars, and the ability to bring superior talent into the organization has never been more important. Talent quality has become one of the few remaining differentiators between banks.

**Adaptable and Flexible**
The banking industry continues to evolve rapidly and at times dramatically. Adaptability and flexibility are "newer" traits that successful CEOs must deploy. Technology leads the pack in terms of change, but regulatory focus and customer desires shift as well, and banks need leaders who can respond quickly and effectively.

**Strong Execution Skills**
While having a current and well developed strategic plan will always be important, execution is the other side of the coin. The ability to drive the plan forward is the key to enhanced performance, and the variable in successful execution always comes down to managing people.

**Ahead of the Curve on Industry Trends**
It's not enough to know what the current trends are by reading the industry news and attending conferences. Standout leaders not only see where the industry is heading before the crowd,

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but begin formulating responses to these trends ahead of the pack.

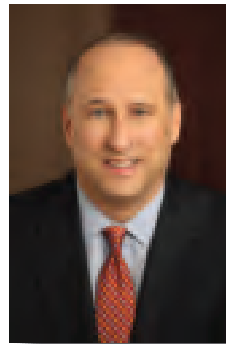
**A Focus on Accountability**
Performance management systems have become the "wave of the present". There is little room in today's bank for complacency, and in a competitive and cost conscious environment, many banks seek a leader who can enhance accountability and recognize/reward individual performance.

**Build a "Culture of Excellence"**
Excellence is a habit, the saying goes. Banks that truly seek to distinguish themselves need a culture based on excellence every day. Leaders who understand the need to "raise the bar" to survive and thrive will drive this focus home.

**Knows How to Work Constructively With a Board of Directors**
One of the quickest ways for a bank CEO to falter is to lose the trust of the Board. A successful CEO today must appreciate the pressure that Directors face (from regulators, investors, communities, etc.), and partner with the Board in managing the pressures and challenges that the institution is facing almost daily. A truly constructive working relationship benefits everyone.

The intangible aspects of effective leadership are as important as the technical skills and industry expertise in today's banking industry. While the tangible proficiencies may be more obvious and identifiable on the surface, it is often the attributes, competencies and qualitative elements of leadership that make the difference in the success of truly great leaders.

There is no perfect template of skills which will guarantee success, particularly in the pressure-filled and constantly evolving banking industry. However, finding a CEO with a foundation grounded in these ten industry skills will increase your bank's odds of surviving and thriving.



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# Fiduciary Standard Expanding to Brokerage, Rollover Advice

by Donald W. Nicholson, Sr.

As the second oldest regulated industry in the U.S.,[1] bankers have long been accustomed to fiduciary accounts, which are a staple of bank trust departments. However, trust departments are about to get some company. And the fiduciary standard is also likely to undergo some changes in the way it is applied and to whom, thanks to Congress and a couple of federal agencies.

In recent years, Capitol Hill and federal regulators – principally the Department of Labor (DOL) and the Securities and Exchange Commission (SEC) – have begun expanding fiduciary coverage to stockbrokers and certain pension providers. While the new initiatives do not directly impact banking regulation – at least for now – it's helpful to be aware of fiduciary trends in a related part of the financial services industry.

For example, my independent wealth management/financial planning firm is registered with the SEC but my firm is subject to two somewhat different standards of fiduciary care. Under current SEC requirements, registered investment advisers (RIAs) are subject to a fiduciary duty with twin duties of loyalty and care.[2] For the most part, under the duty of loyalty the SEC emphasizes disclosure as a means of managing conflicts of interest. Under the duty of care, there also is an implied suitability requirement that the SEC was going to formalize under a 1994 rule proposal. However, it was never adopted.[3]

As a related part of my practice, I am also subject to an older, and more highly prescriptive fiduciary duty under Delaware trust law through my management of clients' trust account portfolios. Delaware trust law also contains twin duties of loyalty and care, the latter term often referred to as the "Prudent Man" standard of care under trust laws as well as the Employee Retirement Income Security Act of 1974 (ERISA). Under Delaware law, the duty of loyalty prohibits self-dealing, or acting in a way that compensates the fiduciary advisor over the interests of the trust beneficiaries.[4] Under the duty of care, every kind of investment is eligible for inclusion in a trust portfolio, limited only by the duty of loyalty prohibiting self-dealing, and the Prudent Man Rule that requires that a fiduciary "shall act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use…"[5] In similar fashion, the SEC does not prescribe limits on the kinds of investments in an advisory account, only that the portfolio meets the implied suitability requirements.

Broker-dealer reps, too, have a form of fiduciary duty, but only in special circumstances. The duty of loyalty is largely a facts-driven review in a court or arbitration forum to determine whether the broker was in a position

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of trust and confidence in the customer relationship, or held discretionary authority over customer assets. Interestingly, a broker's suitability requirement is more articulated under rules promulgated by the Financial Industry Regulatory Authority (FINRA) than is the implied requirement for investment advisers. In the last several years, FINRA also added to the list of specific factors for determining suitability of a broker's investment recommendations.[6] Ironically, because all of these same factors are traditionally followed by RIAs, they are now more in alignment in terms of following an appropriate due diligence process.[7]

Since nearly nine out of 10 brokers are also dually registered as investment adviser reps, they may often "switch hats" by acting as an RIA fiduciary to a customer's advisory account and as a non-fiduciary broker (in most instances) servicing the customer's brokerage account. This has caused considerable confusion among investors, as documented in various studies. Moreover, most investors do not understand the difference between a suitability standard (essentially a half loaf), and the twin duties that comprise the traditional fiduciary standard.

The investor confusion problem has been exacerbated by the fact that most financial intermediaries are subject to a functional test, and not a 'holding out' test, in determining fiduciary status. In other words, anyone can use a title such as 'financial advisor' or 'wealth manager,' terms that imply acting in a position of trust and utmost good faith to the client, but using fiduciary-like titles does not always correlate with a legal obligation to act in the client's best interest. In some ways it's no different from consumer labeling in other industries. Right now consumer groups are pushing the Food and Drug Administration to ban the use of "natural" on food labels, which they claim is misleading.

The problem with misleading titles in the industry probably isn't going to go away, although there are wedges here and there in regulation.

The original investment adviser statute prohibited then, and still does today, use of the term "investment counselor" unless registered with the SEC. It was protected in response to legitimate investment advisers who wanted to halt stockbrokers using the term to imply fiduciary status. Over the decades that term has fallen into disuse and the organization supporting the 1940 prohibition since changed its named from the Investment Counselors Association of America to the Investment Adviser Association. In 1987 the SEC also developed guidance that prohibited holding out as a financial planner unless registered with the SEC as an investment adviser. In 2005 the SEC adopted a rule that allowed brokers to accept fees for their investment advice without being subject to the fiduciary requirements of the Investment Advisers Act of 1940 (Advisers Act). However, acknowledging complaints from financial planning groups, the rule prohibited the use of the term "financial planner" unless registered under the Advisers Act. A court later threw out the rule for other reasons.

In the wake of the 2008 financial crisis, among other things the Obama Administration pushed for reform in this area by proposing that brokers be subject to a fiduciary standard based on a functional approach, i.e. the test being whether they provide retail investment advice. The end result was provisions in the 2010 Dodd-Frank reform act requiring a study of the different standards for brokers and advisers providing retail investment advice, and authorizing the SEC to adopt a uniform fiduciary standard for both brokers and advisers.

It was not until March 2015 that SEC Chair Mary Jo White announced that she would support a uniform fiduciary standard for both groups. A proposed rule has been placed on the rulemaking calendar for October of this year, but these schedules are often pushed back. Still, it appears that a common fiduciary standard is in the works for retail investment advice. Banks have a broad exemption from this requirement except for mutual fund advisers.

This leaves us with the DOL's fiduciary initiative, which was first begun in 2010, halted in 2011 by stringent industry opposition, and then resumed in April 2015 with a revised proposal. Called the "conflict of interest" rule, the DOL's proposal would discard a 40-year-old, cumbersome, five-point test to determine functional fiduciary status under ERISA. The latest proposal would replace it with a more streamlined definition that would bring in thousands of securities and insurance brokers who were previously exempt. Not only would they and their firms be fiduciaries for the first time, but fiduciary coverage would be expanded to include rollover advice on plan distributions to participants and IRA advice as well.

In terms of a 'holding out' standard, there also is one change proposed by the DOL. Where an ERISA service provider could claim to be a fiduciary under the current five-part test, the DOL has noted that in enforcement cases the courts have rejected a holding out test, looking only at whether defendants have met all five prongs of the functional test. Under the proposed rule, this would no longer be the case, since representing oneself as a fiduciary would trigger status as an ERISA fiduciary.

The debate over the rule has raged on for five years -- now going on six -- with opponents asserting industry compliance costs six times the DOL's estimate. The DOL in turn points to economic benefits of at least $17 billion a year to investors by eliminating the costs of conflicted advice, a claim that opponents argue is flawed.

At the same time, in responding to industry and bipartisan pressure from Congress, the DOL has conceded a few points to critics claiming the Department wanted to ban commissions by permitting incentive compensation to be received by brokers for their investment advice. In the past, ERISA fiduciaries were permitted to charge only "level-fee" advice to discourage firms from "steering" clients to investments with higher payoffs to the firm and agent. In exchange the proposed DOL exemptions from prohibited transaction rules under ERISA would, among other

things, require the incentive commission to be reasonable, add several new disclosure requirements related to investment costs, and mandate a duty of prudence for the first time with respect to advice on plan rollovers and IRA accounts.

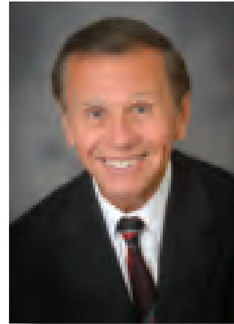
Earlier, I mentioned that the Advisers Act and Delaware trust law have no restrictions on investment products. However, the Department of Labor's duty of loyalty standard departs from current trust law by restricting the use of investment products in conflicted advice arrangements to conventional and more liquid investments like mutual funds. Industry opponents complained that this was a throwback to 19th century trust law, in which state legislatures sometimes banned riskier investments from trust portfolios.

To-date the DOL rule proposal has survived numerous oversight hearings in Congress, legislative attempts to derail the rule, and has now been forwarded to the Office of Management and Budget for one last review before being released to the public in final form. The rule is also likely to undergo a legal challenge in court and a possible Hail Mary pass by Congress under a little-used law allowing final congressional review of major agency rules, leaving some uncertainty over its final fate.

If the DOL rule survives these final hurdles, as most observers believe, we will see dramatic changes to the contours and boundaries of the fiduciary standard under securities and pension law. On the other hand, fiduciary purists do see a slight downside, albeit far less than opponents. Supporters of the DOL rule see a potential for some dilution in the duty of loyalty if brokers and insurance producers are able to receive commission compensation that is counter to the "sole interest" standard under ERISA, which requires fiduciaries to act 'solely' in the interest of the beneficiary. Nor is it clear whether a final SEC rule governing fiduciary conduct of brokers and advisers will be aligned more closely with the existing Advisers Act requirements or with FINRA's lower, commercial standard of good faith and fair dealing between equal parties.

The changes brewing in these two agencies will likely take many years to incorporate into the best practices of financial intermediaries. But over the long-term, if implemented, these upgraded market conduct standards are likely to replace the sales culture still embedded in many firms with a fiduciary, best-interest standard that is more closely aligned, albeit imperfectly, with the standard applied to fiduciary accounts at banks.

In the meantime, it's worth watching these developments by the banking community. Over time, it's possible that the DOL and SEC rules will have a ripple effect on other quarters of the industry.



*Donald W. Nicholson, Sr., is president of Donald W. Nicholson & Associates Ltd.(nicholson-associates.com). Although Donald W. Nicholson Sr. started his company in 1987, he has been providing financial planning to clients since the early 70's. Don received a degree in marketing from the University of Maryland. Don is the Former President and Chairman of the Philadelphia Tri-State Chapter of the Financial Planning Association and served as National Chairman of the Alliance Forum for the Financial Planning Association. Don is also on the board of the Malvern Retreat League & the Estate Planning Council of Delaware. He is a member of the Delaware Banker's Association. He has been quoted in the New York Times, Wall Street Journal, The News Journal, The Philadelphia Inquirer, USA Today, Fortune and various other publications. Don is the former radio host of "It's your Money"*

*1- Insurance was the first regulated sector of the financial services industry when New Hampshire appointed the first insurance commissioner in the country in 1851. See New Hampshire Insurance Department website, History, (2015), available at http://www.nh.gov/insurance/aboutus/index.htm . The Office of the Comptroller of the Currency, the first national bank regulator, was created by Congress in 1863 as a bureau of the U.S. Department of the Treasury. See OCC website, History: 150 years of the OCC (2013), OCC, available at http://www.occ.gov/about/what-we-do/history/index-history.html.*
*2- See staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers ("2011 SEC Study"), January 2011, available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf.*
*3- SEC, Suitability of Investment Advice Provided by Investments Advisers, IA Release No. 1406 (Mar. 16, 1994), proposing a rule under Advisers Act sec. 206(4) antifraud provisions requiring advisers to give clients only suitable advice.*
*4- For example, in Delaware a trustee "owes the [trust] beneficiaries the duty of loyalty and must exclude all self interests." Gans v. MDR Liquidating Corp., No 9630, 1991 WL 114514.*
*5- Del. Code Ann. Tit. 12, §3302(a). Available at http://delcode.delaware.gov/title12/c033/.*
*6- See FINRA Rule 2111. Suitability requirements differ for institutional and retail customers of a broker-dealer. The broker's duty is satisfied with respect to institutional customers if s/he has a reasonable basis to believe that the institutional customer is capable of an independent evaluation of investment risks. However, when recommending investments to a retail customer, the broker is generally required to assess nine customer-specific factors such as age, liquidity needs, investment time horizon, and risk tolerance.*
*7- The nine factors listed in Rule 2111 are: 1) age; 2) other investments; 3) financial situation and needs (including annual income and liquid net worth); 4) tax status; 5) investment objectives; 6) investment experience; 7) time horizon; 8) liquidity needs; and 9) risk tolerance.*

# Delaware Silent Trusts

by
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Delaware trustees and practitioners are routinely called upon to administer or form "Delaware silent trusts" drafted in accordance with 12 Del. C. §§ 3303 and 3339. This column assumes the reader has a general understanding of the aforementioned statutes and provides a non-exhaustive checklist of issues for the Delaware trustee and/or practitioner to consider in creating Delaware silent trusts.

## Clear Drafting

Delaware's statute generally provides that a trust instrument can vary or eliminate a beneficiary's right to be informed for a period of time. Put simply, without specific and clear provisions in the trust instrument eliminating a beneficiary's right to be informed, the trust will not be a silent trust. Some drafting issues to take specific note of, include:

**a. No Duty vs. Prohibition.** Many trustees are uncomfortable with language that merely provides the trustee "has no duty to notify the beneficiaries." Preferred language would be the trustee "shall not notify the beneficiaries." Most trustees prefer the latter language as it is a clear direction not to notify as opposed to the former language which arguably would require the trustee to exercise its discretion in order for the trust to be silent.

**b. Specificity as to Scope.** It is important the language specify the extent to which the trust is silent. Is it all matters, simply the trust's existence, just as to its holdings, etc.? The settlor's intent should be discerned in this regard and language drafted accordingly. If the trust is to be totally silent for the particular period, the trust should contain very broad language – e.g., the trustee shall not notify the beneficiaries of any information regarding the trust, including without limitation, statements, the existence of the trust, the beneficiary's interest in the trust, any trust assets or holdings, etc.

**c. Reasonable Period.** While Delaware's statute does not require any particular time period after which the silent period should terminate, 12 Del. C. § 3303(c) provides examples and most practitioners believe a "reasonable" time period should be used. That is, a trust that is indefinitely silent is not the most ideal situation for a trustee.

**d. Designated Representative.** The trust should include language appointing a Designated Representative that will represent and bind the beneficiaries during the silent period. The Designated Representative is presumed to be a fiduciary and other common fiduciary language should be included: standard of care and indemnification, compensation, resignation and appointment of successors, etc. Ideally the trust should also include a signature block for the Designated Representative to sign and thereby indicate his or her acceptance to serve (alternatively, a separate acceptance instrument could be prepared).

**e. Premature Knowledge of the Beneficiary.** The trust should address the situation where the beneficiary learns of the trust's existence and/or other information during the silent period, and then requests additional information or distributions from the trustee. When such circumstances arise, if the trust is silent as to how to address this situation, the trustee is in the precarious position of weighing the settlor's intent vs. the beneficiary's interest. Alternatively, one method to address the issue would be for the trust instrument to provide that upon

such occurrence the silent period immediately terminates.

**f. Avoiding Inconsistencies.** The trust instrument should be thoroughly reviewed to avoid any inconsistencies which could complicate the administration for the trustee. Some rather obvious inconsistencies which could be overlooked include: Crummey powers and withdrawal rights at particular ages.

### Selection of the Designated Representative

The Designated Representative will represent and bind the beneficiaries during the silent period. Important considerations should go into the selection of the Designated Representative, including:

a. Conflict of Interests. Conflicts with other fiduciaries (e.g., Investment Advisers, Distribution Advisers, etc.) must be considered. Since the Designated Representative will be representing and binding the beneficiaries, it is generally wise for the Designated Representatives to be independent from the other fiduciaries administering the trust.

b. State Income Tax Issues. Since the Designated Representative is presumed to be a fiduciary, state income tax issues must be considered. The residency of a Designated Representative could subject the trust to income taxes in his or her state of residency depending upon the laws of such state.

c. Other Practical Issues. Given the role, in an ideal situation, the Designated Representative will have some financial and trust knowledge and a relationship with the beneficiaries or the family.

*The content of this column is based largely upon a more comprehensive article by Vincent C. Thomas, Esquire, and the presentation of Mark E. Doyle and Vincent C. Thomas at the 2015 Delaware Trust Conference.*


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# Compliance Focus

by
Marsha Dahl
Senior Compliance Manager, CRCM
FIS™ Risk, Information Security
and Compliance (RISC) Solutions

*"Servicing mortgage loans and assisting borrowers experiencing difficulty paying are high-risk areas that should be managed carefully."*

## Mortgage Servicing Pitfalls and Best Practices

Less than nine months after the Consumer Financial Protection Bureau (CFPB) Mortgage Servicing Rule took effect in January 2014, the CFPB brought action against a large bank mortgage loan servicer, citing a lack of effort to comply with the new rules and underscoring the importance of understanding unfair, deceptive or abusive acts or practices (UDAAPs). Most notably, it included problematic activities dating as far back as 2011 – before the rule was effective. This set the stage for examiners and mortgage servicers to keep servicing compliance on the radar – not just moving forward, but looking back over the past several years.

These heightened expectations have institutions asking how they can successfully service mortgage loans while avoiding a high volume of complaints especially from consumers going through the mortgage loan modification, collection and foreclosure processes.

Because consumer complaints are a driving factor for examiner focus, day-to-day interactions with customers represent a situation ripe for misunderstanding, heightening the risk of noncompliance findings. It is critical that communications with borrowers be well documented in loan files. To ensure that your institution is not caught by this common pitfall, implement the following best practices:

- Maintain conversation logs in the servicing system
- Establish a minimum standard for documenting conversations
- Implement scripts for accurate and consistent communication
- Implement risk-based call monitoring
- Record some or all customer calls

### Complaint Monitoring

Consumer complaints serve as an early warning system that enables you to proactively identify emerging problems, so you should have in place a robust complaint management program that includes:

- Board-approved policy with a clear definition of the term "complaint" and assignment of responsibility
- Written procedures for complaint handling, responses, logging and monitoring
- Complaint log for complaints received via all methods (e.g., CFPB, in person, email, telephone, etc.)
- Periodic log monitoring for patterns, trends and standout issues, such as potential UDAAPs
- Root cause analysis
- Corrective action tracking

### State Law Requirements

State laws vary widely, and servicing and loss mitigation are no exception. A well-developed process for monitoring state law requirements and tracking changes to them is necessary to avoid violations. Typically, this is overseen by the legal department or outside counsel and communicated to affected parties including compliance.

In addition, be sure to thoroughly research state law requirements before beginning to do business in a new state, and add that state's requirements to your checklists and monitoring documents.

### Processing Times

You need a documented process for noting when key events occur, such as days past due, application date, when notices are provided and other key events. Variances in state laws are a trap, so be sure to adjust documentation depending upon the jurisdiction. In some instances, there may be no timing requirements under federal law, while there are strict requirements under state law. Consult with your legal counsel to ensure you have mechanisms in place to comply with key timing requirements.

## SPOC Changes

Emerging from the financial crisis was the requirement to have a single point-of-contact (SPOC) for borrowers in default. This is to eliminate confusion and implement a more efficient process for borrowers in default. Servicers should avoid reassigning a borrower in default to a different SPOC if possible. While the SPOC can be changed if the employee leaves, the servicer must provide the borrower with written notice within five business days. One way to reduce turnover is to consider slightly higher compensation and/or benefits for employees serving the SPOC function.

## Compliance Testing

Monitoring and testing are key components of an effective compliance management system (CMS). Findings should result in root cause analysis and corrective action, which should be reported to the board, an appropriate committee or relevant managers and executives. Well-executed compliance testing will ensure that you are able to self-identify and correct compliance deficiencies before examiners do.

## UDAAPs

Any violations can also be interpreted as UDAAPs, a catch-all that can either be tacked onto a regulatory violation or cited as a standalone violation. Regardless of the nature of a UDAAP violation, it serves as a vehicle by which examiners and attorneys can seek large-scale fines, extensive restitution and sweeping changes to processes and product offerings.

It is critical that your organization have a written UDAAP program, and it should be woven throughout your CMS in a meaningful way, including policies and procedures, monitoring and testing, compliance audits, training and complaint monitoring.

## Conclusion

Servicing mortgage loans and assisting borrowers experiencing difficulty paying are high-risk areas that should be managed carefully. Additionally, the underlying UDAAP risks found throughout the mortgage life cycle are heightened in these areas. By implementing the best practices highlighted in this article, you can improve the customer experience, reduce complaints and increase the likelihood that your next examination will go smoothly.

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# DBA Calendar of Events

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**2016 FDIC Directors' College**
**Atlantic Sands Hotel and Conference Center, Rehoboth, DE**

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## November 2016

**November 15th, 16th & 17th**
**2016 Regulatory Compliance School**
**University & Whist Club, Wilmington, DE.**

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# Web and CD Seminars

For more information, or to register, please visit the Web Seminar link at www.debankers.com. The DBA has introduced an improved web seminar catalog featuring an easy to view, searchable listing. There is no log-in required to view the catalog. The checkout function has also been improved and includes itemized receipts.

## May - July 2016

**May 10 - CRA Review & Update**

**May 11 - Introduction to ACH: ACH Basics & Overview Part 1**

**May 12 - Dissection of Malware**

**May 13 - Commerical Real Estate Cash Flow Analysis**

**May 17 - Letters of Credit**

**May 19 - Introduction to ACH: ODIF Operations Part 2**

**May 20 - Basics of Global Cash Flow Analysis**

**May 23 - Call Report Fundamentals**

**May 24 - Introduction to ACH: RDFI Operations Part 3**

**May 26 - Information Security Program Basics**

**June 1 - Advaced Loan Documentation**

**June 2 - Feeling the Heat: Regulatory Pressure for Third-Party Management**

**June 3 - Employment Compliance Basics**

**June 6 - Call Report Operational Schedules**

**June 7 - Untangling the Web of Fee Discloures**

**June 8 - Same Day ACH: Coming to You Very Soon**

**June 9 - Mobile Threats & Best Practices**

**June 17 & 20 - Bank Accounting Essentials**

**June 21 - Your First TRID Exam: What to Expect**

**June 22 - Managing Fraud in the Payments World**

**June 24 - Conducting Successful HR Audits**

**June 27 - Commerical Real Estate Lending in Today's Economy**

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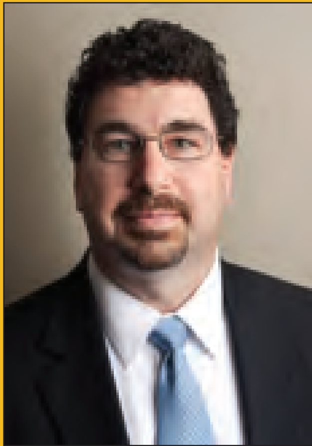

by
Louis D. Memmolo, GBA, CHRS
Employee Benefits Advisor
Weiner Benefits Group

***"The balancing act of juggling regulatory compliance and managing employee engagement continues!"***

No sooner than employers start to catch their collective breath after scrambling across the ACA Reporting finish line, the ripple effect of the Affordable Care Act and other legislation continues to keep businesses on their toes! The balancing act of juggling regulatory compliance and managing employee engagement continues!

The DOL, HHS, CMS and other agencies have been busy expanding regulatory obligations with the threat of audits to ensure compliance. Here are a few to keep your eye on:

- **DOL Proposes Changes to FLSA White Collar Exemption Rules**
- **Phase 2 of HIPAA Audit Program**
- **DOL Increases FMLA Enforcement**
- **DOL Health Plan Audits and ERISA Compliance**

While the left hand juggles the never ending regulations, the right hand continues to seek new ways to engage employees with creative benefit programs that meet their diverse needs. Proper advice and consultation allow employers to successfully manage both simultaneously.

With an array of thoughtfully selected products and services that employees can purchase on a voluntary basis, employers can fill in the gaps of traditional employee benefits and allow employees to customize their selections. These "life style bundles" can be selected through an innovative online store front private market place. With new and imaginative products and services becoming available every day, employers and employees alike have a wide variety of choices. A few of the new ideas listed below will give you a taste of what imaginative employers are doing to attract, retain and engage their employees through their employee benefits programs.

**Telemedicine** – a solution growing in popularity that delivers on-demand healthcare anytime and anywhere via mobile devices, the internet, video, and phone. It connects employees with a national network of board-certified physicians that treats a wide range of conditions.

**Legal Services** – provides access to attorneys for legal document creation, advice and other services.

**Care Services** – these solutions can provide a network of caregivers and businesses specializing in child and senior care, pet care, housekeeping and tutoring. Employees gain peace of mind knowing that there are services that provide access to high quality caregivers through its service, including complete background checks if necessary.

**Loan Services** - socially responsible financing solutions for employees offered as a voluntary benefit program at no cost or risk to the employer. As an alternative to 401k loans, these services are a financial wellness tool that can be used by employees to pay down high interest debt, for out-of-pocket medical expenses, personal emergencies or other times of economic hardship.

**ID Theft Protection** –ID theft protection and credit monitoring services.

**Retirement Account Management** – automates the management of your 401(k), 403(b) and other accounts, makes recommendations, places the trades for the employee and rebalances the account.

**Concierge Services** - on-demand concierge service that helps employees navigate the health care system or answer any benefit related questions.

**Fitness Rewards Programs** – provides for the purchase of fitness devices and integrates them with mobile apps and employer sponsored incentives to promote wellness and activity.

**Traditional Voluntary Programs** – commonly offered programs that provide cancer, accident, critical illness indemnity programs along with supplemental life insurance and disability insurance.

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