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Delaware Bankers Association
The Delaware Bankers Association
P.O. Box 781
Dover, DE 19903-0781
Phone: (302) 678-8600 Fax: (302) 678-5511
www.debankers.com

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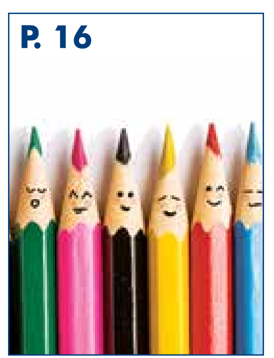

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View from the Chair

by
Cynthia D.M. Brown
President
Commonwealth Trust Company

Chair
Delaware Bankers Association

"I'd like to suggest a more managable list of resolutions for bankers."

Welcome to another year! By the time you read this the new year will be about a month old. Hopefully, by the time you read this, you'll have put away all the holiday decorations, paid off those end of the year bills, and will have finished your resolutions for 2019. Notice I said "finished." This could mean that you either tackled those good intentions and have emerged an even better version of yourself. Or, if you're like most of us, you've discarded those new years resolutions and decided to live with the incarnation of yourself that the rest of us all love and appreciate.

According to a recent survey from inc.com, the top ten resolutions for 2019 are:

1. Eat healthier
2. Exercise more
3. Lose weight
4. Save more and spend less
5. Learn a new skill or hobby
6. Quit smoking
7. Read more
8. Find another job
9. Drink less alcohol
10. Spend more time with friends and family.

That's a predictable list of laudable goals. Now that the personal goals are taken care of, I'd like to suggest a more manageable list of resolutions for bankers.

1. Improve your career skills. It's always a good time to hone your professional talents. Fortunately, the Delaware Bankers Association makes it easy to do. The DBA and the Delaware Financial Education Alliance provide career development opportunities. If you're looking for college-level instruction DBA members receive tuition discounts at Wilmington University. Want more bank-specific solutions? The American Bankers Association offers a full range of online training programs including instructor-led and self-paced courses. Visit debankers.com/education for information on Wilmington University and ABA courses. The DBA also offers local-based education including: The Delaware Trust Conference; Regulatory Compliance School; and Foundations of Delaware Trusts.

2. Strengthen Business Relationships. The DBA makes it easy to strengthen existing professional relationships and develop new ones. DBA committees are a great way to connect with other professionals in the banking industry. These include committees for: Government Affairs; Strengthening Communities (for community reinvestment and development professionals); CyberSecurity; Regulatory Compliance; Trust; and, Women Connect.

3. Volunteer More. It's great to strengthen your networking skills, but it's also important to give back to the community. And by now, I'm sure you won't be surprised that the DBA provides those opportunities too. The most prominent volunteer event is our annual Teach Children to Save Day. For more than 20 years banker volunteers have been visiting elementary schools throughout the state teaching kids about the importance of saving for building a strong and financially independent future. Last year more than 200 bankers visited over 65 public, private, and parochial schools and taught an estimated 7,200 students. Delaware's banks can boast one of the strongest participation rates nationwide, but that doesn't mean that there isn't room for a few more volunteers.

Now, aren't those three resolutions a lot better than going to the gym five days a week, or eating more kale? And they will go a long way towards improving your career, your bank, and your community.

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Charles J. Durante
302-888-6280
cdurante@connollygallagher.com

Trisha W. Hall
302-888-6421
thall@connollygallagher.com

Daniel R. Stanek
302-884-6591
dstanek@connollygallagher.com

Scott E. Swenson
302-252-4233
sswenson@connollygallagher.com

Gregory J. Weinig
302-888-6411
gweinig@connollygallagher.com

Wilmington
The Brandywine Building
1000 West Street, Suite 1400
Wilmington, DE 19801

Newark
267 East Main Street
Newark, DE 19711

www.connollygallagher.com

President's Report

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

"Delaware banks support hundreds of organizations throughout the State through grants and volunteer hours."

When was the last time you experienced something new? Sometimes experiencing something new means learning a new skill, sometimes it involves shaking things up, and sometimes it means 'putting yourself out there' to move the community forward. Although it can be daunting to try something new, doing something out of the ordinary can be really good for us personally, for the communities in which we live and work, and the businesses that sustain them.

As we look ahead in 2019, Delaware Bankers will celebrate the 21st year of Teach Children to Save the week of April 8th. If you've never read to a class of 3rd or 4th graders, it can be a little scary to think about the prospect. I can assure you though, the butterflies go away when you are met with the smiling faces of eight to nine-year olds. Since the program's inception literally hundreds of thousands of children in public, private, and parochial schools throughout the State have been taught a saving lesson through Teach Children to Save. This year's book is currently being written and illustrated by Greg Koseluk. Tentatively titled: *The Great Investo and Muscles O'Money*, the book will teach the concepts of setting goals, budgeting, and saving to build a strong financial future. I hope that you will volunteer to support this important work in our community.

Although hardly new, the 124th DBA Annual Meeting and Dinner will be held on May 16th. What will be new is our keynote speaker for the evening, **Jelena McWilliams, FDIC Chairman**. Jelena McWilliams is the 21st Chairman of the FDIC. She was nominated by President Donald J. Trump in November 2017 and newly confirmed by the Senate on 5/24/18, to serve a six-year term on the FDIC Board of Directors and designated as Chairman for a term of five years. "With a powerful personal story and real-world banking experience, Ms. McWilliams is shaking things up at the FDIC." – ABA Banking Journal. We're shaking it up a bit as well by awarding the first David G. Bakerian Memorial Scholarships to students enrolled in the Keys to Financial Success elective. The scholarships are judged and awarded based on personal essays on the importance of financial literacy education that each scholar submits.

And speaking of learning new skills, on June 1st, the first class of students will be graduating from the UD Trust Minor. The University of Delaware Minor in Trust Management is filling a critical need to educate and develop financial leaders for the Trust Industry. Not only is Delaware the only State to offer a Trust Minor, it is the only State to have accomplished this through a collaborative partnership which brought together industry leaders, the State of Delaware and UD!

We congratulate the inaugural class of the Trust Management Minor and wish them the best for success. We also thank the generous Founders and Sustaining Sponsors who made the Trust Management Minor a reality. CORPORATE FOUNDERS: Wilmington Trust, Bank of America, WSFS Wealth / Christiana Trust, Commonwealth Trust Company, U.S. Trust Company of Delaware, Gordon Fournaris & Mammarella, P.A., McCollom D'Emilio Smith Uebler LLC, Morris Nichols Arsht & Tunnell, LLP, Richards Layton & Finger, P.A., Young Conaway Stargatt & Taylor, LLP, Reliance Trust Company of Delaware, Brandywine Trust Company, LLC, The Bryn Mawr Trust Company of Delaware, TD Charitable Foundation, Wells Fargo & Company, and Gawthrop Greenwood, PC. INDIVIDUAL FOUNDERS: Anne Booth Brockett, David Diamond, Daniel Hayward, Elizabeth King and Lynn and Dave Watson. SUSTAINING SPONSORS: Brown Brothers Harriman Trust Company of Delaware and RBC Trust Delaware.

Wishing you the best for a New Year filled with new experiences!

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MARILYN & NATHAN HAYWARD, *founders of the 1916 Fund at the DCF, pictured at the Delaware Theatre Company with Executive Director Bud Martin*

TO LEARN MORE, PLEASE CONTACT: Joan Hoge-North • jhoge-north@delcf.org or **302.504.5224**

What's New at the DBA

New Associate Members

Delaware Community Foundation
Joan Hoge-North, Vice President for Philanthropy
phone: 302.504.5224
email: jhoge-north@delcf.org
website: www.delcf.org
The mission of the Delaware Community Foundation is to improve the lives of the people of Delaware by empowering and growing philanthropy through knowledge and relationships, now and in the future. As a facilitator, information resource and manager of charitable funds, the DCF helps communities and philanthropists focus charitable resources for the greatest community benefit statewide. We envision a Delaware where generosity expands opportunity for all and enhances the common good.

Sustainable World Strategies
Melanie George Smith, Founder and CEO
phone: 302.354.5283
email: Melanie@SustainableWorldStrategies.com
website: www.SustainableWorldStrategies.com
Sustainable World Strategies helps organizations grow and prosper responsibly and sustainably. Our services focus on sustainability (education and inspiration, developing a competitive advantage, risk evaluation and opportunities, strategy, reporting, supply chain compliance, among others) community relations, and business development. Our company's expansive network, deep relationships and unique experience innovating sustainability uniquely qualifies us to help Delaware-based organizations grow and thrive.

Women Connect!

More than 40 financial services professionals gathered November 8th and 9th for the third Women Connect event. The event kicked off the evening of November 8th with a reception at Agave followed by an engaging seminar on November 9th at Fish On! The seminar featured Jen Groover, entrepreneur and creator of the Butler Bag, the world's first compartmentalized handbag. The group also enjoyed an inspiring discussion with sculptor Kristen Visbal. Her most well-known work of public art is Fearless Girl, a 50" bronze figure installed in Manhattan's Financial District. Thank you to Silver Sponsor: Charles Schwab Trust Company of Delaware; and, Bronze Sponsors: The Bryn Mawr Trust Company of Delaware; and, County Bank. Pictured: the attendees join Kristen in striking their best fearless poses.

Compliance '18

Compliance professionals gathered for three days of the latest information and updates in the ever-changing regulatory compliance environment. Compliance '18 was held November 13th, 14th & 15th at Wilmington University, New Castle. Sessions and topics included: Fair lending, Deposit Compliance, UDAAP, BSA/AML, Financial Elder Abuse, and more! The faculty included experts from the American Bankers Association, CAPCO, Pepper Hamilton, LLP, and Wilmington University. Thank you to presenting sponsor: Pepper Hamilton, LLP.

FinTech Forum

Dominic Canuso, Chief Financial Officer, WSFS Bank and Jonathan Prendergast, Head of US Payments Strategy, TD Bank, presented "Emerging Technologies in Banking" at the FinTech Forum, held on December 11, 2018, at Arsht Hall. Doneene Damon, Executive Vice President, Richards Layton & Finger participated on the "Evolving Regulatory, Compliance and Legislative

Landscape" panel, and Jennifer McDermott, Executive Director, JP Morgan Chase, led an engaging discussion on the critical need to develop a technologist talent pipeline in the State. Over 150 people attended the Forum.

DBA Welcomes New Members of Delaware Legislature

The Delaware Bankers Association held a "Meet and Greet" for the new members of the Delaware Legislature, Thursday morning, January 3rd in the Senate Hearing Room of Legislative Hall in Dover. The freshman class of 2019 along with leadership from the House and Senate met with bankers to stress the importance of the financial services industry in the First State. Thank you to our supporting sponsors for the event: The Bryn Mawr Trust Company of Delaware; Capital One; County Bank; JPMorgan Chase; M&T Bank; MidCoast Community Bank; New York Private Trust; Wells Fargo; and, Wilmington Trust.

Foundations of Delaware Trusts

Trust professionals attended three new sessions of the Foundations of Delaware Trusts series, January 23rd, 30th, and February 6th at the University & Whist Club in Wilmington. The sessions included: Key Information in a Trust Agreement, with Cynthia D.M. Brown, President, Commonwealth Trust Co., and David Diamond, President, The Northern Trust Co. of Delaware; Silent Trusts, with Elizabeth King, President, Brown Brothers Harriman Trust Co. of DE, and Vincent Thomas, Partner, Young Conaway Stargatt & Taylor, LLP (pictured above); and, Investment Basics, with Margaret Creed, VP, Chief Portfolio Strategist, Wilmington Trust, and Gregory Wood, VP, The Northern Trust Co. of Delaware. The sessions, along with previous Foundations of Delaware Trusts sessions, are available on CD with PowerPoint slides and synchronized audio.

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PARTNER
(302) 351-9374 T
tflubacher@mnat.com

mnat.com

Cover Story

Call to Innovate

Is Your Bank Ready?

by
Mark T. Dabertin
Scott D. Samlin
Richard P. Eckman
Pepper Hamilton LLP

In October 2018 the FDIC became the latest federal financial regulator to announce plans to create an Office of Innovation, following on the heels of the OCC and the CFPB. In separate speeches given in Philadelphia and Washington D.C.,[1] FDIC Chairman Jelena McWilliams explained the rationale for this move. Although technological innovation has always been part of the business of banking, McWilliams noted in her November 13, 2018 speech that: "What is different today is the speed and tremendous impact of technological innovation in and on banking, and the potential for technology to disrupt not just an institution or two, but banking as we know it."

In her November 15th speech, McWilliams highlighted the strong benefits to the nation of a regulated banking industry, citing the importance of having a safe place for consumers to deposit cash and access credit, and noting the "central role" of banks in the payments systems. According to McWilliams, however, banks are at risk of being permanently dislodged as the primary source of key banking products and services. Accordingly, banks have no choice but to look for opportunities to innovate. At the same time, however, there has been no relaxation in safety and soundness standards. McWilliams acknowledged the tension between the need for banks to explore unconventional ways of doing things and regulator caution, noting that "we are looking at ways that the FDIC as a regulator can avoid getting in the way of beneficial innovations and technologies that will help regulated entities stay competitive." In this article, we explore how federal financial regulators are seeking to facilitate innovation through recently-issued formal guidance regarding "responsible innovation."

OCC Guidance

The OCC received enormous media attention in 2017 when it proposed the creation of a special purpose "fintech" national charter. Less noticed, but arguably just as important to the financial services industry, the OCC issued key guidance during 2017 targeting financial innovation.

Risk Management of New, Expanded, and Modified Bank Products and Services

In October 2017, the OCC rescinded longstanding OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services: Risk Management Process," and replaced it with Bulletin 2017-43 of the same name. In making this change, the OCC noted that:

> Today's technological advances include expanded use of artificial intelligence, machine learning, algorithms, and cloud data storage. These changes—in combination with rapidly evolving consumer preferences—are reshaping the financial services industry at an unprecedented rate and are creating new opportunities to provide consumers, businesses, and communities with more access to and options for products and services.[2]

Despite its ostensible emphasis on all things new, Bulletin 2017-43 primarily reinforces longstanding risk management concepts, including the need for a high level of knowledge by bank management and the board of directors. Within these themes, the Bulletin stresses the need for management to understand the underlying technologies that fintech companies employ together with the associated impacts on risk processes and controls. In particular, a bank's change management processes with respect to new technologies are expected to address:

- Reviews by appropriate risk management, line managers, and senior managers in applicable business units (such as lending, finance, treasury, deposits, payments, compliance, audit, legal, technology, and information security) before implementing the new or modified operational process.
- Proper testing of new or modified operational systems, processes, and technology.
- Risk parameters and exception reporting that have been approved by appropriate management.
- Mechanisms for ensuring that delivery to customers occurs as intended.
- An exit strategy that identifies and limits the adverse effect to the bank and its customers in the event of a failed or flawed implementation.
- Employee training in the new or modified operational process associated with the new activities.[3]

Bulletin 2017-43 additionally places a strong emphasis on third-party oversight. Banks are advised to include fintech companies in their third-party risk management processes and determine if the fintech companies' activities meet the definition of critical activities. As banks look to enter into arrangements with fintech companies, third-party due diligence and ongoing monitoring should be deemed essential, and plans should be made to address all life-cycle stages described in OCC Bulletin 2013-29.

In sum, nothing contained in Bulletin 2017-43 attempts to dictate to a national bank what it can and cannot do. Rather, the bulletin stresses the need for careful planning, input from all relevant stakeholders, ongoing monitoring of actual against

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forecast results , periodic reassessment, and the ability to cease new activities, once begun, and change direction if necessary to protect the interests of the bank and its customers.

Expanded Risk Management Guidance for Third-Party Oversight

In addition to replacing OCC Bulletin 2004-20 with Bulletin 2017-43, the OCC expanded its existing risk management guidance for third-party oversight by issuing OCC Bulletin 2017-21, "Frequently Asked Questions to Supplement OCC Bulletin 2013-29." Bulletin 2017-21 further clarifies the OCC's supervisory expectations for third-party oversight by publishing 14 frequently asked questions ("FAQs"), a number of which specifically address relationships between banks and fintech companies:

FAQ 7: Is a fintech company arrangement considered a critical activity?

In its response to FAQ 7, the OCC clarified that a relationship between a national bank and a fintech may or may not involve a "critical activity," depending on the nature of the specific services the bank or the fintech has agreed to perform. A critical activity is defined in Bulletin 2013-29 as an activity that:

- could cause the bank to face significant risk if a third party fails to meet expectations;
- could have significant bank customer impact;
- requires significant investment in resources to implement third-party relationships and manage risks; or
- could have major impact on bank operations if the bank has to find an alternative third party of if the outsourced activities have to be brought in house.

By recognizing that a third-party relationship is not automatically "high risk" because a fintech is involved, the OCC's response implicitly encourages such relationships. In addition, by providing an affirmative response to closely-related FAQ 8, (i.e. "Can a bank engage in a start-up fintech company with limited financial information?"), the OCC further encourages a national bank not to shirk from entering into relationships with a fintech companies that do not have optimal financial depth so long as they are stable.

FAQ 9: How can a bank offer products or services to underbanked or underserved segments of the population through a third-party relationship with a fintech company?

In its response to FAQ 9, the OCC highlights the many ways that banks and fintechs may be able to collaborate, noting that "[b] anks may partner with fintech companies to offer savings, credit, financial planning, or payments in an effort to increase consumer access," and noting that banks and fintechs often offer products that are complimentary to one another.

FAQ 10: What should a bank consider when entering a marketplace lending arrangement with nonbank entities?

Consistent with its response to FAQ 7, the OCC's response to FAQ 10 states that the "bank's board and management should understand the relationship . . . [and] ensure that appropriate personnel, processes, and systems [are in place to] effectively monitor and control the risks inherent within the marketplace lending relationship." With respect to credit risk, the response provides that "banks should have adequate loan underwriting guidelines, and management should ensure that loans are underwritten to these guidelines." Although some fintech lenders were initially optimistic that the OCC's response to FAQ 10 signaled a favorable posture toward "bank sponsor" lending relationships,[4] this optimism dissipated when the OCC issued Bulletin 2018-14[5] which clarified that it "views unfavorably a [non-bank] entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)."[6]

FAQ 11: Does OCC Bulletin 2013-29 apply when a bank engages a third party to provide bank customers the ability to make mobile payments using their bank accounts, including debit and credit cards?

The affirmative answer given by the OCC to this question highlights the need for banks to have a strong understanding of all payment technologies that they allow their customers to access. When they first gained popularity, it was possible for a national bank to assume that a third party-enabled mobile card payment device was not subject to OCC Bulletin 2013-29. To this end, the presence of a third-party mobile payment application has no effect on the underlying card transaction. In its response to FAQ 11, however, the OCC clarified that relationships with mobile payments providers must be managed in a manner consistent with OCC Bulletin 2013-29, and directed banks to work with such providers to establish processes for authenticating the enrollment of customers' account information.

OCC Fintech Charter

On July 31, 2018, the OCC announced that it had started accepting applications for special purpose national bank charters from qualified fintech companies engaged in the non- depository business of banking. At this early juncture, it is not surprising that no applicants have been approved. Given the demands placed on applicants, which are not materially different from those placed on applicants for a depository charter, we anticipate a low volume of applicants. In this regard, the current OCC leadership appears to be more interested in having fintech lenders explore the possibility of becoming a national bank in their own right versus entering into bank sponsor" lending relationships. Clearly here are many other ways for national banks and fintechs to partner beyond lending, including by having the bank serve as a source of funding to the fintech, or by having the bank license underwriting methodologies developed by the fintech.

The FDIC generally issues a lower volume of risk management guidance than the OCC, and that is true of guidance relating to innovation. In this regard, on June 7, 2017, the FDIC issued FIL 22-2017, which applies model risk management guidance that was previously published by the OCC and the FRB to FDIC-regulated institutions with assets of $1 billion or more. Although this guidance is not specifically targeted to relationships with

fintech companies, it serves to foster bank innovation by providing clear expectations regarding the use of models, which are often a key component of innovative financial products and services.

An extremely important area for both banks and non-bank fintech lenders for which the FDIC has yet to provide definitive guidance is bank sponsor lending. Nearly all such relationships currently in existence involve an FDIC-regulated institution. Thus, it is natural that the financial services industry would look to the FDIC to provide direction and leadership. To this end, on July 29, 2016, the FDIC published "Draft Third-Party Lending Guidance" for public comment. This draft guidance appears to endorse bank sponsor lending so long as the expectations of the FDIC's outsourcing bulletin (FIL-44-2008) are met. However, aside from still being in proposed status two and one-half years after it was published, the guidance is intentionally vague regarding the applicability of federal preemption, which greatly diminishes its usefulness.[7]

CFPB Guidance

On July 18, 2018, the CFPB appointed Paul Watkins to lead the Bureau's new Office of Innovation. Although the CFPB regulates banks with assets of $10 billion or more, the CFPB cannot be characterized as a "bank regulator," and does not issue risk management guidance similar to that issued by the OCC and FDIC. Briefly, the CFPB plays a different role in fostering innovation in the financial services industry. For example, on September 14, 2017, the CFPB issued its first-ever no-action letter to Upstart, a company that uses non-traditional or alternative data and modeling techniques in lending decision-making, thereby allowing persons with limited credit history to obtain credit or obtain credit on better terms. Under the terms of its no-action letter, the CFPB committed that it has no present intent to pursue supervisory or enforcement action against Upstart with respect to the Equal Credit Opportunity Act. A key idea behind the CFPB's Office of Innovation is to allow companies "to advance new products and services without being unduly restricted by red tape that belongs in the 20th century."[8] We expect no action letters to emerge as an important component of that strategy now that the uncertainty over the leadership of the CFPB has been resolved.

Conclusion

In reviewing guidance published by the federal financial agencies, we advise that jurisdictional lines between agencies be set aside. The OCC has historically taken the lead in issuing risk management guidance and its positions on such matters have broad influence, not just in the U.S., but globally. Nothing in the guidance reviewed in this article or in other guidance that we are aware of sets a requirement or supervisory expectation that a bank pursue technological innovation. Business competition, and risks to continued survival, provides incentive enough to continuously strive to do things faster, better, and more efficiently.

(continued on p. 14)

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Recent federal agency guidance is remarkable with respect to the urgency with which banks are being encouraged to innovate. However, this clarion call to innovate is tempered by the continued need to adhere to safety and soundness requirements that greatly exceed those of non-bank competitors. In addition, there is the ever-present risk that business decisions that seem wise in today's environment could become fodder for examiner criticism in the next financial downturn. The available guidance is helpful in three primary ways. First, it provides a roadmap for preparedness—if an opportunity to innovate presents itself, a bank that has implemented the recommended actions will be poised to take advantage. Second, if the business results prove disappointing despite best efforts, management will have the means for determining what went wrong and making necessary adjustments. Third, as a general rule, regulators single-out for criticism decisions that were poorly made (i.e., made in the absence of complete information, adequate planning, proper due diligence, etc.) or poorly documented. The strong message federal regulators are sending in their recent guidance and public statements is risk taking by banks related to innovation is welcome; albeit, strict measures must be taken to ensure that all risk taking is done prudently.

Mark T. Dabertin is special counsel in the Financial Services Practice Group of Pepper Hamilton LLP, resident in the Berwyn office. Mr. Dabertin has over 25 years of broad-based experience in financial services law and regulatory compliance. Mr. Dabertin's career includes extensive experience in banking, lending, safety and soundness, and anti-money laundering. His work in regulatory compliance at large financial institutions has been marked by innovations that resulted in fundamental structural changes to existing firm-wide compliance activities, including with respect to regulatory change management, risk assessments, and vendor management.

Scott D. Samlin is a partner in the Financial Services Practice Group and leader of the Consumer Financial Services and Bank Regulatory Practice of Pepper Hamilton LLP, resident in New York. Mr. Samlin's practice focuses on representing financial institutions, corporations and other entities in mortgage banking and consumer financial services issues. He regularly counsels clients on compliance with state and federal laws affecting

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mortgage lending and servicing activities, including the Real Estate Settlement Procedures Act (RESPA), Truth in Lending Act (TILA), Equal Credit Opportunity Act (ECOA) and Fair Debt Collection Practices Act (FDCPA). Mr. Samlin is experienced in myriad consumer lending, servicing and mortgage compliance challenges.

Richard P. Eckman is of counsel in the Wilmington office of Pepper Hamilton LLP. He is a finance and transactional lawyer and from 2003 to 2015 was chairman of the firm's Financial Services Practice Group, which includes over 40 lawyers practicing in the areas of investment management, commercial and consumer financial services, public finance and affordable housing. Mr. Eckman's transactional practice focuses on representing financial institutions, corporations and other entities in complex financing transactions, including mergers and acquisitions, asset securitizations and other lending and venture transactions.

Notes

1- https://www.fdic.gov/news/news/speeches/spnov1318.html; https://www.fdic.gov/news/news/speeches/spnov1518.html.

2-https://www.occ.gov/news-issuances/bulletins/2017/bulletin-2017-43.html, page 2.

3- *Id.* at page 5.

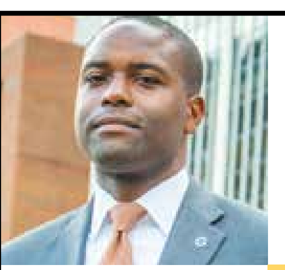
4- This term is commonly used to refer to relationships between banks and non-bank fintech lenders under which the fintech lender markets and services loans that are originated by a bank pursuant to a comprehensive loan program agreement between those parties.

5-"Core Lending Principles for Short-Term, Small-Dollar Installment Lending," May 23, 2018

6- *Id.*, page 1.

7- https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf, page 2, footnote 3.

8-https://www.consumerfinance.gov/about-us/newsroom/bureau-consumer-financial-protection-announces-director-office-innovation/



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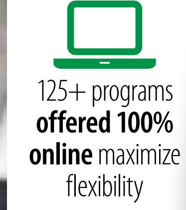

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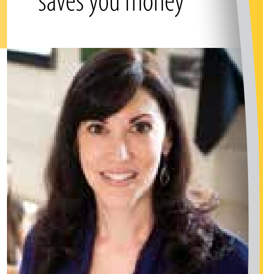

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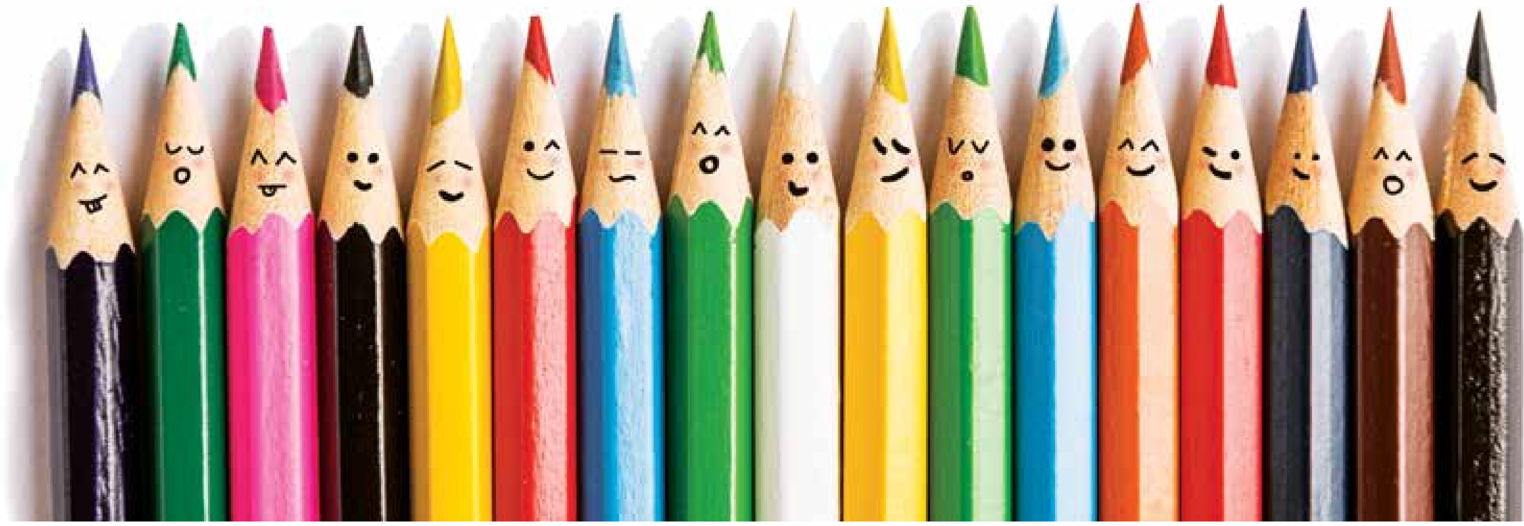
Our Diversity and Inclusion (D&I) Journey



by
by Sharifa Anderson,
Director – Office of Diversity & Inclusion
FHLBank Pittsburgh

Diversity – noun: 1. the state or fact of being diverse; difference; unlikeness; 2. variety; multiformity

Inclusion – noun: 1. the act or state of including or of being included within a group or structure; 2. a person or thing that is included within a larger group or structure

Our Definition

Definitions and interpretations of what is meant and/or what should be meant by "diversity" and "inclusion" are plentiful. From the academic to the practical and from the biological to the cultural, these words represent different things to different people.

We like to think of diversity - when boiled down to its most basic premise - as an invitation to the party. Inclusion is being asked to dance. This analogy is without question oversimplified. But despite its simplicity, the sentiment captures the spirit of our D&I work.

At FHLBank Pittsburgh ("Bank"), embracing diversity and inclusion is a strategic business imperative. We strive to invite as many people to the party as possible. We are taking a systemic approach to embracing all dimensions of diversity, including, but not limited to, race, religion, gender, sexual orientation, age, socio-economic status and physical disability.

We deeply understand that the invitation to join is not enough. We have a responsibility to ensure that everyone who accepts our invitation is asked to dance and feels comfortable on the dance floor.

The Foundation of a D&I Strategy

As we evolve in our journey to improve representation and create an inclusive culture, we've learned that our approach has to incorporate some foundational elements:

- Executive Leadership – the "tone at the top" sets the standard for the entire organization

- Employee Engagement – through surveys, focus groups, employee resource groups and performance management practices, a conversation regarding values, perspectives and experiences is ongoing
- Strategic Partnerships – building relationships with diverse business partners and suppliers strengthens our broader community, as well as our Bank
- Education – training is provided at all levels of the organization – Board, executive leadership, Bank management and front-line employees – on a variety of D&I matters
- Performance Measurement – both quantitative and qualitative metrics guide decision-making and influence the continuous evolution of our D&I efforts

Countless pages could be written on each of these topics, but we have found executive leadership and employee engagement to be critical aspects of our work. The two are fundamentally linked. These are the twin pillars that support and drive every aspect of our D&I strategic plan, which is designed to cultivate a diverse workforce, foster an inclusive workplace and build relationships with diverse business partners and suppliers in the broader marketplace.

We value our strategic partnerships outside the Bank because they challenge us to do more and think differently, but we understand that those relationships have little value without commitment from within. We know that education is essential to identifying and managing bias. We firmly believe that performance measurement gives us the information we need to take our work to the next level and refine our approach.

All of the elements that we've identified are essential for continuous improvement.

Executive Leadership and Employee Engagement

The tone set at the highest levels of the Bank and employee engagement are critical to our D&I work. Without a vision from the top and an engaged workforce to execute the strategy, external partnership is not positioned to be effective. Educational and training activities can easily become exercises in checking boxes, and performance measurement doesn't lead to aspirational dialogue.

In early 2017, our leadership team established the Office of Diversity and Inclusion, and shortly thereafter, the Bank adopted its first D&I strategic plan to guide its work. Execution and ownership of diversity and inclusion is shared across the Bank. Our Board and executive leadership team are committed to embedding the principles of diversity and inclusion in all of our business activities. Our Office of Diversity and Inclusion provides strategic direction and oversight. At the same time, all of our employees have a responsibility to ensure that our culture is supportive for everyone.

The business case for our D&I efforts, as well as our progress and challenges, is regularly communicated by leadership to our employees. As our D&I work evolves, we strive to keep both the business and human outcomes in balance. We know from our own experience and from extensive research in the marketplace that high performance is more likely to be achieved when the teams involved in decision-making are diverse. Different backgrounds

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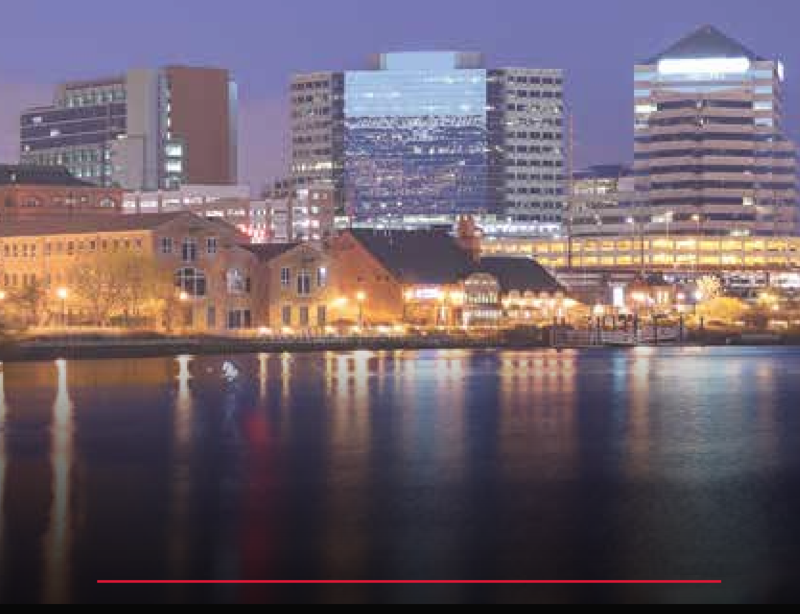

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and experiences yield a variety of ideas and challenges to ideas, both of which are necessary for high performance.

We realize it is not enough to employ a workforce of individuals with diverse backgrounds and views. It is inclusion that drives engagement. The true value of diversity lies in our ability to unite and focus the wide spectrum of skills and experiences our employees bring toward a common purpose and a singular mission. The intersection of diversity and inclusion strengthens our business by empowering us to engage more meaningfully with one another and to strive continually toward new levels of excellence.

Feedback and Evaluation

After an early assessment of our work environment, we made the decision to create employee resource groups to give our employees an opportunity to lead and help drive change. We regularly invite feedback through a variety of tools, including focus groups and surveys. Because our work will not be complete until our employees experience a true sense of belonging in an environment where they feel valued and respected, we take feedback seriously and look for opportunities to respond and refine our work when appropriate.

Moving forward, we will continue to focus on the tone from the top of our organization, as we know the vision and expectations communicated by our executives are essential to driving engagement – and ultimately creating a workplace where everyone is asked to the party and can enjoy the dance. We'll continue to look to establish strategic partnerships that challenge us, to provide learning opportunities that enable us to grow individually and collectively as a Bank, and to measure our performance as a means of ensuring that our work is impactful.

We look forward to continuing to share our journey with you.

Sharifa Anderson joined FHLBank Pittsburgh in November 2014 and currently serves as the Director of the Office of Diversity and Inclusion. Previously, she served as an attorney in the Bank's Legal Department. Prior to joining the Bank, Ms. Anderson held legal roles in the areas of fair lending compliance and affordable housing finance at the law firms of Relman, Dane and Colfax and Ballard Spahr and in the Office of General Counsel at the U.S. Department of Housing and Urban Development. Her background also includes work at Fannie Mae in the areas of housing and community development policy and strategy. Ms. Anderson holds a JD from the University of Pennsylvania Law School, an MPP from the Harvard Kennedy School and a BA in Economics from Hood College.

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STUB Trusts Are the Ticket to Increasing Basis

by
By Peter Desmond Hopkins, CPA, MS
Cover & Rossiter

With the passage of the law commonly called the Tax Cuts and Jobs Act (TCJA) in December 2017, Delaware bankers have noticed a change in the estate planning landscape. Many of their clients have suddenly become less concerned with getting assets out of their estates and more concerned with income tax basis. The TCJA doubled the applicable exclusion, below which no estate or gift tax is payable. After the 2019 inflation adjustment, clients can now pass $11.4 million to their loved ones free of transfer taxes. With proper planning, a married couple can fully utilize both exclusions, resulting in a $22.8 million tax-free wealth transfer.

The TCJA creates a planning opportunity for clients who had already used most or all of their applicable exclusions. Further lifetime gifting will make sense for many, but the answer will not be the same for everyone. One strategy to consider is creating a Step-Up in Basis (STUB) trust, also known as a Section 1014 trust.

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For Whom Might a STUB Trust Make Sense?

Clients with low-basis, high-value assets may be more concerned with future capital gains taxes than they are about estate taxes. These assets might be publicly traded stocks or interests in closely held businesses. Clients who might sell these assets before death are candidates for STUB trust planning.

An older individual expected to die with an estate well below the applicable exclusion is an integral part of the plan. This is often the client's parent, grandparent, aunt or uncle. The person may even be an in-law of or unrelated to the client. For simplicity, we will refer to this older individual as Grandparent for the remainder of this article.

How a STUB Trust Works

STUB trusts are like snowflakes in that no two are alike. The objective is for the assets of the STUB trust to be included in Grandparent's estate, which results in the basis of the assets being reset to fair market value on Grandparent's date of death with no estate tax due.

Several techniques can accomplish the goal. One option favored by many is for the STUB trust's governing instrument to grant Grandparent a testamentary power to appoint the trust's assets to the creditors of his or her estate. Despite the narrow scope of this power and Grandparent's inability to see the results of exercising it while alive, it is a general power of appointment and causes the STUB trust's assets to be included in Grandparent's estate. Grandparent likely would not exercise such a power, and the power does not allow Grandparent to alter the client's wishes for the ultimate disposition of the trust's assets in a meaningful way.

A STUB trust typically provides for discretionary distributions of income and that the trustee may make principal distributions based on an ascertainable standard. Grandparent and the client's descendants are usually named as beneficiaries, but it is not expected that anything will be distributed to Grandparent. While Grandparent is still alive, trust assets can be accessed to pay for descendants' expenses.

The client's spouse may also be named as a beneficiary of the STUB trust. If the client and his or her spouse each create a STUB trust, these trusts can effectively function as paired spousal lifetime access trusts (SLATs). If this strategy is pursued, the usual precautions applicable to SLATs, notably that they not have identical provisions, must be observed.

When Grandparent dies, the trust may terminate and distribute its assets to the client's descendants. Since the basis will have been adjusted to the fair market value on Grandparent's date of death, a sale would likely result in little gain or loss.

Alternatively, the trust could continue after Grandparent's death. This may be an attractive choice, if the client's descendants are young. If it meets the client's planning objectives, the STUB trust could even morph into a dynasty trust, since it will be exempt from generation-skipping transfer tax. The STUB trust could sell any of its assets after Grandparent's death with negligible tax consequences. This provides an excellent opportunity to rebalance the trust's portfolio.

If the client's spouse is a named beneficiary, and the STUB trust is intended to serve as a SLAT, the trust will ordinarily continue at least until the spouse's death. The spouse will have access to discretionary distributions, if the assets are needed. Further, since the descendants are permissible distributees, the trust can pay for descendants' expenses the client would otherwise have paid from personal funds. This includes items that may have been taxable gifts had the client paid them directly.

For unmarried clients who want the option to regain control over the assets, Grandparent's power of appointment may also allow the trust's assets to be appointed back to the client. This can be very effective, if the client does not expect to have a taxable estate. Provided Grandparent cooperates by changing his or her will, this decision can be revised as often as desired until Grandparent dies or becomes incompetent.

There is risk that, if not enough time passes between the gift to the STUB trust and Grandparent's exercise of the power of appointment in favor of the client, the IRS might collapse the arrangement and disallow the step-up in basis. Therefore, Grandparent should not document the exercise of such a power in his or her will immediately after the trust is created. Further, no step-up in basis is available for any assets returned to the client within one year of gifting them to the STUB trust.

A client who wants to regain the ability to access the assets after Grandparent's death but expects to have a taxable estate can grant Grandparent a power to appoint the assets to a trust for the client's benefit, the terms of which can be described in the STUB trust's governing instrument.

Although many clients might find it preferable, a STUB trust with the client named as the residuary beneficiary will not work. This would create a reversionary interest and make the client's transfer to the trust an incomplete gift, resulting in no step-up in basis.

Managing the STUB Trust

Many clients may consider naming a spouse or a sibling to act as trustee. Although they would serve without demanding a fee, the benefits of using a professional trustee are many. A high quality professional trustee offers competence, experience, attentiveness and objectivity, making the professional trustee more capable of managing investments, keeping records, accounting to beneficiaries, communicating with tax and legal professionals, and resolving disputes. A corporate trustee also offers longevity and certainty of situs in a chosen jurisdiction.

While it is often comforting to a settlor to name a spouse and a trust company as co-trustees, care should be taken to consider the state tax consequences. The spouse's residence in a state could cause the STUB trust to become taxable in that state. This would be the case in California and Virginia, to name two. If the spouse moves, this could create a new state income tax problem for the trust.

Delaware is an excellent choice for the situs of a STUB trust. It offers flexible laws and access to the highly respected Court of Chancery for dispute resolution. Depending on where the client and trust beneficiaries live, choosing a Delaware trust company as trustee could result in the trust paying no state income tax, even in the client's home state.

Risks Associated with STUB Trusts

The TCJA provision doubling the applicable exclusion is scheduled to sunset after 2025. No one knows whether Congress will extend it, make it permanent or allow it to expire. The conservative approach is to choose an individual as Grandparent who is not expected to have an estate in excess of the applicable exclusion, even if doubling the exclusion sunsets. An incorrect assumption that Grandparent will die before 2026, could lead to joy that a loved one is still with us and distress that there is a tax cost associated with that.

The sunset of doubling the applicable exclusion may also affect whether the STUB trust's assets should be appointed back to the client. Since the client will use some of his or her applicable exclusion on the gift to the STUB trust, there may be none available to shelter the assets he or she receives, after Grandparent dies. If Grandparent has already appointed the trust's assets to the client in his or her will and has become incompetent, it may not be possible to change the will, and the client could end up with an estate tax, even though the estate would have been less than the applicable exclusion had there been no STUB trust.

For this reason, it is often preferable for Grandparent to appoint the assets to a trust for the client's benefit rather than directly to the client. If it becomes clear after Grandparent's death that the client's estate will not owe any tax, a provision in the governing instrument allowing a non-adverse trustee to terminate the trust can be invoked. This could create another step-up in basis on the assets at the client's death, if he or she still holds them.

The client may be concerned about the consequences of the relationship with Grandparent souring. If Grandparent dies with large debts, for instance, from a judgement related to an environmental matter, he or she could unexpectedly appoint the assets of the trust to his or her estate's creditors with the intention of spoiling the client's plans for their disposition. To avoid this, the power to do so can be made exercisable only with the consent of a non-adverse party, such as a Delaware trust company. As long as the party whose consent is required has no interest in the trust, Grandparent's power of appointment will remain a general power and cause the assets to be included in his or her estate.

Action plan

Delaware bankers should evaluate which of their clients might benefit from creating a STUB trust. At the next meeting with a candidate client, the banker can explore the possibility of creating basis without paying estate tax. The banker can gauge the client's interest and discover whether anyone fits the Grandparent profile.

If the client is interested in a STUB trust, the banker can set the planning process in motion with the client's tax and legal

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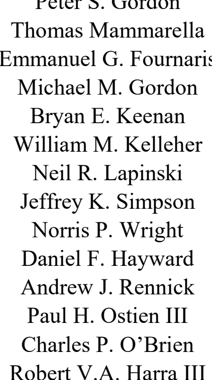
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advisers or recommend competent professionals, if the client has no advisers. Since the STUB trust can take many forms, detailed discussions with the client will be needed to help him or her understand the options and choose the right provisions to include in the governing instrument.

Once the plan is fully developed, the STUB trust should be funded with high-value, low basis assets. The trust will need its own tax ID number and be required to file an income tax return. The client will need to file a gift tax return. If it is intended that Grandparent will exercise the power of appointment, care must be taken to ensure this is done at the correct time. Clients who have a Delaware banker on their team will find management of the STUB trust relatively painless.

Conclusion

Every Delaware banker likely has clients who can benefit from creating a STUB trust. Bringing this planning option to a client's attention adds value to the other services a banker provides. While the design of STUB trusts can be flexible enough to suit the varying needs of many clients, there are also very expensive pitfalls looming, and it is important to involve competent tax and legal advisers in the planning process.

Peter Hopkins is a Tax Manager at Cover & Rossiter. Cover & Rossiter is one of the first and most respected full-service CPA & advisory firms in Delaware, providing tax, audit, trust, and accounting services to individuals and families, businesses, nonprofits, and captive insurance companies. The firm was recently honored with the 2018 Marvin S. Gilman Superstars in Business Award by the Delaware State Chamber of Commerce.

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by
Louis D. Memmolo, GBA, CHRS
Employee Benefits Advisor
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"...It's a good idea to review mandatory notices with your employee benefits professional to ensure full compliance..."

2019 Compliance Deadlines, Mandatory Notices and Training

The new year brings many state and federal requirements for employers and their group benefits programs. We've outlined a few of these in this article.

New Sexual Harassment Training Requirements

On January 1, 2019 the new Delaware Discrimination in Employment Act (DDEA) became effective. The new Delaware law specifically addresses the prohibition against sexual harassment, sets an affirmative defense for employers, imposes mandatory notice distribution on employers with at least four employees within the state, and provides anti-sexual harassment training requirements for employers with at least 50 employees in the state.

Managers and Supervisors should participate in required interactive training to ensure they understand the new regulations, their responsibilities regarding prevention and correction of sexual harassment, legal prohibition against retaliation and their company compliance with the new regulations.

Affordable Care Act Reporting Deadlines and Extensions

Affordable Care Act (ACA) reporting under Section 6055 and Section 6056 for the 2018 calendar year is due in early 2019.

- The deadline for filing returns with the IRS for 2018 is Feb. 28, 2019, if filing on paper, or April 1, 2019, if filing electronically.

- The deadline for furnishing individual statements for 2018 was extended to March 4, 2019.

Health Plan Compliance Deadlines

Group health plan sponsors that provide prescription drug coverage to ***Medicare Part D***-eligible individuals must disclose to the Centers for Medicare & Medicaid Services (CMS) whether prescription drug coverage is creditable or non-creditable.

Plan sponsors must make the disclosure annually and at other select times, using CMS' online disclosure form. Plan sponsors must submit the annual disclosure to CMS within **60 days** after the beginning of the plan year. For calendar year plans, the deadline is March 1, 2019.

Employers with self-insured health plans must pay an annual fee to fund the ***Patient Centered Outcomes Research Institute (PCORI)*** using IRS Form 720. This filing is due by the July 31 of the year that follows the last day of the plan year. The PCORI fees are temporary—the fees do not apply to plan years ending on or after Oct. 1, 2019.

Employers with ERISA-covered welfare benefit plans are required to file an annual ***Form 5500***, unless a reporting exemption applies. The Form 5500 must be filed by the last day of the seventh month following the end of the plan year, unless an extension applies.

In addition to these compliance items and deadlines, there are a host of ***mandatory notices*** the employers must provide to their employees including but not limited to: Summary of Benefits and Coverages, Women's Health and Cancer Rights Act Notice, Children's Health Insurance Program, Summary Plan Description, Summary of Material Modifications, COBRA notices. This list is *not all inclusive* as space is limited.

Many of these requirements are often missed and therefor generate fines as well as failed audits. It's a good idea to review these and other mandatory notices with your employee benefits professional to ensure full compliance, full disclosure for your employees and a good night's rest for you.

Compliance Focus

by
Leah Robinson
Consultant
Center of Regulatory Intelligence
CAPCO

"Recent developments have underscored the potential for legal and regulatory violations in the use of such platforms for marketing."

Will Regulators 'Like' Your Social Media Marketing?

Financial institutions have increased advertising and marketing through social media platforms for several years, as this can be a very cost-effective way to attract and retain younger customers. However, recent developments have underscored the potential for legal and regulatory violations in the use of such platforms for marketing.

Last August, the U.S. Department of Housing and Urban Development announced a complaint against a popular social media website. HUD asserted that the site allowed landlords and home sellers to engage in discriminatory marketing using the site's "targeted advertising" tools. These tools allow marketers to filter the audience for their advertising in a variety of ways. HUD claims that the site invited housing advertisers to target their ads according to categories such as race, sex, familial status, and national origin, which violates the Fair Housing Act.

HUD began investigating the website after an article in 2016 claimed it provided advertisers opportunities to exclude specific ethnic groups from receiving ads. HUD halted and then reopened its investigation in 2018 after fair housing groups filed lawsuits against the company, claiming ad placements discriminated against women, veterans with disabilities, and single mothers. HUD then determined that advertisers were using the website's tools to limit displays of housing ads according to sex; to not show ads to users categorized as interested in "child care" or "parenting," interested in particular places of worship, or interested in some countries; and to "redline" certain zip codes and not display ads to users living in those zip codes.

This complaint sent shock waves through the financial services industry. It followed closely an SEC complaint charging five parties with violations of the Testimonial Rule in their social media marketing practices. These actions indicate the importance of understanding the regulatory environment and careful planning and execution of any social media marketing strategy.

First, be sure you have read and understand existing guidance from the regulators. In addition to understanding the HUD complaint, these documents can help:

- FINRA Regulatory Notice 10-06 (Guidance on Blogs and Social Networking Web Sites); Communications Rule 2210-2216 (Communications With The Public); and Regulatory Notice 17-18 (Guidance on Social Networking Websites and Business Communications).
- SEC Division of Investment Management's Guidance on the Testimonial Rule and Social Media.
- FFIEC guidance released in 2013 outlining the applicability of consumer protection and compliance laws, regulations, and policies to social media activities.
- The Office of Compliance Inspections and Examinations (OCIE) Risk Alert published in September 2017 which discussed areas of concern in social media marketing.

Here are some additional tips for staying compliant in your social media marketing:

Marketing Filters. Be fully aware of marketing filters being used and their likely impact on certain customers

whether employed by your institution directly or by a third-party vendor as part of any social media advertising to ensure that the targeting or exclusion of certain segments of the population (e.g., based on age, gender, marital status, etc.) doesn't violate applicable law or regulatory guidance.

Required statements. Make sure your social media advertisements follow all guidelines for required statements, such as FDIC or NCUA membership.

Privacy and data security guidelines. Consider the Gramm-Leach-Bliley Act and other privacy regulations that may apply to how you protect customers that interact with or respond to social media advertisements. Also, be sure to have specific procedures to take down any information about users under age 13 (e.g., within a comment to a post).

Disclosures. Advertisers should place disclosures as close as possible to the triggering claim, and only use hyperlinks for disclosures in limited circumstances.

Endorsements. Be aware of guidelines for use of endorsements and testimonials, especially through blogs or social media influencers. This includes monitoring the truthfulness of and ability to substantiate any claims and disclose connections.

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Accounting for Success

by
George Fournaris, CPA, CGFM
Belfint Lyons & Shuman, P.A.

"A nontraditional engagement is any assurance service other than the preparation, compilation, review, or audit of financial statements."

Agreed-Upon Procedures and Other Nontraditional CPA Engagements

Most corporate, government, and nonprofit finance officers, executives, and board members are very familiar with the annual accounting or audit services they receive from their CPA firm (practitioner). However, management may at times have more specific needs that cannot be met by the traditional services they are receiving. In these cases, thinking outside of the box with a "nontraditional engagement" may be a valuable alternative. What is a "nontraditional engagement"? In general terms, a nontraditional engagement is any assurance service other than the preparation, compilation, review, or audit of financial statements. It's a side of accounting that offers creativity and flexibility. Nontraditional engagements include the following:

Agreed-upon Procedures (AUP) – An AUP engagement is one in which a practitioner is engaged by a client (and sometimes a third party) to report findings based on specific procedures on a subject matter mutually agreed upon by the client and practitioner.

Compliance Examinations – Many times businesses, government and nonprofit entities are required to comply with certain laws, regulations, and policies contained in contracts and grant agreements. The organization may engage the practitioner to 1) obtain reasonable assurance about whether it complied with the specified requirements, or 2) to express a written opinion about whether it complied with specified requirements.

Engagements Regarding Internal Controls over Compliance – Instead of reporting directly on compliance, an organization may engage their practitioner to report on the effectiveness of internal control over compliance. If deficiencies are found during the engagement, management may choose to implement remedies to correct the deficiencies before noncompliance occurs.

Forensic or Fraud Engagements – Fraud detection is not the primary objective of a financial statement audit. If an organization suspects that fraud has taken place, it may engage its practitioner to apply procedures specifically directed at establishing whether a fraud has occurred and, if so, its nature and extent.

•Risk Assessment Services – Risk assessment is not a guarantee for success, but it affords management better insight into warning signals that might otherwise be missed. Because of practitioners' experience in assessing financial statement risk, the design of internal controls, and business practices, they can provide valuable assistance to their clients by helping them to identify and monitor risks. Services that a practitioner might perform include the following: Helping identify and assess business risks.

- •Assessing risks that have already been identified by management.
- •Evaluating systems for monitoring and controlling risks.

Performance Measurement – Practitioners can identify relevant performance measures and establish systems for their capture and use them to track results and compare them to industry norms and best practices.

A few advantages of using nontraditional engagements are:

- •They are flexible and can be tailored to meet specific needs.
- •They are cost-effective.
- •They can be completed in a relatively short time period.
- •The organization is not limited to working with the same firm that performs its annual audit – for example, management may choose to engage a CPA who is also a Certified Fraud Examiner (CFE) if it suspects fraud.
- •The organization can use these engagements as support for a larger project such as the preparation of its annual budget or the close-out of a large contract.

If you have questions regarding nontraditional services or what nontraditional service may best serve you, don't hesitate to reach out to Belfint, Lyons & Shuman, CPAs.

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March 6th - 8th - DBA 2019 Washington Visit - This highly acclaimed event for top bank executives features meetings with key regulators, industry representatives at the American Bankers Association, and Delaware's entire Congressional delegation.

May 7th - DBA Women Connect - 8:30 a.m. - 4:00 p.m. - Deerfield Country Club, Newark. The next Women Connect event will focus on personal, community, family, and professional well-being. The morning will feature two panel discussions on Women Leadership and Education along with a keynote speaker during lunch. The afternoon sessions will feature speed sessions on Financial Fitness, Philanthropy, and Community. Confiremed speakers include: Robert Eaddy, Bryn Mawr Trust Company of Delaware; Trisha Hall, Connolly Gallagher LLP; Carla Lawson, Caesar Rodney High School; along with Amanda Bullough, Wendy Smith, and Carlos Asarta from the University of Delaware. Other speakers to be added. Sponsorships available.

April 8th - 12th - 2019 Teach Children to Save Week - Don't miss the 21st annual edition of Delaware's Teach Children to Save Week! Teaching is fun and easy. A full teaching kit and on-line video instruction is provided. Bankers can sign up by visiting debankers.com.

May 16th - 124th Annual DBA Meeting and Dinner - Join the DBA at the historic Hotel du Pont with dinner in the Gold Ballroom. Keynote speaker will be Jelena McWilliams, Chair of the Federal Deposit Insurance Corporation. Sponsorships are available.

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Lending Law Update

by
Eugene A. DiPrinzio
Young Conaway Stargatt & Taylor, LLP

"..all parties to a transaction must take reasonable precautions to prevent their computers from being hacked..."

Email Fraud and Contract Liability: An Interesting Dilemma

In a recent U.S. Sixth Circuit Court of Appeals decision (Beau Townsend Ford Lincoln, Inc. v. Don Hinds Ford, Inc., No. 17-4177, WL 6181643 (Ohio Ct. App. 11/27/18).), a three (3) judge panel ruled that a full fact finding trial was required for a court to determine whether a contract loss suffered through email fraud could be attributed to one party or another. The case involved the sale and purchase of excess car inventory (20 Ford Explorers) between two dealerships, the seller in Ohio and the buyer in Indiana. The two dealerships had historically made deals for transfers of vehicles and simply exchanged checks when effectuating their transactions. In this particular instance, a typical transaction turned ugly when a hacker intercepted a few email messages and was able to convert the transaction from a check exchange to a wire funds transfer. The hacker was successful in causing approximately $736,000.00 to be transferred to a domestic bank account which was subsequently closed and drained with the hacker vanishing into parts unknown.

Prior to the appeal, the District Court for the Southern District of Ohio entertained motions for summary judgment from both sides as to whether or not one party had been either negligent or innocent in the transaction. Because the buyer dealership received the vehicles but the seller dealership never received the cash, the District Court awarded judgment in favor of the seller dealership as the party who did not obtain the money. In the appellate proceeding, the Court analyzed the difficulties involving the fact pattern presented and concluded that it touched many different areas of law, including contract, Uniform Commercial Code, and agency law. In light of the many areas of law affected, it was difficult to reach a final decision on liability without determining the proper party to suffer the loss. Under the Uniform Commercial Code and various state statutes, the Court needed to determine whether the failure to exercise ordinary care contributed to the hacker's success. This analysis suggests that any court would have to apportion the recovery amount according to a party's comparative fault, similar to a negligence standard. The Court also reasoned that a final determination could turn on whether there was a mutual mistake of fact. The judicial panel determined, on the motions submitted, that both parties believed they were acting correctly and neither knew the other was mistaken. Lastly, the Court looked at agency law to provide a basis to determine if one party had justifiably relied upon a proper appearance of authority and had operated in good faith and had exercised reasonable care in the transaction. Given the complexity of the liability issue, the inability to apportion blame on the record presented, and the lack of case law, the Court concluded "to decide this case, the factfinder must determine which party was in the best position to prevent the fraud." To answer that question, an arbiter or judge needs to make findings of fact and therefore, a full trial must be held.

The scope of this article is not intended to predict how the courts will eventually rule on this issue, but merely to point out that there is no clear cut answer in many cases involving wire fraud and funds transfers, particularly where wire instructions and/or email confirmations have been intercepted or hacked. The conclusion one needs to reach in this regard is that all parties to a transaction must take reasonable precautions to prevent their computers from being hacked and must also use careful diligence in making secure wire instructions and transfers when doing business. All roads seem to lead to an analysis of the precautions and firewalls that are being built when utilizing a computer system and whether or not parties are using a standard of care that will in fact prevent or reduce fraud. It is no wonder that cyber security is and should remain at the forefront (and one of the top priorities) for all financial institutions and their customers.

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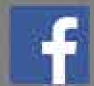
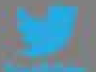
 Weiner Benefits Group

 @Weiner Benefits

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