delaware banker

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Using Common Trust Powers to Achieve Uncommon Results

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Delaware Bankers Association

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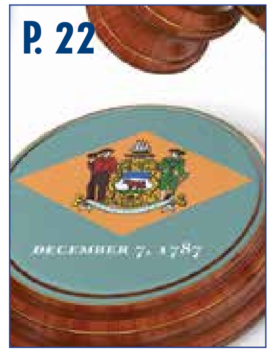

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SUBMISSIONS
Delaware Banker welcomes news items from members of the Delaware Bankers Association. The Editors reserve the right to refuse any advertising or editorial copy deemed unsuitable for publication. The Editors reserve the right to set the publication date in accordance with the Association's needs. Direct submissions to Greg Koseluk at greg.koseluk@debankers.com

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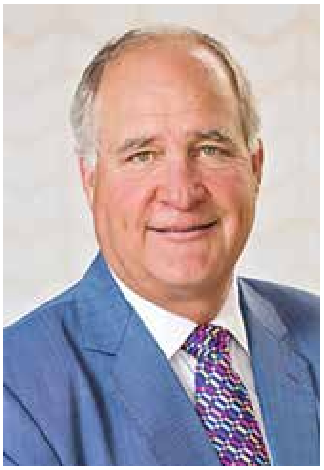
View from the Chair



by
Thomas M. Forrest
President & CEO
U.S. Trust Company of Delaware

Chair
Delaware Bankers Association

"The pandemic has forced us to stretch our capabilities, learn to adapt in the face of trying situations, and persevere."

The 2021 Delaware Trust Conference has just wrapped up. I'm pleased to report that the 16th annual edition of this premier wealth management event was a success. So, naturally, now I'm thinking about the boll weevil! Naturally? Boll weevils? Let me explain.

Down in Alabama, there's a city named Enterprise. The town was founded in the 1880s. For the first 35 years of its history, the town grew and prospered on the foundation of the area's main cash crop: cotton. Then in 1915, the town's very existence was threatened when the boll weevil infestation spread from Texas. Nearly 60% of Enterprise's crop was destroyed, and the city's lifeblood dried up.

Rather than give in to this tiny but devasting threat, the town sought fresh streams of productivity. Enterprise turned to the hearty peanut, impervious to the weevil. Within two years, Coffee County, the home of Enterprise, harvested more peanuts than any other county in the United States.

In 1919, the town erected a monument that still stands there today. Not a statue to the man who suggested they change the crop, or even to Mr. Peanut. They honored the boll weevil. The plaque on the base reads: "In profound appreciation of the boll weevil and what it has done as the herald of prosperity this monument was erected by the citizens of Enterprise, Coffee County, Alabama."

While I don't think we're ready to erect a monument to the COVID-19 virus, just like the boll weevil down in Alabama, the pandemic has forced us to stretch our capabilities, learn to adapt in the face of trying situations, and persevere. I'm speaking specifically of the 2021 Delaware Trust Conference.

When it first started in 2006, the conference was held in the DuBarry Room of the Hotel duPont. For that inaugural edition, all the materials were printed and issued in heavy 5" looseleaf binders. The staff and attendees probably still have phantom backaches from lugging those around!

Subsequent editions saw many modern improvements. Binders were dispensed with in favor of USB flash drives, but for years we still knocked down acres of forests to print out materials and reams of survey forms. In 2015 the Delaware Trust Conference outgrew the confines of the hotel, and we moved down to the Chase Center on the Riverfront. The 2017 conference saw the introduction of the conference app, a start towards us going paperless.

Yes, things were going nicely, and then the pandemic hit. When many conferences, some much larger than ours, took a year off, we ran the entire conference virtually, with all sessions also available on-demand. The DBA was not content, however, to be satisfied with this. Instead, when other conferences were either coming back virtually or in person, we decided to do both. All sessions for the conference this year were available in-person or via high-quality live streaming on the conference app. In addition, all sessions were then available on-demand. In past years attendees had to choose between breakout sessions running concurrently. Now wealth managers don't have to miss a moment of the excellent line-up of nationally renowned speakers... all available for continuing education credits.

So, just like those folks down in Alabama with their boll weevil, we've learned to overcome adversity with innovative solutions... and that ain't peanuts!

President's Report

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

"The DBA strongly opposes any proposal that would create new tax information reporting requirements for financial institutions."

From its beginnings in 1895, the Delaware Bankers Association has grown to become the face and voice for the Delaware banking system, serving an industry with more than 47,000 employees and more than $4 trillion in assets. The DBA provides a range of services that enhance the standing of the financial services industry and is known and respected for its educational offerings, advocacy, and constructive engagement in policy matters.

For over 125 years, the DBA has focused on providing member institutions, their employees, and the citizens of Delaware with a safe and viable financial services industry. Delaware is a national leader in financial services because of its business-friendly environment. In turn, Delaware's financial institutions provide the stability that benefits all of the State's citizens. A key component of which is to build a diverse talent pipeline and hire a skilled workforce.

The Delaware financial services industry is diverse. Some of the country's largest institutions have operations in the State, as well as State-Chartered Community Banks, Savings Banks, and Trust Companies. The breadth and depth of financial services make the state an ideal place to engage all types of institutions in addressing the financial health crisis facing our nation. Our members are committed to building economic well-being for all.

Delaware financial institutions keep local economies growing by providing tax dollars over $89 million annually that support education, healthier communities, and economic development. On an annual basis, our members invest millions of dollars in Community Development Financial Institutions, provide over $15 million to hundreds of nonprofit organizations, and contribute over 185 thousand hours of service to support community needs. We must continue to safeguard our industry through thoughtful regulation and legislation. A top priority is advocating on behalf of members. We make known our positions and priorities at the state and federal level with policymakers, legislators and regulators, through grassroots and direct political advocacy efforts:

- Lobbying every day that the Delaware General Assembly is in session.
- Holding Legislative meet and greets with new members, leadership, and banking committee members.
- Meeting regularly with the Delaware Congressional Delegation and their staff members.
- Submitting comment letters to policymakers and regulators at the federal and state level.
- Publishing white papers, op-eds, and articles to further knowledge about the financial services industry.
- Submitting Amicus Briefs when we have a strong interest in a matter before the court.
- Maintaining a strong DELBANKPAC State PAC.

As this column goes to press, the Biden Administration has proposed a series of policy initiatives to address some of the nation's most pressing issues. This includes a proposal to develop a set of tax compliance measures that curb tax evasion. While the proposal is still in development, the proposal would require financial institutions to report the total amount of funds deposited into an individual's bank account and the total amount withdrawn over a year. The DBA strongly opposes any proposal that would create new tax information reporting requirements for financial institutions.

We support adequate funding and resources to promote compliance with our Nation's tax laws. However, the expansive requirements are complicated and would generate a new trove of data that the IRS is unlikely to use or protect, which could impact the privacy of most Americans.

Privacy concerns are one of the top reasons that individuals choose not to open bank accounts. A reporting regime of this magnitude would potentially push households on the cusp of banking services back into the unbanked and underbanked population. We suggest the administration consider more targeted measures to reduce the tax gap. Never underestimate the importance of what you have to say. As a professional, you bring a unique perspective to the financial services industry's issues and have a working knowledge that provides insight for our country's lawmakers. We urge you to let your voice be heard both in Dover and in Washington.

Sarah

What's New at the DBA

New Associate Member

Office Depot

Contact: Kimberly Gilbert
(855) 337-6811 Ext. 12885
Email: kimberly.gilbert@officedepot.com

Office Depot provides DBA members significant discounts on a wide range of office and banking supplies, cleaning supplies, personal protective equipment (PPE), furniture, break room provisions, print solutions, promotional products and more. DBA's partnership with Office Depot is part of a national state bankers association discount program accessed by hundreds of banks across the country. The program has proven to deliver an average cost savings of 20-30% to participating members.

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Over generations of serving the Rockefeller family and institutional investors, Rockefeller has cultivated a suite of complementary and interconnected services designed to identify and make available extraordinary opportunities for asset preservation and growth.

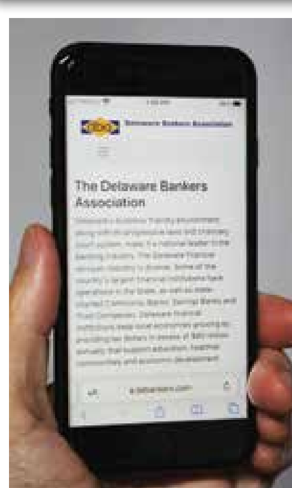
DBA Partners with Talent Management Firm

Bank Talent HQ

The Delaware Bankers Association has partnered with BankTalentHQ to provide our members with the premier talent management site for financial industry careers. When you post on BankTalentHQ through our partnership with Circa, your open position is also posted on a combination of 15,500+ employment offices, community-based organizations, and other specific diversity hiring sites. Your position will also be funneled to Top USA Jobs, U.S. Military Pipeline, multiple state banking association's websites, as well as 100s of others. Our goal is to generate candidates who have the skills and experience that your organization needs. Visit debankers.com/BankTalentHQ for more details.

Delaware Bankers Association Relaunches Website

The DBA recently unveiled the latest version of its website: debankers.com. The new site is fully responsive to all devices. In 2020 over 68% of all website visits came from mobile devices, with more than half coming from smartphones. Visitors to the site can fully navigate all pages via the "hamburger" icon (the stack of three parallel lines) that appears automatically when viewing the site on a smaller screen. In addition to being more viewable, the new site features a streamlined design with more dedicated pages. The site's front page features a full drop-down menu at the top along with six larger buttons for direct access to the site's more popular pages. The bottom of the home page, and the side of all interior pages, highlight direct links to the sites of DBA sponsors. We hope you will find the DBA's new site a useful tool that enhances your membership experience.



Either in full desktop computer mode (above) or on your mobile devices (at left) the newest version of debankers.com is designed for ease of use across all platforms.

Using Common Trust Powers to Achieve Uncommon Results

by
Jeffrey C. Wolken
National Director of Delaware Trust Planning
Wilmington Trust, N.A.

There are several common trust provisions or powers hiding in plain sight that may be activated to manage trust assets on a more tax efficient basis. These powers include (1) a grantor swap power, (2) the appointment of SLAT assets to grantor-spouse, (3) the 65-day rule for distributions, (4) lending to beneficiaries, (5) cost basis step-up using the Delaware Tax Trap, and (6) advance distributions to fund a beneficiary's estate plan. As we scramble to implement new trust structures to achieve estate planning goals, we should also be mindful of these common trust powers to maximize the benefits of existing trusts.

Grantor Swap Power to Manage Income Tax Basis and Location of Future Asset Appreciation

A popular form of personal trust is an intentionally defective grantor trust (IDGT) because the grantor can pay the income taxes for the IDGT, so the trust assets grow free of federal and state income taxes. A common provision for obtaining grantor trust status is a power of substitution—or "swap power." If the grantor has the power to reacquire any property held in an irrevocable trust by substituting other property of equivalent value, then the trust will be a grantor trust under section 675(4) of the Internal Revenue Code. The mere existence of the grantor swap power is sufficient to maintain grantor trust status so the grantor swap power is often included pro forma during the planning phase without an intention to exercise the power.

The opportunity presented by the swap power is the ability to increase the tax cost basis for trust assets. A grantor may substitute high-basis assets or cash of equivalent value in exchange for an IDGT's low-basis assets that have significant built-in capital gains. The low-basis assets would be included in the grantor's estate and receive a step-up in basis upon the grantor's death, while the IDGT would own the same fair market value in the form of high-basis assets swapped into the trust.

The swap power also allows a grantor to manage the location of future appreciation. Assets that have completed their rapid expansion in value while held in trust may be swapped for new assets with greater appreciation potential. By actively managing the location of asset appreciation outside the taxable estate using the swap power, this common power can help leverage estate and gift tax exemptions.

In situations where the grantor does not have liquidity or high-basis assets to swap into the IDGT, they may consider borrowing the cash using a secured line of credit. In the current low interest rate environment, the amount paid to facilitate the swap may be offset by the significant tax savings from eliminating capital gains tax liability following a step-up in basis. However, using leverage is attractive primarily when the grantor has a short life expectancy because the anticipated savings from reduced capital gains are offset by the interest paid on the loan.

The window to use this swap power to manage tax basis may be closing due to proposed federal legislation related to grantor trusts. Depending upon the final form of tax legislation enacted into law, a swap with a grantor trust may be treated as a sale of the asset and potentially included in the grantor's taxable estate. If these changes are enacted, the tax benefits of the swap power will be lost. Consequently, now is the time to act to lock in the benefits.

Appoint Slat Assets to Grantor-Spouse to Retain Access

A common use of a married person's lifetime exemption is the funding of a spousal lifetime access trust (SLAT). A SLAT is a gift in trust by one spouse for the primary benefit of the other spouse to retain direct and indirect access to the trust's assets by the married couple. One concern when funding a SLAT is what happens if the beneficiary-spouse dies prior to the settlor-spouse since this generally would cut off the surviving spouse's access to the trust as it passes on to descendants.

Giving the beneficiary-spouse the power to appoint the trust back in favor of the settlor-spouse is the obvious answer, but any flaw in asset protection potentially causes estate inclusion. However, Delaware Title 12 Del. C. Section 3536(c)(3) provides creditor protection when the grantor is the proper object of the exercise of a power of appointment held by someone other than the grantor (e.g., the beneficiary-spouse). Moreover, the 2021 Delaware Trust Act augmented this statute to clarify that a trustor of a trust who becomes a beneficiary pursuant to the exercise of a testamentary power of appointment is only treated as a beneficiary, and the SLAT assets should not be subject to the claims of creditors.

A common provision in most SLATs is for the beneficiary-spouse to hold a special (or limited) power of appointment over the SLAT both during lifetime and at death. However, the scope is often limited to descendants or individuals other than the settlor-spouse to avoid any creditor protection concerns. In Delaware, however, the settlor-spouse may be included within the permissible objects of the power of appointment, which allows the beneficiary-spouse to exercise (typically through the Will) his or her testamentary limited power of appointment back in favor of the settlor-spouse. Otherwise, the default provisions of the SLAT allow the assets to pass in favor of descendants if the beneficiary-spouse is not survived by the settlor-spouse. This added flexibility to appoint the assets back in favor of the settlor-spouse may provide the comfort needed to effectively implement SLAT planning.

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Uncommon Results

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Distributions to Minimize Income Taxes Under the 65-Day Rule

Section 663(b) of the Internal Revenue Code allows a trustee or executor to make an election to treat all or any portion of amounts paid to beneficiaries within 65 days of the close of the trust's or estate's tax year as though they were made on the last day of the prior tax year. This rule is applicable for irrevocable trusts that file their own tax returns—revocable living trusts and other grantor trusts are subject to different tax rules. Therefore, it is possible for trusts and estates to receive an income tax deduction on the prior year's tax return for distributions made in the first 65 days of the following year.

The 65-day rule may provide substantial tax savings because trusts are subject to higher income tax brackets sooner than individuals. In 2020, trusts reached the highest tax bracket—37% federally at taxable income of only $12,950; in contrast, married couples who filed jointly were subject to the 37% tax bracket at income levels of $622,051.

Most irrevocable trusts allow "income" to be paid out at least annually, with "principal" available to the beneficiary under an ascertainable standard. It is important to note that the trustee or executor must actively make an election on a timely filed tax return to include subsequent distributions on the prior year's return. A fiduciary may make the election for only a portion of the distributions made within the 65-day window, but once the election is made, it is irrevocable. The election is made on a year-by-year basis, so taking advantage of the 65-day rule may be customized each year. With potential increases in income tax rates starting in 2022, even an accumulating trust may benefit from passing out its 2021 income during the first 65 days of 2022.

Lending to beneficiaries to facilitate estate planning and tax minimization

The power of a trustee to invest includes the authority to lend in proper circumstances. The distribution powers of the fiduciary also generally allow the trustee to lend to, or for the benefit of, a trust beneficiary, especially on favorable terms. In addition, Delaware statutes clarify that loans in lieu of distributions are not investment decisions subject to investment adviser direction but distribution decisions that may remain in the trustee's discretion or upon the direction of a distribution advisor.

These lending powers present opportunities to enhance a trust's administration. In some cases, an outright distribution may not be allowed, so the trustee may be able to loan trust assets instead. In many cases, an outright distribution will increase a beneficiary's taxable estate, but a loan will not. A loan retains the estate tax (and generation-skipping transfer tax, or GSTT) advantage of retaining assets in a trust. Finally, a loan from a trust with multiple beneficiaries can assist one beneficiary without making an outright distribution that would exceed such beneficiary's share of the trust assets. Essentially, the loan locks in the advancement concept if loans are outstanding when the trust is distributed.

A trustee must exercise caution when making loans to beneficiaries by determining whether it is an investment or distribution decision. Depending upon which power is used, the fiduciary must review the spendthrift clause and state statutes or determine whether the trust agreement provides specific authority to make a loan to a beneficiary, especially if it is in lieu of a distribution. Although the loan may be on favorable terms, the fiduciary must still conduct due diligence on the loan to ensure that the borrower can repay the loan. However, strict loan terms and security agreements may put the trustee in the position of foreclosing on a trust beneficiary they have an obligation to support. Finally, the trustee must avoid potential conflicts of interest if the trust loan will facilitate repayment of personal debt to the trustee.

Delaware Tax Trap to Step-Up Income Tax Basis of Trust Assets

The Delaware Tax Trap is an opportunity for trust beneficiaries to control the use of their available exemption amount customizing its use to the precise amount of their remaining exemption, while targeting the lowest-basis assets held in the trust to maximize the basis step-up upon their death. The Tax Trap does not expose trust assets to the beneficiary's creditors and avoids the potential misuse of trust assets by beneficiaries prior to his or her death.

By using the otherwise unused estate tax exemption, the beneficiaries may include trust assets in their taxable estate to obtain a step-up in the income tax cost basis of the assets upon their death under § 1014 of the Internal Revenue Code and allocate unused GSTT exemption. The beneficiaries must possess a limited testamentary power of appointment, and the trust must be administered in a state, such as Delaware, that permits a limited power to be exercised to trigger the Tax Trap through the creation of a second limited power of appointment. Most trust-friendly states do not permit the Tax Trap to be sprung in this manner, so it is truly the Delaware Tax Opportunity.

The Tax Trap tool should be available to beneficiaries residing in any state if the trust granting the power of appointment is being administered in Delaware with a Delaware trustee. With the increased federal estate tax exemption and the likelihood that many trust beneficiaries may die with unused federal estate tax exemptions, administering a trust in Delaware retains the flexibility for the beneficiaries to spring the Tax Trap using special powers of appointment when appropriate.

Advance Distributions to Fund a Beneficiary's Estate Plan

One strategy used to achieve a basis step-up is to have the beneficiaries request a significant distribution from an existing family trust to "top up" their estate and obtain a step-up in the cost basis of the assets upon their death. The beneficiaries can place distributed assets back into a trust upon their death for the same beneficiaries of the original trust to continue the estate plan created by their ancestor. At a minimum, an advance distribution may help beneficiaries fully utilize their own available tax exemptions before the anticipated cuts in these exemption amounts, even if they are not able to take advantage of basis step-up upon death. However, the beneficiaries receive a carry-over basis upon distribution so they would incur the capital gain if the asset was sold during their lifetime.

Some risks to consider with advance distributions include the fact that these assets would be exposed to the beneficiary's creditors and the beneficiary may misuse or dissipate the assets instead of using them for estate planning purposes. If the goal is a step-up in cost basis upon the beneficiary's death, it can be a challenge to precisely match the required distributions from the original trust with the exemption that will be available upon the beneficiary's death. It is possible that trust assets could be over-distributed, appreciate in value, or the available exemption reduced to cause the beneficiary's gross estate to exceed the exemption amount available to the beneficiary upon death and, thereby, owe federal estate tax.

In the rush to structure and fund new trust vehicles, please remember that you may be able to achieve uncommon results by activating these common trust powers.

As part of the Wilmington Trust Emerald Family Office & Advisory team, Jeff is responsible for developing trust planning strategies for wealthy individuals and families throughout the United States and abroad. He works closely with his clients' legal, tax, and investment advisors to construct and implement appropriate trust structures that take advantage of the state of Delaware's unique trust and tax laws.

Prior to joining Wilmington Trust in 2005, Jeff spent seven years in private legal practice as a member of the Estates and Trusts Practice Group of the Philadelphia-headquartered law firm of Montgomery, McCracken, Walker & Rhoads, LLP. Jeff earned his JD (summa cum laude) and MBA (with honors) from Syracuse University and holds a bachelor's degree in economics from Northwestern University, where he was a member of Phi Beta Kappa. He is a frequent lecturer on topics involving the use of Delaware trusts for asset protection, state income tax minimization, and investment management for unique trust assets. Jeff is a recipient of the Wilmington Trust Chairman's Club award. He is a member of the Estates and Trusts Section of the Delaware State Bar Association and the Real Property, Trust & Estate Section of the American Bar Association.

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Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

This article is for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service or as a determination that any investment strategy is suitable for a specific investor. Investors should seek financial advice regarding the suitability of any investment strategy based on their objectives, financial situations, and particular needs. This article is not designed or intended to provide financial, tax, legal, accounting, or other professional advice since such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought.

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A Sweet Return!

The 16th Delaware Trust Conference: In-Person Live-Streaming and On-Demand!

Robert W. Eaddy, President, The Bryn Mawr Trust Company of Delaware, serves conference attendees from the BMT Ice Cream Van at the 2021 Delaware Trust Conference.

Conference chairs, George W. Kern, Esq., Managing Director, Bessemer Trust Company of Delaware, N.A. Co-Chair: David A. Diamond, President of The Northern Trust Company of Delaware welcome attendees to the conference.

Wealth management professionals gathered October 19th and 20th both at the Chase Center on the Riverfront and via live streaming for the 16th annual Delaware Trust Conference. All sixteen sessions of the conference were also available on-demand through the conference app for full credit through November 30th.

The Delaware Bankers Association thanks the members of the trust conference planning committee who helped make the 2021 Delaware Trust Conference a success:

Executive Committee
Chair: George W. Kern, Esq., Managing Director, Bessemer Trust Company of Delaware, N.A. Co-Chair: David A. Diamond, President of The Northern Trust Company of Delaware. Cynthia D.M. Brown, Esq., President, Commonwealth Trust Company; Todd A. Flubacher, Partner, Morris Nichols Arsht & Tunnell LLP; Mark A. Oller, CTFA, President - Family Wealth Delaware, Wilmington Trust Company

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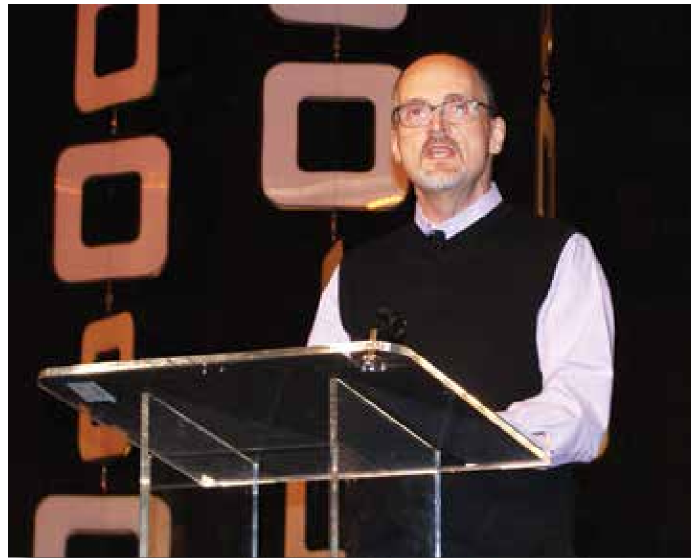
DBA Ambassadors
Special thanks to the DBA Ambassadors who greeted new members and attendees: Dominic Canuso; Jennifer Cuva; David Diamond; Tom Forrest; George Kern; Mark Oller; George Kern; and, Isabel Pryor.



Samuel A. Donaldson, Professor of Law, Georgia State University, navigates changing estate plans because "Stuff Happens!"

Vincent Thomas, Partner, Young Conaway Stargatt & Taylor LLP, and Jeffrey Wolken, National Director, Delaware Trust Planning, Wilmington Trust, N.A., present "Déjà vu All Over Again – Driving the Planning Process Through the Rearview Mirror."

How do they do that live streaming? Corinne Stayton, the DBA's Event Technologist, and video tech Oleg Bogdanovych make the complicated seamless!

Thomas M. Forrest, President & CEO, U.S. Trust Company of Delaware and DBA Chair; Mark A. Oller, President - Family Wealth Delaware, Wilmington Trust Company; Isabel A. Pryor, Chief Administrative Officer & SVP, Key National Trust Company of Delaware; and Gregg Homan, Head of Domestic Business Development - PCS Americas - Private Client Services; enjoy the reception at the 2021 Delaware Trust Conference.

Elizabeth Luk, Head of Delaware Trust, BNY Mellon; and, Sarah Long, President, Delaware Bankers Association at the Delaware Trust Conference Reception.

Dana G. Fitzsimons, Jr., Principal, Fiduciary Counsel, Bessemer Trust, reviews "The Past Year's Most Significant, Curious, or Downright Fascinating Fiduciary Cases."

Gregory J. Weinig, Partner, Connolly Gallagher LLP, and Jocelyn Margolin Borowsky, Partner, Duane Morris LLP, provide an update on Delaware legislation, cases, and trends.

Paul Lee, Chief Tax Strategist, Wealth Management, Global Family & Investment Offices, The Northern Trust Corporation leads the conference on a Quest for Quantum Exclusions!

Diversifying the Financial Services Industry: Solutions for an Inclusive Future - Kalimah Z. White, Wealth Strategist, TD Wealth Private Client Group, moderates the prestigious panel of: Ray Odom, Director of Wealth Transfer Strategies, Northern Trust; Jennifer Z. McCloskey, Director of Trust Management Minor, University of Delaware; Elizabeth Luk, Head of Delaware Trust, BNY Mellon; and, Vanesa Browne – Private Employer.

Todd Flubacher, Partner, Morris Nichols Arsht & Tunnell LLP, and Cynthia D.M. Brown, President, Commonwealth Trust Company, discuss "Unitrust Conversion V. Power to Adjust: How? When? Why?"

Marie Holliday, Managing Director, Cover & Rossiter; Vernita L. Dorsey, Senior Vice President-Director of Community Strategy, WSFS Bank; and, Elizabeth B. Wagner, Senior Vice President, Director of Institutional Wealth Management, Bryn Mawr Trust, hold a : "High-Impact, Trust-Based, Multi-Generational Conversation on 21st Century Philanthropy."

Trust Administration Developments Following the Enactment of Delaware Trust Act 2021

by
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On June 30, 2021, Delaware Governor John Carney signed new trust legislation (the "Trust Act 2021") into law, which includes several changes and additions to Delaware trust law that will provide greater clarity and flexibility to settlors, beneficiaries, and fiduciaries.

I. Designated Representatives- 2021 Changes; Hierarchy of Appointment; Applicability to Pre-2016 Trusts; Silent Trusts

A. Background: One key feature of Trust Act 2021 is an amendment to 12 Del. C. § 3339, which governs the appointment of designated representatives. The position of designated representative was introduced in Delaware in 2016 and provides for the appointment of an individual to represent and bind beneficiaries whose rights to receive notice or information concerning a trust are curtailed or eliminated, for both judicial and non-judicial matters.

The designated representative position has become a valuable tool for corporate trustees, who often seek the consent or release of trust beneficiaries for various reasons but are sometimes hampered by "silent trust" language prohibiting the corporate trustee from notifying beneficiaries of the trust's existence for a period of time. Prior to the enactment of the designated representative statute, corporate trustees were stuck between a proverbial rock and a hard place if those beneficiaries could not be bound through virtual representation. Their options were to either violate the terms of the trust agreement. by sending notice of the trust via the release or to not obtain a full release from all beneficiaries. After the enactment of Section 3339, corporate trustees could feel comfortable relying on a designated representative, who is presumed to be acting in a fiduciary capacity under the statute, to act in the best interests of trust beneficiaries when receiving accountings for the beneficiaries or acting on their behalf for judicial or non-judicial matters.

B. Hierarchy of Appointment: Section 3339(a) has controlled how a designated representative could be properly appointed. The 2021 Trust Act modifies Section 3339(a) to establish a clear hierarchy for the appointment of designated representatives. Now, a designated representative can be (i) appointed under the governing instrument, (ii) authorized or directed under the governing instrument to bind one or more beneficiaries, or (iii) appointed by someone expressly authorized to do so under the governing instrument. A trustor can also appoint a designated representative, but only if the designated representative is not appointed in accordance with (i) through (iii) and subject to further limitations found in Section 3339(a)(4). Further, a beneficiary can appoint a designated representative to bind them, but only if one is not effectively appointed in accordance with (i) through (iii) or by the trustor.

C. Applicability to Pre-2016 Trusts/Relaxation of Appointment Requirements: Previously, under Section 3339(a), a designated representative's appointment was not effective until they provided their written acceptance to the trustee. Since a designated representative had to be explicitly appointed under trust agreement or appointed separately by the grantor or beneficiary, the usefulness of the statute was limited to trusts created after 2016. Under the 2021 Trust Act, a designated representative's acceptance can now be inferred through service or similar actions. With this change, for trust agreements that predate 2016, or trust agreements drafted after 2016 that do not expressly reference Section 3339, if an individual is receiving accountings and other information on behalf of beneficiaries and generally acting like a designated representative, they can now be considered a designated representative for purposes of the statute even if they have not been named as such or formally signed a written acceptance.

D. Additional Uses: The 2021 Trust Act introduced one other notable addition with Section 3339(b), which provides instances in which a designated representative may be appointed. It first explicitly cross-references Section 3303(d) (when a beneficiary's rights to be informed have been restricted or eliminated), which had been the only situation for which a designated representative could be used. It also provides an additional permissible use of a designated representative: to represent a minor, incapacitated, or unborn beneficiary, or a beneficiary whose identity or location is unknown and not reasonably ascertainable in any nonjudicial matter. This addition makes Section 3339 even more useful to corporate trustees who can now rely on a designated representative to bind minor and unborn beneficiaries not effectively bound under the Delaware virtual representation statute, even if there are no silent provisions in the trust agreement.

II. Electronic Execution of Trust and Trust Related Documents

A. Applicable Documents: A noteworthy addition in the 2021 Trust Act is the introduction of Section 3550, which offers greater flexibility in the execution of trust documents. Section 3550 provides that any of the following documents may be executed electronically, so long as they are (i) otherwise validly executed and (ii) executed in accordance with the Uniform Electronic Transaction Act (the UETA): a governing instrument (other than a will or codicil) described in Sections 3325(29)(re trust mergers), 3338 (re Nonjudicial settlement agreements), 3342 (re trust modifications by consent while trustor is living), 3343 (re allocation of trust duties among trustees), 3528 (re trustee authority to invade principal or income), or 3545 (re limitation on oral trusts and requirements for written trusts); a resignation, removal, appointment or acceptance of any trustee, adviser or protector described in Section 3313(a), or designated representative described in Section 3339; a consent, release, ratification, or indemnification described in Section 3588; any other document addressed under Chapters 33 and 35 to the extent they are not excluded from the scope of the UETA.

B. Implementation: This needed development offers options to trustors, beneficiaries, fiduciaries, and attorneys impacted by the ongoing Covid-19 pandemic and general restrictions caused by individuals living in different parts of the world. Now that the legislature has made it clear that the UETA applies to generally all Delaware trust documents, the first step for corporate trustees is to determine their comfort level with relying on electronic document signature software for the execution of trust documents and deciding which e-signature programs they will accept and utilize. The second step will be implementing policies and procedures that will minimize the risk of fraudulent signatures. For example, a corporate trustee may decide it will only accept e-signatures from clients on documents initiated and sent by the trustee from an approved e-signature program to a known email address of the client, with a follow up verbal confirmation.

III. Other Amendments

Other amendments under 2021 Trust Act include the following:

A. Discretionary Interests as Mere Expectancy; Additional Asset Protections: Enhancements and clarifications on the rights of beneficiaries through amendments to 12 Del. C. §§ 3315 and 3536. Section 3315(b) governs the interests of beneficiaries in a discretionary trust and the rights of the beneficiaries' creditors. The Trust Act 2021 revised this section to clarify that a beneficiary's interest in a discretionary trust is a mere expectancy and not a property right, regardless of whether such interest is subject to an ascertainable standard or whether it is subject to the absolute discretion of the trustee. In either case, a beneficiary's creditors cannot compel distributions from the trust. Section 3536 provides strong asset protection for non-trustor beneficiaries of trusts. The 2021 Trust Act modified Section 3536(c) to provide additional protections, adding that a person who becomes a beneficiary of a trust resulting from someone else exercising a power of appointment shall not be considered the trustor of the resulting new trust, even if that beneficiary was the trustor of the original trust. Accordingly, the rights of that individual's creditors are limited to the rights of a creditor with respect to any other beneficiary as provided elsewhere in Section 3536.

B. Resignation & Removal of all "Officeholders": Expansion of 12 Del. C. §§ 3326 and 3327 to cover the resignation and removal of all "officeholders" of a trust, including trustees, advisers as defined in § 3313, and designated representatives as defined in § 3339. Under amended Section 3326, an officeholder may resign pursuant to the terms of the trust's governing instrument, or, in the absence of such resignation provisions, by complying with the requirements of Section 3326(b)(2) and providing 30 days' written notice to the beneficiaries, those holding the power to appoint the successor officeholder, and any other officeholders. Section 3327 was amended to clarify that an officeholder may be removed in accordance with the terms of a governing instrument. These revisions add some flexibility for older trust agreements that may not contain explicit resignation provisions but do provide a mechanism for the appointment of successor officeholders.

C. Opt-Out for Future Trust Modifications. Providing an opt-out option for trustors under 12 Del. C. § 3342. Section 3342 has become a useful tool for trustors and their attorneys to modify trust instruments when the trust instruments themselves do not provide a valid mechanism for amendment. Prior to the 2021 Trust Act, Section 3342 provided that, notwithstanding any provision of law or provision in the trust instrument prohibiting amendments, an irrevocable trust may be modified in any way so long as (i) the requirements of Section 3342 are met, and (ii) the provisions being added/amended could have been included in the trust instrument upon the date of the modification. Recognizing that not all trustors may wish to have this power available to revise their trusts, the 2021 Trust Act amends Section 3342 to make it available to any trust unless the governing instrument expressly provides that it cannot be modified under Section 3342, Section 3338 (nonjudicial settlement agreement), any similar provision, or a modification agreement.

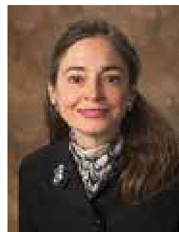
D. Reimbursable Tax Payments. Expanding income tax reimbursement categories for trustors under 12 Del. C. § 3344. The Trust Act 2021 now allows for a trustor to be reimbursed by a trust for income taxes attributable to the trust for county, metropolitan, city, local, foreign, and other taxes owed by the trustor. This expands on the original list of reimbursable tax categories, which included just federal and state taxes.

E. Clarification re Trust Modifications. Adding clarification to 12 Del. C. § 3545. Section 3545 governs the creation, modification, or revocation of trusts. The Trust Act 2021 did not change the requirements that need to be present for a validly executed trust instrument (see Section 3545(a)); however, it did add a new Section 3545(c) to clarify that the requirements for a validly executed trust instrument listed in Section 3545(a) shall apply to trusts not described in 3545(a).

IV. Conclusion

We hope this article has highlighted some key provisions of the 2021 Trust Act, which further facilitates administration of Delaware sitused trusts to enhance Delaware's status as the premier trust state.

Cody Snyder serves as Vice President, Senior Trust Counsel for Christiana Trust Company of Delaware, a subsidiary of WSFS Financial Corporation. In this role, he is responsible for ensuring that Christiana Trust's fiduciary responsibilities are properly discharged on all account for which Christiana Trust serves as trustee. He also works with clients and attorneys, providing guidance on various tax and trust administration related issues.



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This article is provided solely for general information purposes and should not be construed as legal, accounting, tax, investment, or other professional advice. For additional information the authors can be contacted via email at csnyder@wsfsbank.com or eroberts@bmtc.com.

Settled or No? The Past, Present, and Future of Delaware Self-Settled Spendthrift Trusts

by
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As anyone familiar with Delaware trust laws knows, Delaware constantly seeks to improve on an already good statutory foundation. The Qualified Dispositions in Trust Act (the "Act"), 12 Del. C. § 3570, *et. seq.*, is certainly no exception. Nearly twenty-five years ago, through the Act, Delaware became the second state in the nation to allow for a "self-settled spendthrift trust" (also known as an "asset protection trust"). Prior to the Act, only non-US jurisdictions permitted a trustor to have a beneficial interest in a trust that protected trust assets from her creditors.

Since it was enacted, the Act has been amended seventeen times. And, like other Delaware trust laws, the Act has served as inspiration for many of the other nineteen states to date that have enacted their own versions of self-settled spendthrift trust laws.

From gift considerations to burdens of proof, below are several highlights of the past 25 years of legislative updates to the Act include:

1998 – Removed from the class of persons to whom the statute would not apply those who relied on an express written statement of the transferor that any property transferred to the trust remained the transferor's property – retroactive to date of enactment – to ensure trust could be a completed gift

1999 – The definition of "spouse" and "former spouse" was added (meaning only persons to whom the transferor was married at, or before, the time the qualified disposition is made), thereby ensuring that a spouse who married the transferor after a transfer to the trust is made is not protected by the exception for court orders pursuant to divorce awarding alimony or spousal support.

2000 – The statute expanded the rights a settlor could retain in the trust and still have transfers to the trust be qualified dispositions, and made clear that any attempt by a settlor to retain rights outside of the trust instrument are void.

2005 – Provided that if a creditor successfully avoids a qualified disposition and tries to claim assets previously distributed to a beneficiary or trust assets before the trustee's fees and expenses have been paid, that the creditor must show by clear and convincing evidence that the beneficiary or trustee acted in bad faith (unless the beneficiary was also the settlor in which case, the standard is a preponderance of the evidence).

* * *

There have been a handful of Delaware cases citing the Act, but only two do so in any depth. In *Trustco Bank v. Mathews*, the Delaware Court of Chancery weighed in on whether New York's, Florida's or Delaware's statute of limitations would apply to a creditor's claim of fraudulent transfer. 2015 WL 295373, at *11 (Del. Ch. Jan. 22, 2015). In its analysis, the Court did not need to determine whether the Act required application of Delaware's fraudulent transfer statute of limitations because it found that Florida had the most significant contacts. *Id.* Although the trust at issue in In re *Daniel Kloiber Dynasty Trust* was not actually a self-settled spendthrift trust, it was argued and ruled on under the Act. In *Kloiber*, the Delaware trustee petitioned the Court of Chancery for instructions on whether Delaware had exclusive jurisdiction over claims against the Delaware trust such that an attempt to avoid a transfer to it in a Kentucky court were invalid. 98 A.3d 924, 952 (Del. Ch. 2014). The Court held that the Act's provision that "The Court of Chancery shall have exclusive jurisdiction over any action brought with respect to a qualified disposition" referred to the Court of Chancery's having exclusive jurisdiction over claims under the Act vis-à-vis other Delaware courts, but not over other states' courts. Id. at 938 (citing 12 Del. C. §§ 3570-3576).

Nationwide, there have been only six relevant cases involving self-settled spendthrift trusts in the twenty-five years since the first statute was enacted. See 12th ACTEC Comparison of the Domestic Asset Protection Trust Statutes (available at https://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf?hssc=1). This dearth of case law either speaks to the acceptance of self-settled trusts as valid trust vehicles, or the success of self-settled trusts creating sufficient barriers to force creditors to avoid suit or settle, or both. Regardless, without courts weighing in, it is difficult to determine how and to what extent self-settled trusts have been leveraged by trustors. Little additional insight has come from the few federal tax law rulings involving self-settled spendthrift trusts. Two private letter rulings have been issued holding that self-settled spendthrift trusts were completed gifts despite the trustor's beneficial interest. This is based on that reasoning that because the trustor's creditors cannot reach the trust assets, the trustor retains no power to revest title in herself to name new beneficiaries or change the interests of other beneficiaries.

Despite – or perhaps because of – the lack of formal rulings, the reaction to the (rise) of the domestic asset protection trust in the bankruptcy and fraudulent transfer community has been more robust. In 2014, the Uniform Law Commission adopted the Uniform Voidable Transaction Act which provides that the law of the debtor's principal residence governs whether a transaction is voidable. A comment under this Uniform Act states that if the debtor's principal residence does not allow self-settled spendthrift trusts, any transfer to a self-settled spendthrift trust in another state by such debtor is voidable. That said, this Uniform Act has only been enacted

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Trusts

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in some form by 20 states, 5 of which have their own self-settled spendthrift trust statute, and another 4 which declined to adopt the comments.

Section 548(e) of U.S. Bankruptcy Code was amended in 2005 to include a new 10 year look back period for transfers to "self-settled trusts" made with actual intent to hinder, delay or defraud any entity to which the debtor became indebted on or after the date of transfer. Late last year the Consumer Bankruptcy Reform Act of 2020 was introduced in the United States Senate. The bill would amend 548(e) to: (1) remove "actual intent" from the self-settled trust look-back; (2) prohibit the trustee from avoiding any transfer that was not made with actual intent to hinder, delay or defraud, and; (3) place the burden on proving the lack of actual intend to hinder, delay or defraud on the defendant. To date, this bill has not moved out of committee.

* * *

Like the Act itself, the application of self-settled spendthrift trusts have evolved over time. In addition to pure "asset protection," self-settled spendthrift trusts have long been recommended to trustors wanting to remove assets from their taxable estate, but who worry about the potential (or perceived) need to access the same assets in the future. As a result of the 1999 amendment to the definition of "spouse" in the Act, a single or newly engaged trustor may use a self-settled trust as a unilateral pre-nuptial device. More recently, the Delaware Incomplete Non-Grantor Trust has become a popular mechanism for saving state capital gains tax on the sale of highly appreciated capital assets. And spouses looking to transfer assets out of their estate without losing full access to the assets can use a Special Power of Appointment Trust. That particular trust benefits the spouses' descendants now, with an independent third party authorized to add a trustor as a beneficiary if and when needed. Or, the trust could grant a beneficiary a testamentary non-general power of appointment that could be exercised in favor of the trustor.

Among attorneys and financial advisors, awareness of the appropriateness for certain clients or situations has also evolved. Likely candidates are those with significant enough wealth that sufficient assets will remain outside of the trust to adequately support the trustor. Another likely candidate may be an individual pursuing a high risk career or endeavor. Additionally, self-settled trusts must be established and funded well before any potential claim comes to fruition. A trustor must be willing to give up a certain amount of control and access to the assets transferred to the trust. Some trustors are those that find themselves with newly acquired wealth – for example, the receipt of a large inheritance, a hefty signing bonus or endorsement deal, or stock in a fast-growing employer.

When establishing or transferring a self-settled trust to a Delaware trustee, trustors and their advisors should be aware that the trustor will have to complete an affidavit of solvency.

(Although such an affidavit is not a requirement of the Act, it is the practice of most, if not all, Delaware corporate trustees to require one.) Trustees will also perform due diligence on the trustor and sources of wealth to have some context for the trust and the property to be transferred to it (or that is already held by it) by reviewing public realm filings and Know-Your-Customer information. Corporate trustees are also likely to seek information on a trustor's past business dealings and financing.

* * *

For those who haven't drafted a self-settled spendthrift trust under the Act yet, or for those who have but would like a refresher, the Act itself is a fantastic resource. It sets forth the required elements to be valid, and also a series of powers and rights that the trustor may retain. The trust document must:

- Be irrevocable;

- Include an express statement that Delaware law governs validity, construction and administration;

- Designate a "qualified trustee" who is either a natural person and resident of Delaware, other than the trustor, or in all other cases: (1) is authorized by Delaware law to act as a trustee; (2) is subject to the supervision of the Delaware Bank Commissioner, the FDIC, or the Office of the Comptroller of the Currency; and (3) maintains or arranges for custody of trust property in DE, maintains records for the trust, prepares or arranges for the preparation of fiduciary income tax returns, or who otherwise materially participates in the administration of the trust; and

- Provide that the interest of the transferor or other beneficiary in the trust property or the income therefrom may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the trustee or trustees actually distribute the property or income therefrom to the beneficiary. Such provision of the trust instrument shall be deemed to be a restriction on the transfer of the transferor's beneficial interest in the trust that is enforceable under applicable non-bankruptcy law within the meaning of § 541(c)(2) of the Bankruptcy Code (11 U.S.C. § 541(c)(2)) or any successor provision thereto.

Some of the optional powers and rights include:

- Power to veto distributions;

- A lifetime or testamentary non-general power of appointment (meaning);

- Potential or actual receipt of income, including reained right to income;

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- Potential or actual receipt of income or principal from a CRUT or CRAT, and to release such interest;

- Potential or actual receipt of income or principal from a GRAT or GRUT;

- Potential or actual receipt or use of principal, if resulting from trustee acting in its discretion, pursuant to a standard that does not confer a substantially unfettered right;

- Right to remove and/or appoint a trustee or adviser;

- Possession and enjoyment of an interest in a QPRT;

- Potential or actual receipt of income or principal to pay income taxes if resulting from trustee acting in its discretion, an adviser's discretion, or the settlor's exercise of a lifetime power of appointment;

- The ability of a trustee to pay, after the death of the grantor, grantor's debits, expenses of the state administration and/or estate or inheritance taxes;

- Ability to appoint or serve as a designated representative; and

- Ability to serve as an adviser.

* * *

Although the formal analysis of self-settled spendthrift trusts is sparse, its continual evolution – both in statute and application – demonstrates that it has and will continue to be a unique tool to be leveraged both for those particular clients and practical applications discussed here, and also for new individuals and applications yet to be developed.

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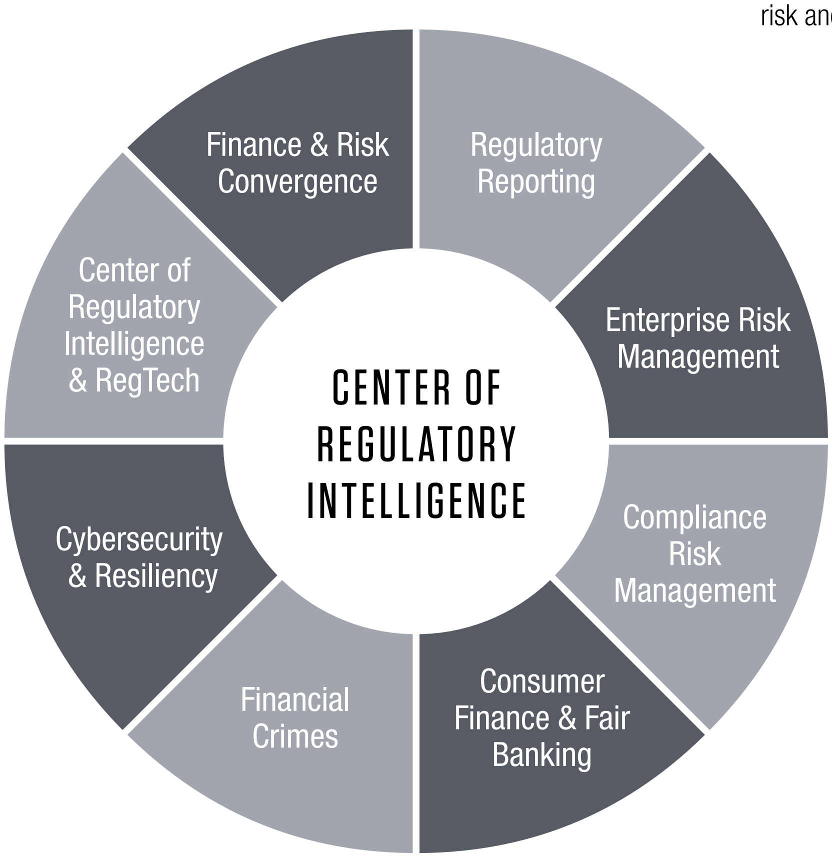

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Two Hot Topics - ESG Investing & Retirement Reforms

Louis D. Memmolo, AIF, GBA, CHRS
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"Only some of the retirement reforms being considered will ultimately be enacted and many details have yet to be worked out. "

Heraclitus observed: "There is nothing permanent except change." Regulatory and legislative movements in Washington testify to the truth of this statement, specifically in the following two areas highlighted in our quarterly newsletter.

New Regulations Greenlight the Use of ESG Funds in Retirement Plans

In August, the Department of Labor submitted new proposed ESG rules to the White House's Office of Management and Budget - the last step before publishing regulations. The proposed rules should be published before the end of this year. There is no doubt these rules will be favorable to ESG investing.

ESG investing, which considers environmental, social and corporate governance criteria, in addition to traditional financial criteria, has greatly increased in popularity in recent years. Money invested in ESG funds at the end of 2020 was estimated at about $17 trillion. Retirement plans have followed this trend and many now offer an ESG option.

For many years, the Department of Labor has gone back and forth in its position regarding ESG investing. Democratic administrations tend to favor ESG investing while Republican administrations have been skeptical. At the very end of the Trump Administration, in December of last year, the Department issued new ESG rules that make it difficult for retirement plans, subject to ERISA, to offer an ESG option. The essence of these rules is that nonpecuniary factors may not be considered in selecting investment options. In effect, the fact that a fund employs ESG criteria may only serve as a tie breaker.

Early this year the Biden administration announced that it would walk back these rules and promulgate regulations more favorable to ESG investing.

SECURE Act 2.0 - Both Houses of Congress are Considering Retirement Reforms

Bills in both the House and the Senate aim to build on the SECURE Act passed in 2019. This legislation is called Securing a Strong Retirement Act and is nicknamed SECURE Act 2.0. There is enough bipartisan support for some of these measures to become law before the end of this year.

A number of these reforms are in the Democrats $3.5 trillion stimulation package. Progressive Democrats are hoping to use the reconciliation process to push through some of their more aggressive policy goals which likely would be blocked by Republicans in the normal legislative process. These proposals include items such as universal family and medical leave and federal support for skilled nursing facilities.

Only some of the retirement reforms being considered will ultimately be enacted and many details have yet to be worked out. Some of the more significant proposals are:

- Require small employers to sponsor either an auto enroll IRA or a 401(k) plan - one of these proposals would require auto enrollment at 3 percent with auto escalation to 10 percent;
- Move back the age for required minimum distributions from 72 to73 in 2022, to 74 in 2029, and, to 79 in 2032;
- Increase the catchup contribution limit from $6,500 to $10,000 for individuals 62, 63 and 64 years of age;
- Give employers the option to make their contributions after tax so there would be no tax deferral for employees (not clear why anyone would elect this);
- Allow plan sponsors to make contributions on behalf of employees not contributing to their retirement plan because they are paying off student loans (really a point of clarification as the law already allows this);
- Allow 403(b) plans to participate in MEPs.
- Direct the Department of Labor to issue new standards for benchmarking target date funds; and,
- Increase to $200,000 the amount that can be applied, without taking a taxable distribution, to purchase a qualified longevity annuity contract (QLAC) - the current limit is the 25 percent of the account up to a maximum of $135,000.

We will be monitoring the changing regulatory and legislative landscape. Please contact me to for further information or to receive our newsletters.

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Photo by Tom Blagden Jr.

Fintech Due Diligence

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"Financial institutions should look to the nature, scope, and frequency of controls reviews as part of its due diligence."

For financial institutions in today's rapidly changing market, remaining on top of trends in products and services can be the difference between growing and losing customers to competition. Partnering with fintech companies may expand product availability, increase revenues and decrease expenses, furnish expertise, and assist the financial institution in meeting strategic goals. But the use of fintechs does not diminish the responsibility of an institution's board of directors and management to ensure that fintech operates in a safe and sound manner and in compliance with applicable laws, regulations, and internal policies.

The federal bank regulatory agencies (Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency) released "Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks" (Guide). The Guide is intended to assist community banks with assessing the risks and the benefits as part of a financial institution's due diligence process.

The Guide focuses on six due diligence areas for financial institutions to evaluate for fintechs.

Business Experience and Qualifications:

Financial institutions must evaluate a fintech's business experience and qualifications when considering a fintech's experience in conducting the desired activity and its ability to meet the financial institution's needs. Considerations for business experience include, but are not limited to a fintech's operational history, complaints, and legal or regulatory actions.

To determine the fintech's business strategies and plans, financial institutions should discuss any key decisions it is considering. Look for plans to launch new products or pursue new arrangements, such as mergers, acquisitions, joint ventures, or joint marketing. Financial institutions should evaluate the fintech's business strategies and plans. Financial institutions should inquire about the fintech's management style to determine if the fintech's culture, values, and business style fit those of the financial institution.

Financial Condition

Institutions must evaluate a fintech's financial condition to assess its ability to remain in business and fulfill any obligations created by the third-party relationship. Financial institutions should review the fintech's financial reports when evaluating the fintech's capacity to provide the desired activity, to remain a going concern, and fulfill any if its obligations. Furthermore, being aware of a fintech's funding sources provides information on a fintech's financial condition. Due diligence also includes looking at market information. Is there a competitive environment for the desired product or service? Does the fintech have a few significant clients or does it have a wide client base? Determine if the fintech is susceptible to external risks that may affect the fintech's financial condition.

Legal and Regulatory Compliance

Financial institutions should evaluate a fintech's legal standing, its knowledge about legal and regulatory requirements, and its experience working within the legal and regulatory framework. As part of its due diligence efforts, financial institutions should:

- Review the fintech's risk and compliance processes to determine its ability to support legal and regulatory requirements, including but not limited to privacy, consumer protections, fair lending, and anti-money laundering.
- Determine if the fintech has experience working with other financial institutions and is it familiar with financial institutions' regulatory environment.
- Review information pertaining to any consumer facing applications, delivery channels, disclosures, and marketing materials to determine any potential consumer compliance issues.
- Review organizational documents and business licenses, charters, and registrations, which provide information on where a fintech is domiciled and authorized to operate.
- Review the nature of the proposed relationship to include roles and responsibilities of all parties to identify potential legal considerations.
- Assess any outstanding legal or regulatory issues in search of insight into a fintech's management, its operations, and its ability to provide certain activities, products, or services.

Risk Management and Controls

Due diligence for risk management and controls determines if the fintech can conduct the desired activity in a safe and sound manner, consistent with the financial institution's risk appetite and in compliance with applicable legal and regulatory considerations.

Financial institutions should review a fintech's policies and procedures to gather intelligence into how the fintech outlines its risk management responsibilities and reporting processes, and how the fintech's employees are responsible for complying with policies and procedures. Financial institutions should look to the nature, scope, and frequency of controls reviews as part of its due diligence. Look to see if the fintech has an in-house or outsourced audit function. Review any findings, conclusions, and action plans to determine if the fintech is responsive.

Information Security

The Interagency Guidelines Establishing Information Security Standards set forth standards of the GLBA and address developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of customer information. Financial institutions should evaluate a fintech's information security measures to determine if it has processes in place for handling and protecting sensitive information.

Financial institutions should consider the fintech's security framework for managing cybersecurity risks. Look to the fintech's information security control assessments to determine if the fintech identifies any weaknesses, mitigates such weaknesses or corrects vulnerabilities in its security program. Determine if the fintech trains and tests its employees and subcontractors on its information security program and processes. Does the fintech have solid incident response and notification procedures?

Operational Resilience

Operational resilience identifies business continuity planning and incident response, service level agreements, and reliance on subcontractors as key components in a financial institution's due diligence.

Continuity planning and incident response due diligence should include:

- Evaluating the fintech's business continuity plan, incident response plan, disaster recovery plan and related testing.
- Evaluating the fintech's recovery objectives, including any established recovery time objectives and recovery point objectives.
- Discussing responses to actual cyber events or operational outages and if there was any impact on other clients or customers.
- Considering whether a fintech has appropriate insurance policies and the financial ability to make the financial institution whole in the event of a loss.

Financial institutions should review service level agreements between it and the fintech to ensure that the rights are responsibilities of each party are set forth. Consideration should be given to incorporating performance standards to ensure key obligations are met. Financial institutions should know if the fintech intends to rely on subcontractors to meet any of its performance obligations. Ask if the fintech depends on a small number of contractors for operations and if so, what activities do the subcontractor provide. Consider if the fintech conducts background checks on subcontractors. Don't forget to incorporate any performance measures into the contract.

Due Diligence Challenges

Some of the challenges around due diligence for any third-party vendor includes determining examiner expectations, starting the process, allocating resources, and obtaining needed documentation from the fintech. Examiners will expect the financial institution to evaluate risk in outsourcing activities, identify high risk vendors and conduct appropriate due diligence, know who their vendor's vendors are, and periodically review vendors based on risk pursuant to its vendor management program.

This article is excerpted from a white paper by Becky Breland that may be accessed at https://www.capco.com/Intelligence/Capco-Intelligence/Conducting-Due-Diligence-On-Financial-Technology-Companies-A-Guide-For-Community-Banks.

Accounting for Success

How Can You or Your Clients Evaluate Prospective Auditors and Accountants?

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"Credentialed Auditors Are Not All Equal."

Do you work with a CPA that is a "Jack of all Trades, but a Master of None?" This question has become harder to evaluate as the results of the Department of Labor (DOL) study on audit quality has shifted the industry focus to the qualifications of auditors. CPA firms with specialized audit practices demonstrate their commitment to quality audits by displaying their AICPA audit badges and other industry credentials on marketing materials, social media, and email signature lines.

How can you differentiate between prospective audit and accounting teams that seem to be equally credentialed?

I chair the Employee Benefit Plan Audit practice at BLS so I will focus on EBP credentials, but the information provided below can pertain to other specialized audit, tax, and accounting services that accounting firms provide.

What Do the AICPA Badges Mean?

The AICPA issues badges to accountants who pass tests showing proficiency in their specialty area. In our EBP practice group, the Advanced Defined Contribution Plans, Defined Benefit Plans, and Health and Welfare Plans Audit Certificate Exams test an auditor's ability to plan, conduct, and report on each type of plan audit in accordance with the latest AICPA standards, DOL requirements, and IRS requirements. Intermediate level badges are designed for auditors with approximately three to seven years of experience in performing EBP plan audits. Advanced level badges are designed for auditors with seven or more years of experience performing and reviewing EBP audits.

The Race to Demonstrate Expertise.

When the AICPA created the badge program, firms with large enough practice areas quickly moved to ensure that their teams were credentialed. The costs associated with these open-book tests were not prohibitive at approximately $239 – 299 per person. Since 2016, over 400 EBP digital badges have been awarded to EBP auditors, pretty much making this designation a minimum requirement that employers should expect when selecting a plan auditor. Similar races are occurring within other audit practice groups, such as Nonprofit and Governmental.

Credentialed Auditors Are Not All Equal

As in the case with other professions with advanced degrees and certifications, credentialed auditors are not interchangeable. More than a degree or credential is often required to show true expertise. In addition to digital badges, here are additional considerations when evaluating accountants and auditors:

- The size of the specialized practice. For EBP audit practices, the DOL audit quality study shows a correlation between the number of EBP audits performed and the rate of deficiency in the audits. 93% of the nation's CPA firms perform less than 25 EBP audits and the study showed deficiency rates ranging from 67.4% to 75.80% in those groups. The following link has more information on the results of the DOL Audit Quality Study - https://employeebenefitplanaudit.belfint.com/the-dols-assessment-on-the-quality-of-financial-statement-audits-the-aftermath/

- The experience of the team. How many EBP audits have the members of the audit team assigned to the audit perform? Some of our takeover clients' predecessor audit teams were not specialists and missed important audit steps, even though their firm audited numerous plans. Prospective clients should inquire what percentage of their total chargeable time supervisors, managers, and engagement partners spend auditing EBPs. The answer to this question will quickly identify true specialists.

• Has the DOL reviewed the firm's workpapers? Although the DOL does not issue approvals in writing when audit quality is satisfactory, the prospective auditors should be able to provide several examples of successful DOL reviews of its workpapers.

• IRS Audits. References listed on the proposal should include clients whose plans have been audited by the IRS. Dig deeper by inquiring of the reference if the IRS had findings that the auditor had failed to identify.

• Other references. Ask for a list of not only client references, but references from industry service providers. For the EBP practice group, these could include third-party administrators and ERISA attorneys, in addition to plan sponsors of similar plans.

• Continuing Professional Education. What percentage of the CPE credits obtained by the supervisors, managers, and partners of the audit team is industry or service specific? The answer to this question is another way to reveal whether they are true specialists. Our EBP managers, principals and partners earn substantially all of their CPE credit in EBP topics that also support their industry-specific designations separate from the AICPA badges.

• Other industry involvement. What is the extent of the prospective firm's involvement in the industry in the form of published articles, industry organization memberships, teaching engagements, etc.

As with any other profession, the piece of paper or digital badge indicating the person can do a type of work should be a minimum requirement. True expertise and commitment to a specialty requires continued education and extensive experience in that specific area. CPAs who truly specialize in an industry or practice should be able to show that a significant percentage of their client time, training, and industry involvement are spent in the retirement plan space. Absent this proof, you should say "Hit the Road Jack!"

Delaware Designated Representatives: Statutory Update

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Since its enactment, 12 Del. C. § 3339 has permitted the appointment of a designated representative to represent and bind a trust beneficiary in any judicial proceeding or nonjudicial matter affecting the beneficiary's interest in the trust. Although often used in tandem with 12 Del. C. § 3303, the so-called "silent trust statue" which allows a trust instrument to vary or eliminate a beneficiary's right to be informed for a period of time, Delaware's recently amended statutory framework regarding designated representatives creates maximum flexibility in the administration of both "silent" and "non-silent" trusts.

Role of the Designated Representative

During the course of the administration of a trust, various matters often necessitate the involvement of trust beneficiaries (for example, to provide consent or a release with respect to investment decisions, distributions or other actions of trust fiduciaries). Because direct participation by beneficiaries with respect to trust administration matters is not always possible (e.g. silent trusts or in the case of minor beneficiaries), 12 Del. C. § 3339 permits a designated representative to stand in the shoes of any nonparticipating beneficiaries to represent and bind such beneficiaries in any judicial proceeding or nonjudicial matter affecting their interest in the trust—for example, with respect to a nonjudicial settlement agreement, pursuant to 12 Del. C. § 3338, or a modification by consent, pursuant to 12 Del. C. § 3342.

Appointment of a Designated Representative

The designated representative typically serves by express appointment as such in the governing instrument or by subsequent selection by someone authorized by the governing instrument to appoint a designated representative. However, the need for a designated representative may arise as a post-execution consideration.

For example, 12 Del. C. § 3547 generally allows the virtual representation of a trust beneficiary by another beneficiary with a substantially identical interest or a custodial parent of the trust beneficiary. However, such virtual representation is prohibited if there is a material conflict of interest between the representative and the beneficiary with respect to the particular question or dispute. So, virtual representation is not always an option in the context of family wealth planning where material conflicts of interests may exist between a trust beneficiary and his or her parents or the other beneficiaries of the trust.

Recent updates to 12 Del. C. § 3339 provide a creative solution to the virtual representation problem discussed above by allowing the trustor to appoint a designated representative when one is not appointed pursuant to the terms of the trust instrument. It should be noted that appointment by the trustor is subject to certain restrictions contained in 12 Del. C. § 3339(a)(4).

Acceptance by a Designated Representative

In addition, the revised statutory language of 12 Del. C. § 3339 modifies the means by which a designated representative may accept his or her appointment. Prior to the most recent amendments, an appointment became effective only after a designated representative delivered his or her written acceptance thereof to the trustee. However, the revised statutory language provides that acceptance may be accomplished through service or similar action by the designated representative.

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– Dr. Charles Robertson, Charles & Patricia Robertson Charitable Fund

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