delaware banker

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OMG!
Here Comes the CTA!

Delaware Bankers Association

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

Delaware Banker
Editing & Design
Greg Koseluk

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View from the Chair

by
Dominic C. Canuso
EVP & Chief Financial Officer
WSFS Bank

Chair
Delaware Bankers Association

"Sustainability is really just doing the right thing… consistently. "

Recent events have made me think about the old adage: "In life, don't go for the fast nickel. You've got to go for the slow dime."

This makes me think of Delaware's history, consistency, and resiliency in banking. For a long time, banking and Delaware have been synonymous. And while trends in FinTech, Crypto, and other hyper-growth strategies can look sexy and appealing, typically, it's "Consistency that's King."

Some recent bank strategies, especially outside of Delaware and our region, have been aggressive in some areas, including pushing the needle on some of the most critical aspects of Bank Stability: Liquidity and Capital, which may result in short-term gains but do not always stand the test of time.

As long as there have been opportunists, there have been schemes and speculations promising incredible returns. Here are just a few of history's great speculative bubbles.

The Tulip Bubble - In the 1600s, tulips were first introduced to Holland and became so popular that wild speculation developed around the incoming crop of bulbs. People mortgaged their homes and business to buy bulbs anticipating fantastic returns on the following year's blooms. Then consumer confidence crashed, and investors were ruined, holding now worthless bulbs.

The South Sea Bubble - In the following century, the South Sea Company was formed, promising a monopoly on all trade with the Spanish colonies in South America. Investors bought into tales of fabulous riches to be had in new lands. Share prices rose eightfold before crashing and leading to a deep economic crisis.

The Dot-Com Bubble - None of us were around in the 1600s or 1700s, but few of us can forget the Dot-Com Bubbles of the 1990s. Everything internet and with a .com name was hot, and hundreds of start-up internet businesses received billion-dollar valuations on an idea and a promise. Tech stocks soared and then crashed in 2000, triggering a recession.

There are many more examples, from speculation in railroads in the 1840s to the housing bubble that triggered the Great Recession of 2008. The common thread running through all of these are overconfidence, overexuberance, and overconcentration, which results in a surge in prices, speculation, and typically a precipitous fall. They're called bubbles because they're ultimately not sustainable. They burst.

As I mentioned in my last column, Sustainability has been a hot topic, particularly in banking, especially as it relates to ESG. It seems to me that Sustainability is really just doing the right thing… consistently. The right thing for our communities, customers, clients, and employees. And the banks in Delaware have proven that over time.

Sometimes it's hard not to jump on the latest craze bandwagon, especially in business and especially in a world of investor short-term-ism (focusing on the next quarter's earnings and not long-term value), but at the end of the day 'slow and steady wins the race' which leads to consistency, sustainability, and ultimately stakeholder value.

Dominic

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The **LPP program** provides a lower, blended interest rate to borrowers through the State's participation in a loan issued and administered by a participating lender.

DELAWARE SSBCI | DCAP
DELAWARE CAPITAL ACCESS PROGRAM

The **DCAP program** requires the borrower and lender to make a one-time premium payment (matched with SSBCI dollars) into a bank account that the lender can then use as additional collateral on the loan.

Learn more at de.gov/ssbci

President's Report

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

"Financial literacy allows individuals to make smarter decisions and act more responsibly with their personal finances, which leads to stronger financial futures!"

April showers may bring May flowers, but what else does April bring? Financial Literacy Month and Teach Children to Save Day!

Teach Children to Save is part of a national program first developed by the American Bankers Association's Education Foundation to teach children the importance of saving. When children learn good savings habits, they become financially aware, which will lead them down a path toward financial stability.

Since the program's inception 25 years ago in Delaware, 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. The Delaware Bankers Association and the Delaware Financial Education Alliance coordinate the program in partnership with the University of Delaware's Center for Economic Education and Entrepreneurship.

This year, throughout the week of April 24th to April 28th, hundreds of banker volunteers will team with classroom teachers to teach 3rd and 4th-grade students the importance of consistently saving money to reach financial goals.

Over the years, children have been following the misadventures of the Great Investo, the world's worst money magician, and Penny, his smart and faithful assistant, who, in the end, always gets Investo to see that consistently saving is the only way to make wise money decisions.

What makes this program unique to Delaware, and the best in the Nation, is the vital role UD's CEEE plays in preparing the lesson based on the book's content to meet Delaware's state economic education standards.

This year's Teach Children to Save Day lesson is taken from the new comic book, *Big Money Trouble*, written and illustrated by Greg Koseluk. The comic book features copyrighted characters, the Great Investo and Penny, highlighting the economic concepts of scarcity, decision-making, and saving.

This year, with the generous support of Delaware banks, each student will receive their own comic book to take home and share with their family. The book also features games and puzzles to reinforce the concept of saving.

April may be financial literacy month, but understanding personal financial well-being is ongoing. The concepts of saving and investing need to be learned and applied to life every day. Every May, the DBA awards two annual scholarships to Delaware high school students participating in the Keys to Financial Success elective course. Winners are selected on the strength of essays on the importance of financial literacy education.

In 2019 the DBA was proud to rename the Keys to Financial Success Scholarship in honor of David G. Bakerian, the late former president of the Association.

The Delaware Financial Education Alliance, in cooperation with UD's CEEE, the Consumer Credit Counseling Services of Maryland and Delaware, and the Federal Reserve Bank of Philadelphia, piloted the course in one Delaware high school in 2001-02. Since then, the course has expanded to additional schools statewide. Keys covers future financial goals and decision-making, career planning, intelligent money management, and other important topics.

The goal of Teach Children to Save and Keys to Financial Success is to better equip young people with the solid money tools needed for fiscal independence. Financial literacy allows individuals to make smarter decisions and act more responsibly with their personal finances, which leads to stronger financial futures!

Sarah

What's New at the DBA

New Associate Members

Hightower Trust Company

Jordan Wolff, CTFA, MBA, ATFA
Director of Trust Administration
1007 N. Orange St, 4th Floor, Suite 441,
Wilmington, DE 19801
302.485.5949
Email: jwolff@hightoweradvisors.com
Website: www.hightowertrust.com

Hightower Trust Company, N.A. started as Pinnacle Management & Trust in 1994. Originally created to administer the many trusts of the founding partners' families, it grew into a state-chartered trust company where it began to offer private client family office services and served as Trustee for hundreds of families. It was later acquired by an RIA and became Salient Trust Co. in 2004. In 2018 and with over $1B Assets Under Administration it joined forces with Hightower Advisors and gained a national charter in 2022. Today, rapidly expanding to over $1.5 billion in assets under administration, Hightower Trust Company, N.A. serves advisors and the families they are committed to. The trust company offers directed, delegated, and agency models so that it may be flexible depending on individual clients needs. With the resources of Hightower Advisors behind it, Hightower Trust Company, N.A. has the capability to serve uncomplicated client needs, all the way up to sophisticated ultra-high net-worth families estate planning needs.

Porzio, Bromberg & Newman, P.C.

Cheryl A. Santaniello
Managing Principal
302-526-1235
Email: CASantaniello@pbnlaw.com
Website: https://pbnlaw.com

Porzio, Bromberg & Newman, P.C. is a full-service law firm with offices in New Jersey, Delaware, Massachusetts, New York, Pennsylvania and Puerto Rico. The firm has over 90 lawyers who are committed to serving clients, providing high-quality work, and achieving results through legal strategy, advocacy, technology, and consulting services offered through the law firm and its two wholly-owned subsidiary companies, Porzio Compliance Services, LLC and Porzio Governmental Affairs, LLC. Please visit www.pbnlaw.com for more information or contact Cheryl Santaniello, Managing Principal, Delaware at CASantaniello@pbnlaw.com.

Wipfli

Summer Gustin, Chief of Staff
170 N Radnor-Chester Road
Radnor, PA 19087
480.289.6052
Email: summer.gustin@wipfli.com
https://www.wipfli.com/industries/financial-institutions

Financial institutions face many challenges today, including regulatory pressure, financial performance, shareholder value, and fierce competition to retain market share and employees. Wipfli's financial institutions professionals are dedicated to serving financial institutions. Our goal is to help your organization succeed by providing constant communication, value-driven consultation and education. Some of the services we provide to financial institutions include networking and educational forums, educational webinars and trainings, timely blogs and podcasts, and relevant articles and whitepapers. Our professionals are featured speakers at various financial institution trade association meetings around the country and are committed to sharing their knowledge within the industry.

2023 DBA Legislative Reception

Dozens of bankers and members of the Delaware Legislature met Wednesday, March 29, in Dover for the 2023 DBA Legislative Reception. The annual event affords bankers the opportunity to meet one-on-one with the senators and representatives who pass the laws that directly impact the financial services industry. "The Legislative Reception is an excellent event to interact with lawmakers," said DBA President, Sarah Long, "and demonstrate the importance of the banking industry in the First State." The reception was sponsored by Discover Bank.

2023 DBA Washington Visit

After three years, the DBA Executive Officer Washington Visit was held in person!, March 1 to 3. The 2020 Visit was conducted the last week before the COVID lockdown. The group received extensive briefings from the American Bankers Association, the FDIC, FHFA, Treasury, and the OCC. There were also meetings with Senators Carper and Coons and Representative Blunt Rochester's office. Thank you to all our sponsors! Platinum Sponsor: Federal Home Loan Bank of Pittsburgh. Reception & Dinner Sponsor: S&P Global. Lunch Sponsor: Discover Bank. Reception Sponsors: Richards Layton & Finger; Sallie Mae; and, WSFS Bank. Shuttle Bus Sponsor: JTC.

Cover Story

OMG, Here Comes the CTA!

Digesting the Alphabet Soup That is the Corporate Transparency Act

by
J. Zachary Haupt
and
Anne Grae Martin
Morris, Nichols, Arsht & Tunnell LLP

IDK, What is the CTA?

The Corporate Transparency Act (the "CTA") was passed in Fiscal Year 2021 as part of the National Defense Authorization Act ("NDAA") in an effort to "better enable critical national security, intelligence, and law enforcement efforts to counter money laundering, the financing of terrorism, and other illicit activity."[1] Prior to the enactment of the CTA, the United States did not have a uniform system requiring individuals or entities to disclose information regarding those who establish or beneficially own entities that are formed or operate within the country. Times have changed. Pursuant to the CTA and the final regulations issued by the US Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") on September 30, 2022[2] (the "Regulation"), every "reporting company" will soon be required to submit a report to FinCEN disclosing, among other things, certain beneficial owner information ("BOI"), or will face possibly significant consequences for noncompliance.[3] Although much remains uncertain regarding the implementation and enforcement of this massive program, disclosure obligations will become effective in 2024, so it is time to become familiar with the CTA and the Regulation, and how this may affect you, your clients and customers.

Will This Affect My BFFs?

The obligations imposed by the CTA apply to each so-called "reporting company." A reporting company is defined as an entity that is created by filing a document with a secretary of state or similar office under the law of a State or Indian Tribe, or is formed in a foreign country and registered to do business in the United States by the filing of a document in such office.[4] Entities that may qualify as reporting companies include, but are not limited to, corporations, LLCs, LLPs, and business trusts (or, as they are called in Delaware, statutory trusts).[5] Although the CTA casts a wide net, twenty-four entity categories are exempted from the statute, including banks, tax-exempt entities, large operating companies, and inactive entities.[6] Additionally, trusts that are not created pursuant to a filing with the secretary of state or similar office (e.g. Delaware common law trusts) do not fall within the definition of reporting company.[7] However, many trusts hold interests in entities that will qualify as reporting companies, so certain trustors, trustees, fiduciary and nonfiduciary officeholders, powerholders and beneficiaries will be affected by the CTA.

Under the CTA, each reporting company is obligated to provide information regarding its "beneficial owners" and, depending on when it was formed, its company "applicants." The CTA and the Regulation describe two categories of beneficial owners: (1) those who exercise "substantial control" over a reporting company, and (2) those with at least 25% of the ownership interests of a reporting company.[8] While the ownership test should, theoretically, be relatively easy to apply (and the rules that apply to beneficiaries of trusts are described in more detail below), determining whether someone possesses substantial control appears to be a more amorphous standard. An individual is deemed to exercise substantial control over a reporting company if the individual serves as a senior officer; has authority over the appointment or removal of any senior officer or a majority of the board of directors; directs, determines, or has substantial influence over important decisions made by the reporting company (e.g., important decisions regarding the nature of the business, major expenditures or investments, issuances of any equity and incurrence of any significant debt, compensation schemes, etc.); or has any other form of substantial control over the reporting company.[9] FinCEN intended this broad definition to "close loopholes that allow corporate structuring that obscures owners or decision-makers," but it may cause some uncertainty among reporting companies, especially until additional guidance and standard practices are developed.[10]

Notwithstanding the breadth of the CTA and the Regulation, the following five categories of individuals and entities are excepted from the definition of a beneficial owner:

- minor children (whose parent or parents' information is reported);
- individuals who are acting as nominees, intermediaries, custodians, or agents on behalf of other individuals;
- an individual acting as an employee for a corporation, LLC,

(Continued on p . 12)

(continued from p. 11)

or other entity and "whose control over or economic benefits from such entity is derived solely from the employment status of the person";
- an individual with a right of inheritance interest in a corporation, LLC, or other entity; or
- a creditor of a corporation, LLC, or other entity unless they exercise substantial control or own more than 25% of the ownership interests of the entity.[11]

In regard to company applicants, the term "applicant" includes both the individual filing the document that creates the entity (or that registers it for business in the United States) and the individual who has directed or controlled another individual to file such a document.[12] Consequently, a variety of service providers that help facilitate the formation of entities, but who are otherwise unaffiliated with or have limited involvement with such entities, will be captured by the statute.

OMG, I Have To File What? And What if the Information Is Incorrect or I Fail to File?

Initial reports are required to include the following information regarding the reporting company: (1) the company's full legal name, (2) the company's trade name or "doing business as" name, (3) the company's complete current address of its domestic principal place of business for companies with a principal place of business in the US and for all other cases, the US address of the primary location where the reporting company conducts business, (4) the company's formation jurisdiction, (5) for a foreign reporting company only, the jurisdiction where it first registered, and (6) the IRS Taxpayer Identification Number ("TIN") that includes the reporting company's Employer Identification Number of if a foreign reporting company does not have a TIN, such TIN that has been issued by its foreign jurisdiction.[13] BOI reports are also required to include four categories of information about each beneficial owner: (1) name, (2) date of birth, (3) address, and (4) some form of unique identifying number, such as a driver's license number, with an image of the document containing such number.[14] The CTA also requires this same information be provided about the company applicant; provided, however, that company applicant information will only need to be reported for entities formed after January 1, 2024.[15] Furthermore, an individual may provide the required information directly to FinCEN and may obtain a FinCEN identifier, which can then be used in lieu of the above information on future BOI reports.[16] FinCEN received comments during the rulemaking process expressing concerns over entities' use of a FinCEN identifier, and pledged to "address them before the effective date."[17]

A reporting company discovering that a BOI report includes inaccurate information, or realizing that once-accurate information has since changed, has 30 days from the time the information changed or from the time it became aware or should have been aware that information was inaccurate to report changes to FinCEN.[18] Those willfully providing false or fraudulent information, willfully failing to report, or willfully failing to update inaccurate information,[19] could face criminal or civil penalties,[20] including a civil penalty of not more than $500 for each day inaccurate information remains unfixed and may also be fined not more than $10,000 and/or face two years of jail time.[21] Having received many comments regarding penalties through the rulemaking process, FinCEN stated that "any assessment as to whether false information was willfully filed would depend on all of the facts and circumstances surrounding the certification and reporting of the BOI, but as a general matter, FinCEN does not expect that an inadvertent mistake by a reporting company acting in good faith after diligent inquiry would constitute a willfully false or fraudulent violation."[22] Nevertheless, those with reporting obligations should be vigilant about reporting information accurately in the first instance and about keeping information up to date, or will potentially face serious adverse ramifications.

What's the ETA?

Starting January 1, 2024, reporting companies will have disclosure obligations with respect to BOI and, depending on when they were formed, company applicants. Companies established before January 1, 2024 ("previously existing companies") will have a different deadline and filing requirements than companies created or registered to do business in the United States on or after January 1, 2024 ("later created companies"). Specifically, previously existing companies will have until January 1, 2025 to file a BOI report and will not be required to disclose information regarding the company applicant.[23] Later created companies, however, will have 30 days after receiving notice of their creation or registration to file their initial BOI reports and will be required to provide company applicant information when the BOI report is filed.[24]

Importantly, both previously existing companies and later created companies will have an obligation to ensure their information remains up to date. If a reporting company discovers that reported information is inaccurate, or if control or ownership changes in a manner that causes previously-accurate information to become incorrect, the reporting company has 30 days from the time it become aware or should have become aware of such inaccuracy to report the changes.[25]

BTW, How Will This Affect Trusts?

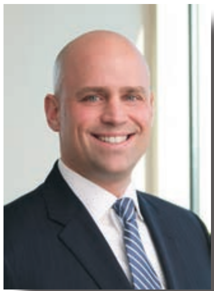
Notwithstanding that most trusts will not fall within the definition of a reporting company under the CTA, many trusts own one or more entities that will qualify as a reporting company, which may cause a trustor, trustee, fiduciary or nonfiduciary officeholder, powerholder or trust beneficiary to qualify as a "beneficial owner" within the meaning of the CTA if such person is deemed to beneficially own at least 25% of the entity or possess substantial control over the entity.

In determining whether an individual has substantial control of a reporting company held by a trust, in addition to the general control factors described above, the Regulation provides that an individual, including a trustee, may directly or indirectly exercise substantial control over a reporting company through: "(A) [b]oard representation; (B) [o]wnership or control of a majority of the voting power or voting rights of the reporting company; (C) [r]ights associated with any financing arrangement or interest in a company; (D) [c]ontrol over one or more intermediary entities that separately or collectively exercise substantial control over a reporting company; (E) [a]rrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or (F) any other contract, arrangement, understanding, relationship, or otherwise."[26] Indeed, FinCEN stated that a trustee, depending on the circumstance, can exercise substantial control over a reporting company "through the exercise of his or her powers as a trustee over the corpus of the trust, for example, by exercising control rights associated with shares held in trust."[27]

In determining whether an individual is deemed to own at least 25% of the ownership interests in the reporting company held in a trust, the Regulation provides that an individual may directly or indirectly own or control an ownership interest of a reporting company through "any contract, arrangement, understanding, relationship, or otherwise," including, in part "(1) [a]s a trustee of the trust or other individual (if any) with the authority to dispose of trust assets; (2) [a]s a beneficiary who: (i) [i]s the sole permissible recipient of income and principal from the trust; or (ii) [h]as the right to demand a distribution of or withdraw substantially all of the assets from the trust; or (3) [a]s a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust."[28] Notably, the Regulation provides that an individual's total ownership will be considered, so the various capacities in which an individual may be deemed to own an interest must be considered.[29] Furthermore, more than one person can qualify as a beneficial owner of a trust's interest in a reporting company, so all of the different individuals who possess interests and powers must be considered for reporting purposes.

Given the incredible flexibility of Delaware trusts and the number of roles and powers often possessed by trustors, trustees, fiduciary and nonfiduciary officeholders, powerholders and beneficiaries, the potential fact patterns are limitless, which makes it very difficult to establish general rules that will apply in every situation. Based on published guidance, however, it is clear that certain trustors, trustees, officeholders, powerholders and beneficiaries will fall within the definition of beneficial owner provided they possess the powers and ownership thresholds generally described above and in further detail in the Regulation. Consequently, a reporting company should understand the governing instrument for trusts that hold an interest to assess whether someone may qualify for mandatory disclosure under the CTA. All of this can, of course, be complicated greatly by factors such as limitations upon rights to information in silent trusts and bifurcation of trust powers among co-trustees and advisers. In light of the myriad designs of trust instruments and relationships in jurisdictions like Delaware, interesting questions are certain to arise. Members of the trust industry and their advisors will certainly be monitoring developments closely for additional guidance regarding CTA application in unique circumstances.

(continued from p. 13)



J. Zachary Haupt is special counsel at Morris Nichols in Wilmington, Del. Zach's practice focuses on trust law, estate planning and state and federal taxation. He regularly works with clients to settle new trusts and to modify existing irrevocable trusts through decantings, mergers, consent modifications, non-judicial settlement agreements, administrative amendments, and judicial reformations.

Anne Grae Martin is an associate in Morris Nichols' trusts and estates group. Her practice focuses on advising individuals, institutional fiduciaries, private wealth managers, and their counsel on matters involving Delaware trusts and estates.

Notes

1- Corporate Transparency Act, Pub. L. No 116-283, § 6403, 134 Stat. 4604, 4605-06 (2021). The NDAA includes the Department of Defense's plans for the coming fiscal year, and gathering information regarding those who create and own entities in the United States is one of the latest security measures the Department of Defense is taking.
2- 31 C.F.R. § 1010.380.
3- See generally, FINCEN, BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE FACT SHEET (2022), https://www.fincen.gov/ beneficial-ownership-information-reporting-rule-fact-sheet.
4- 31 U.S.C. 5336(a)(11).
5- FINCEN, supra note 3.
6- 31 U.S.C. § 5336(a)(11)(B).
7- FINCEN, supra note 3.
8- 31 U.S.C. § 5336(a)(3)(A).
9- 31 C.F.R. § 1010.230(d).
10- FINCEN, supra note 3.
11- 31 U.S.C. § 5336(a)(3)(B).
12- 31 U.S.C. § 5336(a)(2).
13- 31 C.F.R. § 1010.380(b)(1)(i).
14- 31 C.F.R. § 1010.380(b)(1)(ii).
15- 31 C.F.R § 1010.380(b)(2)(iv).
16- 31 C.F.R. § 1010.380(b)(4).
17- Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,525 (Sept. 30, 2022) (to be codified at 31 C.F.R. pt. 1010).
18- 31 C.F.R. § 1010.380(iv)(2).
19- 31 C.F.R. § 1010.380(g).
20- 31 U.S.C. § 5336(h)(1)(A)-(B).
21- 31 U.S.C. § 5336(h)(3)(A).
22- Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,515.
23- 31 C.F.R. § 1010.380(a)(1)(iii), (b)(2)(iv).
24- 31 C.F.R. § 1010.380(a)-(b).
25- 31 C.F.R. § 1010.380(a)(2).
26- 31 C.F.R. § 1010.380(d)(1)(ii).
27- Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,529.
28- 31 C.F.R. § 1010.380(d)(2)(ii).
29- 31 C.F.R. § 1010.380(d)(3).

The CRE Lender's Guide To Being Prepared

by
Sara T. Wagner
Katharine Lester Mowery
Richards, Layton & Finger, P.A[1]

In an increasingly complex and rapidly evolving economic climate, commercial real estate (CRE) lenders need to be prepared to take action to protect existing loan portfolios from broader macroeconomic conditions. A confluence of events culminated in the current state of the market, starting with coronavirus business closures, stay-at-home orders, supply-chain disruption, pandemic work-from-home and, most recently, inflation. The Federal Reserve, during its January 31 to February 1, 2023 meeting,[2] acknowledged a level of concern related to financial stability and vulnerabilities associated with higher interest rates and elevated valuations, "particularly in the CRE sector."[3] Prognosticators are expressing concerns that commercial real estate may be the next sector to disrupt financial markets as lending standards for CRE loans continue to tighten.[4] If these conditions progress, as loans mature, sponsors will have challenges refinancing existing indebtedness. Without viable exit strategies to address pending maturities, loan workouts could be on the horizon in 2023. In light of these turbulent conditions, the prudent lender must be prepared for CRE loan defaults and delinquencies. What will this preparedness look like?

Due Diligence

The goal of a loan workout is to provide the lender with the best potential recovery solution to a challenged loan. Some assets may be more susceptible than others over the course of the coming months, so consideration of a lender's loan portfolio and examination of risk areas are advisable. Loans secured by office buildings, in particular, likely warrant careful scrutiny. High vacancy rates in office buildings[5] have created difficult valuation and financing conundrums for sponsors and lenders, with reports of office loan portfolios being in danger of default.[6] So what can a lender do to plan for potential defaults and delinquencies? Be prepared for workouts. Look for signs of stress to the sponsor and the collateral. A class A office building with amenities in a prime location will likely not have the same challenges as B and C class spaces, as pandemic tenant demands have shifted to quality to entice workers back to the office. Preparedness for a workout will include due diligence. We have created a checklist of important considerations for lenders to be mindful of when evaluating existing loan portfolios. Reviewing the items listed in the following checklist may help to prevent or better prepare lenders for contingencies often associated with delinquent or defaulted loans.

The Lender's Due Diligence Workout Checklist

Task (commentary in gray boxes)
Review of borrower's financial condition, including updated and comprehensive financial information of borrower.
Review of each corporate and individual guarantor's financial condition, including updated and comprehensive financial information of corporate and individual guarantors.
Analysis of borrower's global debt service, reflecting projections of borrower's, corporate guarantor's and individual guarantors' expenses.
Review of existing loan documentation, including notes, amendments, security documents and UCCs.
Determine whether there are any gaps in the loan documents. Are all originals accounted for, fully executed, dated, witnessed and/or notarized as needed?
Determine status of any guaranty agreements.
Is the loan full-recourse? Non-recourse but subject to "bad-boy" carveouts?

Are there other lenders in the capital stack? Review intercreditor and/or subordination agreements.
When multiple lender relationships exist there may be obligations to provide notice and possibly cure rights before exercising remedies. Careful review of any intercreditor agreement is recommended before commencing enforcement actions.
Review of current rent roll.
Have there been vacancies since initial underwriting/closing? Is the asset meeting required DSCR, NOI and related covenants?
Review of leases, estoppels, SNDAs.
Any changes to material/significant leases? Termination or default notices? Have tenants contracted or turned over space? When do major leases terminate? Do tenants have termination rights?
Review status of tenant occupancy and notices of lease defaults and/or terminations.
Assessment of loan performance.
Review of lien status of borrower.
Have mechanics' liens been filed? Is lender's priority senior to any such liens?
Review/determine status of all communications with borrower regarding the current status of the loan.
How has lender addressed past defaults? Is there a history of waivers?
Send default notice letters.
Identify sources of additional collateral.
Determine whether borrower or guarantors have accounts with the bank that could be available for set-off.
Review of condition of the real estate collateral.
Determine nature and value of all collateral securing the loan. Review existing appraisals and determine need for new valuation information. Consider procedures for continuous monitoring to ensure collateral does not go to waste.
Review of property insurance.
If insurance has lapsed, it may be necessary to force place coverage. Loan documents should include protective advance provisions for the payment of insurance to protect the lender's security interest in the collateral.
Determine status of taxes.
Lien priority can be lost to the super-priority rights of federal, state and local taxing authorities. Are escrows being held for taxes? If not, the loan documents should include protective advance provisions for the payment of taxes to protect the lender's security interest in the collateral.
Determine entity standing.
Obtain appraisal.
When ordering a new appraisal, ensure it is obtained from an appraiser qualified to testify as an expert in litigation.
Check files for survey of the property.
Ensure title policy has been issued and review policy for title issues.
Pre-negotiation letter/pre-workout agreement.
Agreement that protects the lender against post-default lender liability resulting from the course of discussions; creates a pathway for negotiation and/or potential restructuring of the loan.

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Be proactive. Look for the warning signs of challenges to the borrower and/or the collateral before a default occurs. The items identified on the sample checklist may help identify the early signs of a potential problem. Conducting loan due diligence will arm the lender with information needed for decision-making and potential workout strategies. If an event of default has occurred and remains in existence, under most CRE loan documents the lender will have various rights at its disposal, including, among others, acceleration of the debt, default interest, litigation for past due payment(s), the appointment of a receiver, and the right to foreclose on the property that secures the loan. Borrowers may have cure periods and the cure period for various types of defaults may vary; therefore, a review of the applicable cure periods on a loan-by-loan basis is necessary. Many factors can contribute to troubled loans. With office assets, for example, vacancies, major tenant terminations and financial covenant failures are red flags signaling the possibility of a default. When the signs point to problems, CRE lenders should prepare for the possibility of a workout.

Strategies For Distressed Real Estate

Most borrowers/operators of CRE are experienced, skilled operators who are acutely aware of when and how external conditions are affecting their assets. They want to be proactive in addressing and solving the challenges confronting their properties. While it is exceptionally important for lenders to understand their loan portfolios and know what rights and remedies they may have in the event of default, it is also beneficial for the lender to understand the types of solutions that its borrowers/guarantors may be exploring. In many distressed real estate scenarios, the borrower wants to retain the property, and to do so, borrowers may want to consider a loan modification. When lenders and borrowers can come to terms and document a loan modification in a workout scenario, it is not uncommon to see, among other things, forbearance of the exercise of its remedies, extension of maturity dates and capitalizing of interest. Sometimes there may be value in the lender making an additional advance not contemplated under the original loan terms if the advance will help the property generate or improve cash flow, such as advancing funds to pay a brokerage commissions for a new lease or funds to make tenant improvement allowances to lease a vacant space to a new tenant. A loan modification can take many forms and frequently requires one or more borrower concessions, such as principal curtailment payments, adding additional collateral, equity pledges of membership interests in the borrower, adding or modifying financial covenants and/or liquidity tests, eliminating future funding/revolving or readvance provisions, consenting to the appointment of a receiver, or changes to the property manager.

When documenting an amendment to a loan, it is imperative that any such amendment preserves the lender's lien priority. Amendments of loans, if not properly documented, could have unintended consequences, such as impairing the lender's existing priority position. And when CRE is in distress, if there are other creditors in the capital stack, amendments could open the door to priority loss.

Another request that borrowers may make when trying to implement a plan to address a floundering asset is for permission to add additional funding to the capital stack. Additional funding could be a mezzanine loan secured by the borrower's equity in the project or preferred equity. While an equity infusion may be what the project needs to survive, adding additional debt to the capital stack presents other concerns to the existing senior mortgage lender, such as how a mezzanine lender's rights affect the senior lender's remedies and enforcement powers. Mezzanine CRE loans are secured by a pledge of the property owner/borrower's ownership of the real estate. Since a mezzanine lender is higher up in the capital stack, it will be concerned about a foreclosure by the senior lender, which would render the mezzanine collateral valueless. Therefore a mezzanine lender, as a condition to making its loan, would likely condition doing so on obtaining an intercreditor agreement with the mortgage lender. An intercreditor agreement typically provides a mezzanine lender with the right to cure a mortgage loan default for a specified period, to allow the transfer of a property to a mezzanine lender or a qualified transferee through a foreclosure of the pledged equity interests in a mortgage borrower, and to purchase a defaulted mortgage loan. When preferred equity is added to a project, the preferred equity provider typically seeks similar protections as a mezzanine lender through the use of a recognition agreement. For a troubled asset, permitting a borrower to add additional sources of funding to the capital stack may save a project, but the implications to additional funding can impair the lender's existing remedies and rights. Therefore, the mortgage lender should carefully review any such request against other potential pathways that may be available to restructure the loan.

Sometimes other pathways are not available and borrowers may be willing to "hand back the keys" through the use of a deed-in-lieu of foreclosure. When this is an option, the lender is entering into a negotiated settlement of the loan whereby the borrower transfers title of the asset to the lender. When negotiating with the lender for a deed-in-lieu of foreclosure, for example, borrowers will usually seek relief from the sponsor's personal guaranty as a condition to their cooperation. When this request is made, the lender needs to consider whether it will be made whole by the property alone or whether it wishes to preserve its right to seek any deficiency[7] from the guarantors.

Be Mindful Of Your Communications

The advice of counsel will be paramount during the process of evaluating and addressing troubled loans. When communicating with counsel, be mindful of the basics of attorney-client privilege. Although the definition of attorney-client privilege varies depending on jurisdiction, it generally attaches to a confidential communication between a client and its counsel made for the purpose of facilitating professional legal services.[8] In a workout situation, it is necessary for the lender to maintain the confidentiality of all communications with its attorney. First, when drafting an email it is imperative that the lender includes on the email only those individuals who are necessary in seeking information from the attorney and with whom the lender intends to maintain confidentiality. Second, the lender should be cautious about forwarding email chains with its attorney. For example, when seeking advice regarding how to respond to a borrower's request for a waiver of default involving a tenant vacancy, a lawyer may craft an email with advice to the lender on how the lender could respond. This advice may be on the same email thread where the lawyer and the client have discussed other, confidential matters. Forwarding the email thread to a party not covered by privilege would break the privilege between the lender/client and its counsel. While not dispositive, it never hurts to place a "privilege" indication on emails to counsel.

Think about what you put in writing—not just to a borrower, but internally. In all communications, the lender's internal communications and documentation should be reasonable and appropriate and, in particular, avoid characterizations that would be damaging if exposed in a courtroom proceeding. Most types of business records and internal business communications, absent a privilege, are discoverable in litigation, so assume that anything you write as a lender could be shown in a courtroom. This goes for emails, text messages and social media posts too. Lenders should avoid any documentation of their actions involving a loan that could be characterized as emotional or unreasonable; rather, all assessments should be factual, appropriate and reasonable.

Likewise, lenders should be consistent in communications with borrowers and should avoid vague or ambiguous statements. For meetings or verbal communications with borrowers, lenders should have more than one person present to help counter a borrower's misconstrued recollection of the conversation. Submitting a memo to the borrower's file memorializing the meeting or verbal communication may also assist the lender when memories inevitably fade.

Keep in mind that the goal of communications in a workout is to resolve a troubled loan; however, some situations will not be resolved through the workout process and negotiations may fail. When this happens, failed negotiations could form the basis for lender liability claims because a borrower relied on aspects of the negotiations to its detriment. A well-drafted pre-negotiation agreement is therefore advisable before any discussions are held. Lenders should also be in communication with counsel should negotiations fall through and litigation becomes a reality, as there are important requirements to start preserving documentation relating to the potential litigation when it is anticipated.

Now more than ever, lenders must pay careful attention to their loan portfolios and be ready to confront evolving economic conditions. By being proactive and prepared, lenders can address troubled loans and resolve them in a positive manner for all involved.

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Real Estate Lending

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Sara Wagner is chair of the Real Estate Group at Richards, Layton & Finger, Delaware's largest law firm. She focuses on complex transactions involving the finance, acquisition, sale, lease, and development of commercial real estate properties. Sara represents major real estate developers, financial institutions, significant holders of commercial real estate, and institutional clients in all types of commercial real estate transactions. She is recognized in Chambers USA, The Best Lawyers in America, Super Lawyers, and as a Delaware Today Top Lawyer.

Kate Mowery, a director of Richards, Layton & Finger, focuses her practice on litigation in Delaware's state and federal courts in a variety of areas, including intellectual property, trade secrets, products liability, real estate, and complex commercial disputes. Before joining Richards Layton, Kate clerked for the Honorable Joseph R. Slights III in the Delaware Superior Court. She has been listed in The Best Lawyers in America, Super Lawyers, and as a Delaware Today Top Lawyer.

Notes:

1- The views expressed in this article are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.

2- "Minutes of the Federal Open Market Committee January 31–February 1, 2023," accessed via FOMC Minutes January 31–February 1, 2023 (federalreserve.gov).

3- *Id* at page 7.

4- *A Credit Crunch Could Worsen the Bank Turmoil and Commercial Real Estate Could Be Next Domino to Fall*, BUSINESS INSIDER, March 27, 2023, by Phil Rosen, accessed via Why Commercial Real Estate Could Tumble As the Next Bank Crisis Domino (businessinsider.com).

5- *Office Vacancy Will Increase By 55% by the End of the Decade as Hybrid and Remote Work Push Real Estate to An 'Inflection Point'*, FORTUNE, February 22, 2023, by Tristan Bove, accessed via Office vacancy rates are soaring because of remote work | Fortune.

6- *20% of M&T's Office Loans in Danger of Default*, THE REAL DEAL, January 19, 2023, by Suzannah Cavanaugh, accessed via M&T Bank Reports Higher Office Default Risk in Fourth Quarter (therealdeal.com).

7- The deficiency is the difference between the sale bid (if mortgagee is successful bidder) or net foreclosure sale proceeds (if third party is successful bidder) and the amount of the judgment entered in the foreclosure action.

8- E.g., Del. R. Evid. 502(b).

Tax Considerations for Foreign Investment in the U.S.

Jonathan Turner, CPA
Belfint Lyons & Shuman, P.A.

"Understanding an LLC's reporting requirements (being that it is a legal, but not a tax paying entity) and how it differs from a corporation is crucial."

Foreign investors looking to enter the U.S. market often ask us "should I form an LLC or a corporation?" Understanding an LLC's reporting requirements (being that it is a legal, but not a tax paying entity) and how it differs from a corporation is crucial. We have outlined below common Federal tax considerations assuming a singular foreign investor.

U.S. LLC

A U.S. LLC with only one owner is disregarded for U.S. tax purposes. As a result, the LLC would not file a U.S. income tax return of its own. Instead, its income and related expenses would be reported by its owner on their tax return. This commonly causes a foreign tax mismatch at the parent country's level since the U.S. deems the parent to be the taxpayer and the foreign country typically deems the subsidiary to be the taxpayer.

If the foreign member was an individual, their share of LLC profits would be considered income effectively connected to a U.S. trade or business (ECI). This income would be subject to U.S. tax on a net income basis at the regular graduated rates (max rate is currently 37%). The member would file a Form 1040-NR (Non-Resident) on an annual basis to report and pay any tax due on this income. Filing is required even if the entity isn't profitable, and no tax is due. If profitable, the foreign member would be expected to make quarterly estimated payments that cover 90% of the current year tax or 100% of the prior year tax as applicable. The 1040-NR would be used to claim credit for the estimated taxes paid throughout each quarter of the year.

If the foreign member was a corporate entity, its share of LLC profits would be reportable on Form 1120-F U.S. Income tax return of a Foreign Corporation and subject to the current federal corporate tax rate of 21%. Filing is required, regardless of profitability. The U.S. LLC's net income would also be subject to the branch profits tax at 30% (or lower treaty rate) for any of the U.S. LLC's accumulated earnings that are not reinvested in the LLC. The intricacies of the branch profits tax and related calculation are beyond the scope of this article, but the underlying concept is meant to mimic the taxation of dividend distributions to shareholders of a U.S. corporation. The branch profits tax would be calculated and reported on the foreign corporation's Form 1120-F.

It's important to note that under either of the ownership scenarios above, the Form 5472 Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business would be required to report related party transactions including, but not limited to, capital transactions, remittances to/from the foreign owner or debts payable to/from them. Care must be taken that related party transactions are always at "arm's length". The individual filer files the 5472 with a proforma corporate income tax return; the corporate filer submits twice; one for the U.S. LLC and another for the foreign corporation.

U.S. Corporation

A U.S. corporation would report its activity on a Form 1120 U.S. Corporation Income Tax Return and be taxed on its net income at the current federal rate of 21%. Filing is required regardless of whether the corporation has taxable profits. In addition to reporting net income, the annual report must also include the Form 5472 to disclose related party transactions (as above). The corporation would be required to withhold tax on any dividend distributions to its foreign shareholder at a rate of 30% (or lower treaty rate), typically within three business days following the close of the quarter-monthly period in which the payment was made. Withholding of this tax would be reported by the corporation annually by filing Form 1042/1042-S.

At the shareholder level, the tax effects are similar for both a foreign individual and foreign corporation. Dividend distributions to a foreign shareholder are withheld at a 30% rate (or lower treaty rate) by the U.S. corporation. Provided the foreign shareholder has no other U.S.-sourced income and adequate tax was withheld on the dividends, the Form 1040-NR (foreign individual) or Form 1120-F (foreign corporation), would not be required to be filed.

The above are simplified scenarios; further considerations in choice of entity would include additional state income tax (depending on nexus), estate tax implications, and future exit strategies. When asking "what should I form?" the answer will always be "it depends."

Key Planning Considerations in a High Interest Rate Environment

by
Gina M. Nelson
and Daniel Cihanowyz

Since March of 2020, unpredictability and volatility seem to have become the norm. While supply chain issues were largely resolved going into 2022, inflation became a major factor in nearly all facets of life. March 2023 saw Federal Reserve Chairman, Jerome Powell, announce the ninth consecutive increase in interest rates since the Fed began its rate hikes in March 2022.

For estate planners and advisors, a high-interest rate environment presents a unique set of considerations. The ultimate success or failure of many sophisticated estate planning strategies is tied to interest rates, whether high or low. Here, we will delve into several planning areas highly impacted by the current interest rate environment, and we take a look at significant tax changes that may impact planning strategies.

Utilizing the "Power to Adjust"

A rising interest rate environment is an opportune time to re-evaluate one's investment strategy and asset allocation, focusing on quality over quantity, high conviction investment decisions, and a re-examination of investment objectives, such as taking advantage of higher-yielding bonds for the increased income they provide. Periods of high and rising interest rates require the same strategic thinking as periods of low and falling interest rates, and reviewing the use of the "Power to Adjust" (PTA) is particularly important as trustees navigate these conditions.

The Power to Adjust is a creature of statute that came about largely in the 1990s as a result of Modern Portfolio Theory and the objectives of investing for "total return" (i.e., constructing a portfolio for both its capital appreciation potential as well as its income component). Trustees have a duty to balance the interests of both current and remainder beneficiaries. Prior to the introduction of the PTA, the balance was often achieved by investing in a portfolio heavily weighted towards producing income and preserving principal, but not so much aimed at growing principal. As the idea of total return investing took hold, it became difficult for trustees to produce income and grow principal concurrently, thus leading to the advent of the Power to Adjust.

While the Uniform Fiduciary Principal and Income Act of 2019 made updates to the PTA language, the most enacted version remains based on the 2008 Uniform Principal and Income Act language in section 104, which reads:

> (a) A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in Section 103(a), that the trustee is unable to comply with Section 103(b).

The PTA became a particularly powerful tool in the historically low interest rate environment leading up to 2022. With such low yields on fixed income securities across the board, trustees using the PTA could still ensure that income beneficiaries received a fair income payout without having to invest large portions of the portfolio in fixed income. This has allowed trust principal to grow tremendously, especially since the market lows of the 2008 recession.

While trust companies vary in their approach to calculating and applying the PTA—some calculate a single rate that is used across all accounts subject to PTA, while others calculate each affected account individually based on a variety of factors—one thing is consistent: in the extended period of low interest rates, many trust companies had PTA rates hovering in the low- to mid-2% range, which consequentially resulted in a higher payout to beneficiaries than a true net income distribution.

Now in this environment of rising rates and increasing yields, are trustees nearing a point where accounts using PTA would be best served by converting back to actual net income payments? Using a common 60% Equity/40% Fixed Income portfolio, yields now range from approximately 2.81% to as high as 3.86%, depending largely on the type of fixed income used (corporates, preferred, municipals, etc.). While that number does not net out fees and expenses that would be deducted to reach a net income calculation, it does mean that the use of PTA to increase payments to income beneficiaries is no longer a foregone conclusion. Instead, as rates and yields increase, trustees may find themselves in a position of needing to calculate which method—PTA or true net income—will result in a better payout to current income beneficiary(ies).

Planning Vehicles in a High Interest Rate Environment

Several planning techniques benefit from a reduction in the value of a remainder interest gift that is more easily obtained in a high interest rate environment. The value of such remainder interests within many estate planning strategies is calculated by application of the §7520 rate.

Each month, the Internal Revenue Service publishes the Applicable Federal Rates (AFRs) in Section 1274(d) of the Revenue Code for short-, mid-, and long-term private loans. The AFR is based on data influenced by marketable debt securities of varying durations, such as U.S. Treasury bills, and is used in determining minimum interest rates for private loans. The §7520 rate for a given month is calculated as 120% of the mid-term AFR for that month, rounded to the nearest two-tenths of a percent.

Implementing Charitable Remainder Trusts

While Charitable Lead Trusts (CLTs) ruled the day in the historically low interest rate environment leading up to 2022, Charitable Remainder Trusts (CRTs) now become the more favored strategy in the current high interest rate environment. The Grantor of a CRT receives an annual income distribution (either as a fixed amount or a percentage of assets in the trust) for a fixed term of years as well as an income tax charitable deduction in exchange for an initial gift of assets to be transferred at the trust's termination to a charitable remainder beneficiary. The value of that charitable remainder interest is calculated at the time of the gift using the §7520 rate. A high interest rate environment leads to a higher AFR, driving the §7520 rate higher, which in turn means the CRT will be able to more easily meet minimum thresholds set by the IRS for the value of the remainder interest passing to charity. The higher rate can also reduce the value of the taxable gift at funding and increase the value of the charitable deduction.

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Remember QPRTs?

In a Qualified Personal Residence Trust (QPRT), a Grantor transfers a residence into trust and may retain the right to reside in the residence thereafter for the duration of the trust term. After the term (a fixed number of years), the trust will terminate, and the residence will pass to the trust beneficiaries, often the Grantor's descendants. Those beneficiaries may then rent the home back to the Grantor for fair market value. The value of the remainder interest in the home is calculated using the §7520 rate at the time of the gift to the trust. In a higher rate environment, this means that the value of the grantor's right to use the residence for the duration of the trust increases, thereby reducing the value of the initial taxable gift of a future interest made to the trust. As the §7520 rate increases, the value of the taxable gift made to the trust decreases which makes the QPRT an increasingly attractive planning strategy as rates continue to rise.

What about GRATs?

The success or failure of a Grantor Retained Annuity Trust (GRAT) is commonly judged by whether the assets transferred to fund the trust appreciate at a rate that is greater than the §7520 rate. If assets appreciate at a greater rate, that surplus is transferred to the GRAT beneficiaries gift tax free when the trust term ends. As interest rates climb, so too does the §7520 rate, and the margin for excess appreciation begins to shrink. This makes GRATs less attractive in a high interest rate environment. However, if the Grantor has utilized all or most of their lifetime gift tax exemption, and they have assets likely to appreciate, utilizing a GRAT may still offer certain advantages.

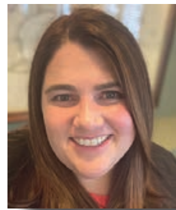
Changing Tax Exemptions and New Opportunities

The higher interest rate environment is expected to remain in place as the Fed battles inflation and tries to regain price stability. As a direct result of inflation, exclusion and exemption amounts that automatically adjust for inflation saw significant increases in 2023. While inflation does erode purchasing power, it is a double-edged sword that can positively adjust numerous allowances that provide benefits.

For gift and estate taxes, the annual gift tax exclusion increased to $17,000 in 2023. With gift splitting, this means a married couple can gift $34,000 in 2023 to any single recipient without needing to file a gift tax return and triggering a taxable gift. Additionally, the federal estate tax exemption increased to $12,920,000 per person in 2023 ($25,840,000 per married couple). Many people used their full exemption amount in late 2020, in anticipation of estate tax law changes that never materialized, so for those who did not make subsequent gifts, there is now an additional $1,340,000 in unified credit available for single filers and $2,680,000 for married couples over and above the 2020 amounts. It is worth noting that the increased tax exemption is set to expire at the end of 2025 and return to 2017 levels, adjusted for inflation. For clients who did significant planning during the period of lower interest rates, the increased exemption allows for, among other things, vehicles that take advantage of the higher interest rate environment.

Also of note, the SECURE Act 2.0 (the "Act"), which passed in December 2020, introduced the potential for a beneficiary of a 529 College Savings Plan to roll unused savings into a Roth IRA without tax or penalty. This may benefit families who "over saved" for college education and want to assist newly working young adults in jumpstarting their retirement savings. The provision, however, has some limitations: the 529 Plan account must have been open for at least 15 years, and the total amount rolled over cannot exceed (a) $35,000 or (b) the total contributions to the account since creation (i.e. capital appreciation cannot be rolled into the Roth). Also note that such transfers do count toward a given tax year's Roth IRA contribution limit.

While some estate and tax planning strategies work well across economic cycles, some tools that have not seen favor over the last several years are now well suited under the current environment. Similarly, trustees who have relied on tools such as the Power to Adjust may now find themselves in a position of re-examining the best outcome for beneficiaries in these circumstances. These changes, along with those in tax laws and exemptions, give planners significant opportunity to help clients best take advantage of existing economic conditions. Naturally, any investment involves a certain degree of risk; these recommendations serve as the starting point of a discussion rather than a basis on which decisions should be made. Please contact an advisor for further information.



Gina M. Nelson is Senior Vice President and Head of Fiduciary Services at Chilton Trust with over 15 years of experience in various trust and estate roles. She has spoken on panels at several key industry events, including the Delaware Trust Conference and the Mourant Ozannes International Trust and Private Client Conference. Ms. Nelson began her career practicing law and opened her own practice where her focus was estate planning and trust and estate administration.

Daniel Cihanowyz is Senior Trust Officer at Chilton Trust with over 12 years of experience in trust and estate administration and relationship management. Mr. Cihanowyz attended Campbell University as a member of the nation's only post-graduate Trust and Wealth Management Program where he received his Master's and Bachelor's degrees in Business Administration with a concentration in Wealth and Investment Management and a Minor in Financial Planning. Mr. Cihanowyz holds both the Certified Trust and Fiduciary Advisor (CTFA) and Accredited Trust Financial Advisor (ATFA) designations.

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Unlawful Negative Option Marketing Practices

Becky Breland, Esq.
Principal Consultant
CAPCO, a Wipro company

On January 19, 2023, the Consumer Financial Protection Bureau (CFPB) issued Consumer Financial Protection Circular 2023-01: Unlawful Negative Option Marketing Practices addressing the question "Can persons that engage in negative option marketing practices violate the prohibition on unfair, deceptive, or abusive acts or practices in the Consumer Financial Protection Act (CFPA)?"

Negative option refers to a term or condition under which a seller may interpret a consumer's silence, failure to take an affirmative action to reject a product or service, or failure to cancel an agreement as acceptance or continued acceptance of the offer. An example of a negative option plan for financial institutions would be offering a trial marketing plan in which the consumer receives a product or service for free or at reduced costs for a trial period. At the end of the trial period, consumers are automatically charged a fee or higher fee unless the consumer affirmatively cancels.

The CFPB states, "negative option programs can cause serious harm to consumers who do not wish to receive the products or services for which they are charged." The CFPB opines that harm is most likely to occur when sellers mislead consumers about terms and conditions, fail to obtain consumers' informed consent, or make it difficult to cancel. The CFPB circular is intended to emphasize that covered persons and service providers who engage in negative option marketing are required to comply with the CFPA's prohibition on unfair, deceptive, or abusive acts or practices.

The CFPB states, "negative option programs can cause serious harm to consumers who do not wish to receive the products or services for which they are charged."

A seller offering a negative option program risks violating the CFPA if the seller:

- Does not clearly and conspicuously disclose material terms of the negative option offer,
- Does not obtain the consumer's informed consent, or
- Misleads consumers who wish to cancel, erects unreasonable barriers to cancellation, or impedes the cancellation procedures.

Disclosures

Sellers may violate the CFPA's prohibition on deceptive acts or practices if they misrepresent or fail to clearly and conspicuously disclose the material terms for a product or service with a negative option feature. Making partial disclosures about the nature of the product or service and failing to disclose other material information is deceptive per the CFPB. For this determination, the CFPB looks to the overall, net impression of the communication. The material terms of a negative option offer may include the following:

- That the consumer is enrolling in and will be charged for the product or service.
- The amount or range of amounts that the consumer will be charged.
- That charges will be on a recurring basis unless the consumer takes affirmative steps to cancel the product or service.
- That, in a trial marketing plan, charges will begin or increase after the trial period unless the consumer takes affirmative steps to cancel.

The circular provides instances where disclosures have been deceptive. For instance, a consumer reporting agency deceptively misrepresented that credit related products were free when in practice, consumers who signed up for the trial where automatically enrolled in a subscription program with a recurring monthly fee unless the consumer cancelled. The CFPB in its enforcement action noted that disclosures about the negative option features were often displayed in fine print, in low contrast, and were placed in less prominent locations and grouped with other disclosures.

Consent

Sellers engaged in negative option marketing are likely to violate the CFPA when they fail to obtain the consumer's informed consent before charging the customer. The circular lists examples of where consent is not likely to be informed: (1) the seller mischaracterizes or conceals the negative option feature, (2) the seller provides contradictory or misleading information, or (3) the seller interferes with the consumer's understanding of the agreement. Per the CFPB, a deceptive practice occurs when the card issuers falsely represented to consumers that they were agreeing to receive information rather than purchasing the product. An example of an unfair practice would be a debt relief company engaged in charging consumers on an automatic, recurring basis where the recuring charges were not clearly explained or disclosed at time of purchase.

Cancellation

Sellers must retain existing customers in a manner compliant with the CFPA by not misleading consumers wishing to cancel. The CFPB cites as an example a credit card issuer engaged in deceptive practices when it represented that consumers could cancel an add-on product immediately and with no questions asked. However, in practice, the credit card issuer directed sales representatives to repeatedly rebut requests to cancel. Misrepresentations about the costs or benefits of the product or service in an attempt to avoid cancellation is also a deceptive practice.

If the financial institution engages in negative option marketing practices for its products or services, including add-on products, we encourage you to review the procedures and processes in place with respect to the product or service.

This article is excerpted from a Regulatory Advisory Services Client Alert. For the complete article, email Regulatory.Services@capco.com.

Secure Act 2.0 and Small Businesses

Louis D. Memmolo, AIF, GBA, NQPA
Weiner Benefits Group, LLC

"SECURE 2.0 drafters were creative in finding ways to encourage workers, particularly those with lower incomes, to take advantage of their plans."

More than two thirds of people who work for companies with fewer than 10 to 24 employees do not have access to a retirement plan at work. Workers with a retirement plan are far more likely to save for retirement than those without a plan. In 2022, those without a retirement plan had accumulated less than $1,000 for retirement, compared with the majority of those with a plan who had saved at least $50,000. More than 40% of workers with access to a work-based plan had amassed a quarter million dollars or more.

Congress intended to address this issue by passing legislation that will help small employers more efficiently and cost-effectively offer retirement plans to their workforces, while providing incentives to help improve participation rates among lower-income workers. The Act is a sweeping set of provisions designed to improve the nation's retirement-planning health. Here is a brief look at some of the provisions that help small employers.

Tax Perks for Employers in 2023

Perhaps most appealing to small business owners, the Act enhances the tax credits associated with adopting new retirement plans, beginning in 2023. For employers with 50 employees or less, the pension plan start-up tax credit increases from 50% of qualified start-up costs to 100%. Employers with 51 to 100 employees will still be eligible for the 50% credit. In either case, the credit maximum is $5,000 per year (based on the number of employees) for the first three years the plan is in effect.

In addition, the Act offers a tax credit for employer contributions to employee accounts for the first five tax years of the plan's existence. The amount of the credit is a maximum of $1,000 for each participant earning not more than $100,000. The amount of the credit is reduced for employers with 51 to 100 employees. No credit is allowed for employers with more than 100 workers.

Rule Changes and Relevant Years

In 2024, employers will be able to adopt a deferral-only starter 401(k) or safe-harbor 403(b) plan, which are designed to be lower cost and easier to administer than traditional plans. Both plan types have auto-enrollment features and accept employee contributions only. Employees are enrolled at minimum contribution rates of 3%, not to exceed 15%, and may opt out. The plans may accept up to $6,000 per participant annually ($7,000 for those 50 and older), indexed for inflation.

SIMPLE plans may benefit from two new contribution rules. First, employers may make nonelective contributions to employee accounts up to 10% of compensation or $5,000. Second, the annual contribution limits (standard and catch-up) for employers with no more than 25 employees will increase by 10%, rather than the limit that would otherwise apply. An employer with 26 to 100 employees would be permitted to allow higher contributions if the employer makes either a matching contribution on the first 4% of compensation or a 3% nonelective contribution to all participants, whether or not they contribute. These changes also take effect in 2024.

Beginning in 2025, 401(k) and 403(b) plans will generally be required to automatically enroll eligible employees and automatically increase their contribution rates every year, unless they opt out. Employees will be enrolled at a minimum contribution rate of 3% of income, and rates will increase each year by 1% until they reach at least 10% (but not more than 15%). These provisions should be carefully planned as you move into your new plan year.

Incentives for Participation

SECURE 2.0 drafters were creative in finding ways to encourage workers, particularly those with lower incomes, to take advantage of their plans. For example, effective immediately, employers may choose to offer small-value financial incentives, such as gift cards, for joining a plan. Beginning in 2024, employers may provide a matching contribution on employee student loan payments, which should help encourage younger workers to plan for their future. Also in 2024, workers will be able to withdraw up to $1,000 a year to cover unforeseeable or immediate emergencies without having to pay a 10% early distribution penalty, which should help address the fear of locking up retirement-plan contributions for many years. Seek the advice of a qualified consultant for assistance in navigating these provisions to design the perfect plan for you and your participants.

The summarized information comes directly from our Broadridge Communication Solutions and Fiduciary Library through our communications partnerships. If you would like to be added to our email list, get more information, or sign up for our webinars, please contact our WBG Team.

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Delaware Loses Claim to Unclaimed Property; May Owe Hundreds of Millions to Competing States

Kenneth L. Norton
Young Conaway Stargatt & Taylor, LLP

"Delaware can no longer collect amounts due on the disputed MoneyGram financial products, from which State Escheator Brenda Mayrack has estimated Delaware derived $20 million annually."

Delaware realizes countless benefits as the most popular jurisdiction for entity formation. Not the least of those benefits has historically been Delaware's ability to collect unclaimed property held by Delaware corporations. But, in Delaware v. Pennsylvania and Wisconsin, 598 U.S. ____ (2023), the U.S. Supreme Court rejected the First State's right to collect certain classes of unclaimed property based solely on the state of incorporation of the entity in possession of such property.

For those unfamiliar with the concept of unclaimed property: each state has the right to take custody of property deemed to be abandoned under state law. Most state laws require the individual or entity in possession of such property (the "holder") to report and remit the property to the state only to the extent that the property, the domicile of the person who is entitled to the property (the "owner"), and/or the place where the property was purchased, is located within that state. Delaware law, on the other hand, seeks to collect unclaimed property based solely on the domicile of the holder—in the case of a corporation, the holder's jurisdiction of incorporation. Thus, Delaware and other states often assert colorable claims to the same unclaimed property.

In prior cases, the U.S. Supreme Court attempted to resolve states' competing claims by developing a two-tiered rule to override conflicting state laws. Under this rule, the right to collect unclaimed property was given, in the first instance, to the state of the owner's last known address, but if such address was not documented in the holder's books and records, the state in which the holder was incorporated could collect.

Then in 1974, Congress, perceiving the Supreme Court's rule as inequitable and difficult to administer with respect to certain intangible property, enacted the Federal Disposition Act (the "FDA"), which abrogated the high Court's rule whenever applicable. The FDA directs that unclaimed property consisting of a "sum payable on a money order, traveler's check, or other similar written instrument (other than a third party bank check)" shall, in the first instance, be subject to the unclaimed property law of the state in which such property was purchased. If such place-of-purchase state cannot be ascertained from the holder's books and records, the FDA provides that the property is collectable by the state in which the holder's principal place of business is located, regardless of the state of incorporation. Therefore, when the FDA applies, it negates Delaware's advantage of being the preferred jurisdiction of entity formation.

Undeterred by the FDA, Delaware continued to enforce its unclaimed property laws based on a holder's domicile—relying on the Supreme Court's pre-FDA rule—with respect to unclaimed property that was not obviously within the ambit of the FDA. Despite several unsuccessful challenges brought by other states, Delaware's collections of unclaimed property proved extremely lucrative for the First State, which derived $319 million - $566 million annually from unclaimed property collections between 2007 and 2022.

But the Supreme Court's 2023 decision could significantly restrict these collections. In Delaware v. Pennsylvania and Wisconsin, a majority of other states challenged Delaware's practices with respect to amounts due on certain financial products issued by MoneyGram Payment Systems, Inc., a Delaware corporation. The high Court construed the FDA broadly, ruling that it applied to all of the property at issue, and thus the Court disallowed Delaware's collection based on state of incorporation under the pre-FDA rule.

The result: at the very least, Delaware can no longer collect amounts due on the disputed MoneyGram financial products, from which State Escheator Brenda Mayrack has estimated Delaware derived $20 million annually. In addition, the Supreme Court is poised to render a second decision on the matter, in which the Court could order Delaware to repay to the challenging states unclaimed amounts previously collected on MoneyGram products. Worse yet, Delaware may need to cease collecting and/or disgorge past-collected amounts due on similar financial products—such as non-MoneyGram teller's checks, cashier's checks, certified checks, money orders, and gift cards—when such collections are or have been made based solely on Delaware's status as the holder's state of incorporation.