The Challenge of Unique Asset Management

The Fiduciary Education Center, LLC
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The Challenge of Unique Asset Management

Unique Assets......also known as Specialty or Hard to Value Assets

According to the OCC, that includes:

- Real Property
- Mineral Oil and Gas
- Closely Held Business
- Notes and Mortgages
- Life Insurance
- Alternate Investments (i.e. Hedge Funds)
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A little history.............

• The oldest trust in the US established by William Payne, 40 years after the Pilgrims landed in Plymouth Rock (1660) was established to hold real estate by William Payne........ ended in litigation in 2012.

• Thomas Jefferson set up an asset protection trust for his daughter in 1826 with the remainder vesting in his grandsons.
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$59 TRILLION Will be transferred from Boomers to Millennial heirs, charities and taxes between 2007 & 2061

$36T Bequests to heirs

$27T Bequests to charity (includes lifetime giving)

Federal estate taxes $5.6T

SOURCE: BOSTON COLLEGE CENTER ON WEALTH AND PHILANTHROPY
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Personal Wealth in 2013—Top Wealth Holders ($5 million or more)

* Other
Private Equity and Hedge Funds
Retirement Assets
Cash Value Life Insurance
Unallocated Investments
Art
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OCC Handbook Guideline Basics:

- Oil and Gas – Valuation, leasing, accounting, inspection, insurance
- Real Property – Valuation, sale, leasing, inspection, taxation, insurance (and a whole special section on farm and ranch properties)
- Loans and Notes – Collection, review of collateral, late payments
- CHB’s – Financial reporting, valuation

The OCC’s Unique and Hard to Value Assets Handbook done in 2012 does not give us as much direction as we would like.
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What else can go wrong?

• Oil and Gas – Can explode, poison innocent cattle and foul your drinking water.

• Real Property – Could be the site of a meth lab (these can explode too), or a vacant lot complete with 55 gallon drums that ooze and glow in the dark.

• Loans and Notes – If collateralized by some of the real property noted above....

• CHB’s – All of the above plus a plethora of employee’s trying to siphon off every cent they can.
Attempts at management of this risk by the directed trust model are meeting some resistance.

“The relief provided to a directed trustee by even the most protective statute is not unlimited.”

Directed Trusts: Making Them Work
by Richard W. Nenno, Esq. Wilmington Trust Company
March 2013
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The Logic Behind the Regulator’s Concerns:

1. Not actively managing the asset
2. Not including the asset in an IPS or Investment Objective
3. Over charging based on incorrect valuation
4. Incorrectly reporting RMD’s
5. Not understanding the associated risk
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Four Types of Risk According to the OCC:

**Strategic Risk**: “A bank fiduciary assumes strategic risk when taking on new product lines without having the expertise and systems to properly manage and control risks associated with the line of business... Because the management of unique assets falls outside the more traditional equity and fixed-income strategies, management must ensure that personnel are qualified to manage these assets”.
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Reputation Risk: “A bank fiduciary’s lack of expertise or oversight of unique assets can subject the bank to significant losses, potential litigation, and reputation risk”.

Compliance Risk: “A bank fiduciary can expose itself to compliance risk if it fails to adhere to the bank’s policies and procedures or fails to secure needed expertise.”
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**Operational Risk**: “Operational risk is the risk to current or anticipated earnings or capital arising from inadequate or failed internal processes or systems, the misconduct or errors of people, and adverse external events. This risk manifests itself in several ways. First, safeguarding unique assets owned by an account for which the bank is a fiduciary or custodian poses unique risks. This involves the physical upkeep and securing of the asset as well as maintaining the account’s legal ownership of the asset. Real estate or collectibles are in this asset type. Secondly, a bank fiduciary holding unique assets such as mineral interests, real estate, or interests in closely held companies generally requires specialized accounting and control systems. Without these systems, the bank risks not properly monitoring and accounting for the various income streams and related taxes associated with these assets.”
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So What do I do?

• Determine your risk tolerance and capabilities
  1. Is this something I need to offer?
  2. Can I do this in house?
  3. Do I need to outsource and how will the cost be covered?
  4. How will I pay for the initial review if outsourced?

• Clean up your account acceptance process—you will never get another shot at doing a pre-acceptance review

• Manage prospects expectations with regard to acceptance policy

• Update your policies, procedures, processes and systems surrounding these assets
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So What do I do---Part II

• Operationally keep track of:
  1. Property tax payments in RE, Mortgages and MOG
  2. Tax and financial filings in Closely held businesses
  3. Late charges and escalations—Loans/Notes/Mortgages

• Fee schedules...market value?
  1. Based on asset vs. portfolio
  2. Ordinary or Extraordinary fees?
  3. Bundled or Unbundled?
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Let Us Help You Put the Pieces Together

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