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NEW YORK STATE BAR ASSOCIATION

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PRIVATE TRUST COMPANIES

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Agenda

Private Trust Companies (PTC)

When should a family consider a PTC?

Where to establish a PTC

Typical PTC structure

Operational and Practical Considerations

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What is a Private Trust Company?

A perpetual entity:

- Legally authorized to act as trustee of family trusts
  - with full control over fiduciary assets
- Owned and controlled by a single family serving only that family and its related entities and individuals
- Legally empowered to provide broad range of financial and other services to the family and other fiduciary services
  - Depending on jurisdiction: agent, conservator or guardian, executor of an estate, investment advisor….
- Explicitly designed to exercise discretion and act according to the family’s expressed values and guidance

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What is a PTC? – Offshore differences

- A company that:
  - Acts as a trustee
  - Identifiable trust or limited class or group of related trusts
  - Does not offer services to the public
  - May be exempt from licensing

- Also used in commercial trust structures for:
  - “In-house” collective investment trusts
  - Special purpose vehicles

When Is a PTC Appropriate for a Family?

Better Question: When is a Family Appropriate for a PTC?

- Convinced that cooperation and working together is the optimal strategy for their family for the long term
- Have determined (or are in process of determining) their family's values and shared goals, usually including
  - Using the family's collective wealth to help each family member in reaching his or her potential as a human being
- Are committed to addressing complexity and risk in their FO structure or in aging relationships

When Is a PTC Appropriate for a Family? (cont.)

What level of wealth is required to justify a PTC?

- Costs:
  - Minimum regulatory capital
  - Annual expenses:
    - Company and fiduciary audits/reviews; Insurance
    - Staffing
    - Space
    - Systems depending on sourcing
- If a rule of thumb is required, then:
  - $1B and up renders start-up and on-going costs less relevant
  - $500M is generally workable for the average family's PTC
  - $250M is possible but only in highly idiosyncratic situations

Family Rationales for Creating a PTC

- Maximize family control over assets held in trust
- Implement its strategic plan
- Involve entire family at appropriate levels:
  - Tailored roles outside the operating business (if any) and outside investment management
  - Forum for developing family member skills and knowledge
- Eliminate trustee succession issues
- Implement state-of-the-art, flexible risk management
  - Rather than be subject to mere risk aversion of individual or corporate trustees
- Insulate family advisors and members from fiduciary liability

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Family Rationales for Creating a PTC (cont.)

- Maximize control over trust and other services provided to family members
- Privacy and confidentiality
- Forum shop with regard to laws governing substantive trust terms, administration and tax
- Flexible trust administration to meet changing family needs and circumstances

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On a Strategic Level:

For the family's financial capital, a PTC (and only a PTC) can provide the:

- **Implementation Structure** and
- **Governance Structure**

Only trustees have ultimate control over both critical decisions faced by families:

- How financial capital is managed (protected, enhanced)
- How, why and when is it spent/distributed

Without control over the trustees, a family does not control its financial capital.

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Why Create a PTC? – Offshore (1)

- Control
  - Family members or trusted legal advisors on board
  - Can ensure trustee knowledgeable of family background

- Comfort
  - Corporate form familiar to settlors/lawyers from civil law jurisdictions unfamiliar with trust concept
  - May be better option that “Settlor directed trusts”

- Investment Freedom
  - Avoids limitations and constraints of institutional trustee
  - Can hold high risk or depreciating assets

Why Create a PTC? – Offshore (2)

- Efficiency and Cost
  - Avoids expensive licensing process
  - PTC as a guarantee company may avoid government fees
  - May avoid the need for multiple trustees in different jurisdictions
  - Tailor made bye-laws for family succession and convenience

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Why Create a PTC? – Offshore (3)

- Dissatisfaction with alternatives
  - Individual trustees: succession, capacity and liability issues
  - Institutional Trustees:
    - **Pros**: Traditional approach; Revenue authorities generally recognise them; Experience; Continuity; Deep pockets for financial redress if breach of trust.
    - **Cons**: Impersonal; Risk aversion; Profit motive; Staff turnover; Confidentiality concerns; Pressure from governmental authorities; Difficulty in changing trustees

Locating the Family's PTC – Onshore

- Situs (jurisdiction of enabling law) vs. where activities occur
- Situs - there is no decision tree; it is a balancing act involving
  - Attracting the best law, whether administrative or substantive
  - Avoiding onerous taxes
  - Capital requirements and start-up costs
  - Regulatory and court environment
  - Need for securities laws exemptions
  - Need for out of state trust office
  - Idiosyncratic requirements in enabling jurisdiction (number of directors, residency thereof, insurance, confidentiality, etc.)
- Location of activities:
  - Can outsource much to outside or affiliated providers wherever located (such as the FO)
  - Certain activities must occur in the proper jurisdiction; family and/or personnel must be realistic about willingness to travel

Factors when Choosing PTC Jurisdiction - Offshore

- Proper law of the trust
- Quality of legislation
- Local and Licensing requirements
- Incorporation time
- Capital requirements
- Cost
- Resident director or officer required?
- Necessary to appoint auditor, file accounts?
- Any local tax concerns?
- Public records and disclosure
- Regulatory oversight

Offshore Jurisdiction Comparison

	Bermuda	BVI	Guernsey	Jersey	Cayman (Restricted licence PTC)	Cayman (Registered PTC)
Local Regulatory Licence required?	No	No	Yes, if PTC charging a fee or receiving monetary consideration	No	Yes	No
Minimum capitalisation?	None	None	Nominal	Nominal	CI$20,000 (paid up capital	None
Local director required?	No	No	No	No	No	No
Corporate directors permitted?	Yes	Yes	Yes	Yes	Yes	Yes
Local representative required?	Yes	Yes	Yes	Yes	Yes (reg office at Cayman licensed trust co	Yes (reg office at Cayman licensed trust co
Local board meetings required?	No	No	No	No	No	No
Local records required?	Yes	Yes (trust deeds with reg agent)	Yes	Yes	Yes	Yes
Time to incorporate PTC (subject to KYC/CDD)	2-3 days	1-2 days	1 day	1 day	1-2 days 4-6 weeks to acquire licence	1-2 days 1 week to obtain CIMA approval

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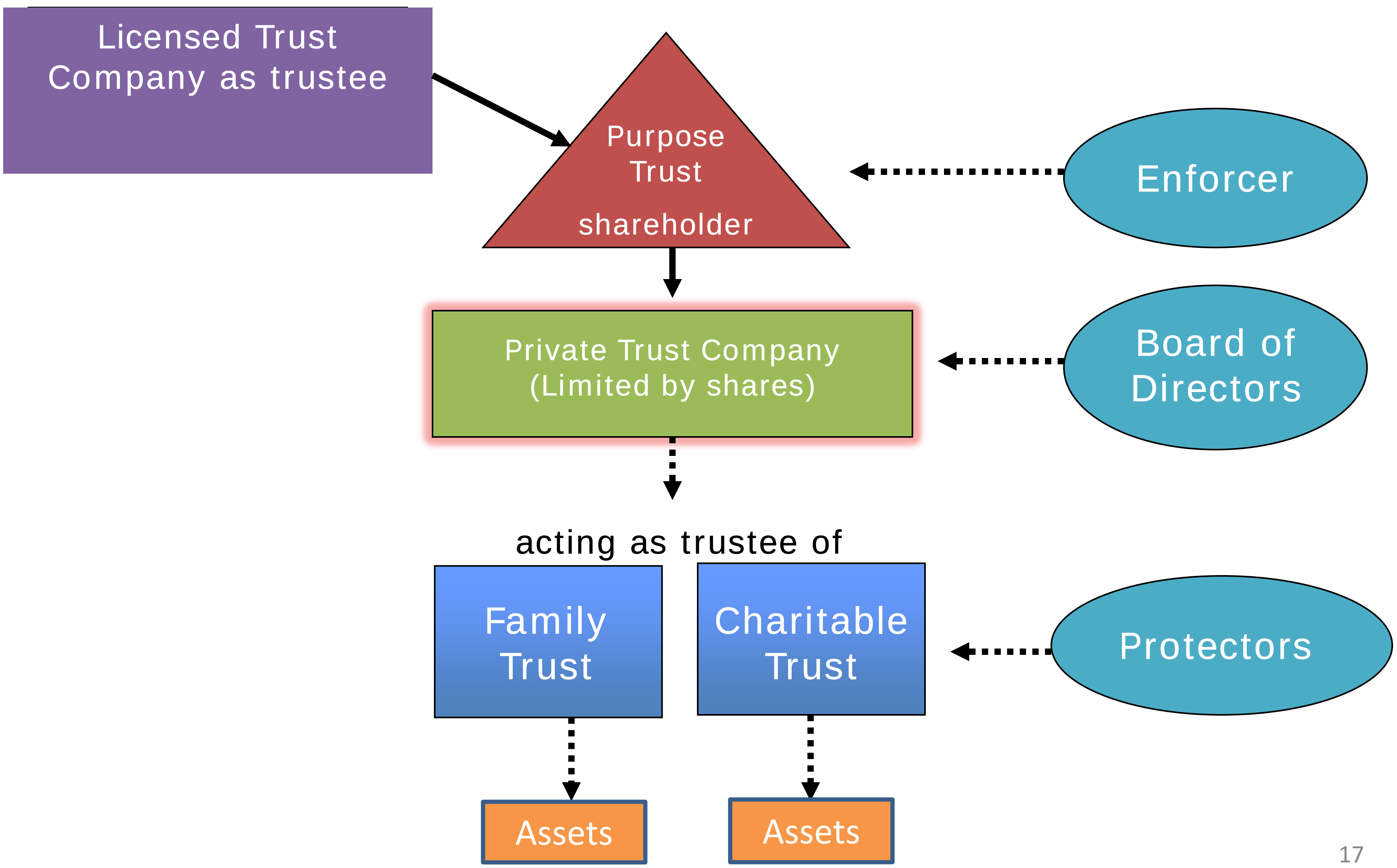
Structuring a PTC? – Offshore (1)

- Company Limited by Shares

  But who is the shareholder?

  - Individual shareholders – but normally better to "orphan" the company
  - Foundation, Discretionary Trust, STAR, VISTA, Bahamas Executive Entity
  - Purpose Trust or Charitable Trust
    - Licensed Trust Company acts as trustee of purpose trust
    - Purpose Trust has no beneficiaries, rather it is created for the purpose of incorporating and owning the PTC
    - Consider who will act as Enforcer

PTC Limited by Shares – Offshore (1) (cont.)



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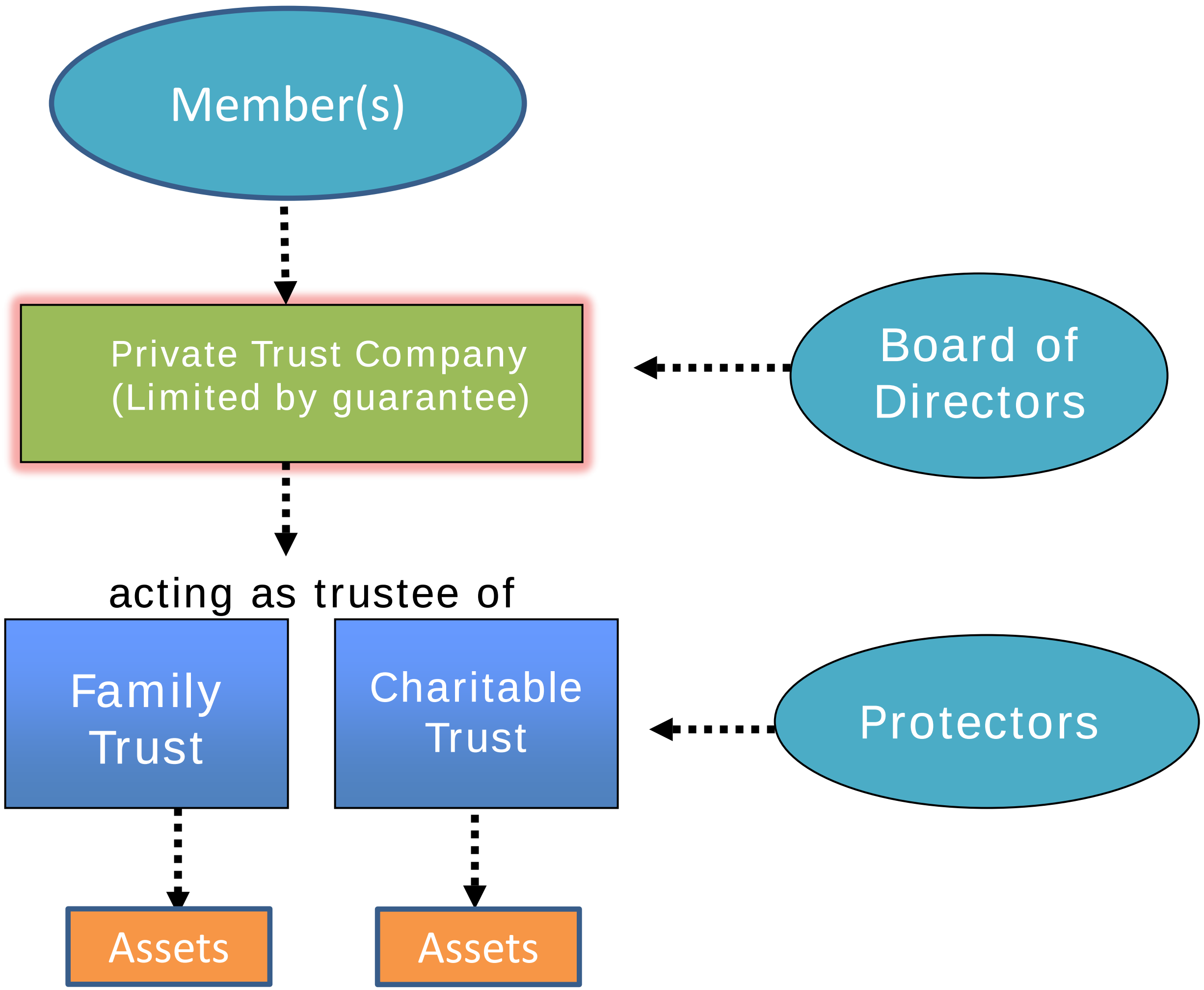
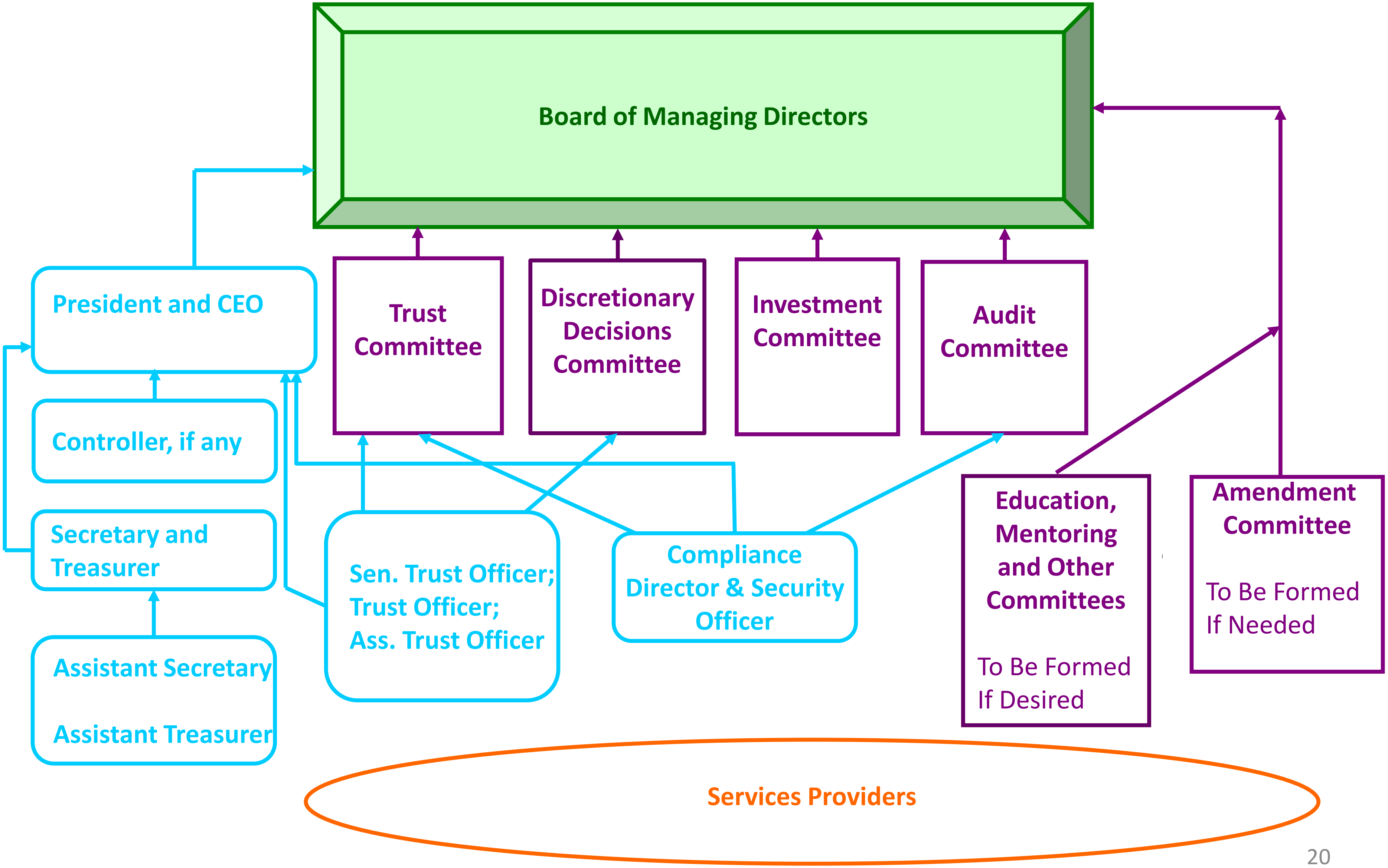
Structuring a PTC? – Offshore (2)

- Company Limited by Guarantee
    - No shareholders
    - Liability of members limited by memorandum to a minimal amount
    - Members elect directors (can be the same)
    - Bye-laws set out process for changing members

PTC Limited by Guarantee



Common PTC Internal Organization



Practical Considerations with a PTC Structure

- Central Management and Control
  - Who will make up the Board?
  - Offshore - important for majority of directors to be in the jurisdiction where the PTC has its registered office
  - Must follow proper formalities re directors meetings and trustee decisions

- Sham Argument
  - Offshore - Avoid by having PTC professionally managed and administered by licensed administrator

Staffing Distribution Committees

Prop. Rev. Rul. Notice 2008-63

- Each irrevocable trust in the proposed ruling:
  - Allows discretionary distributions to beneficiaries
  - Allows the grantor or primary beneficiary to replace a trustee if a vacancy occurs; cannot appoint himself or herself as such
  - DDC controls all discretionary distribution decisions; any person may serve on the DDC
- Family owns all of the stock of the PTC (directly or indirectly)

PTC Governed by State Statute	PTC Governed by Org. Documents Only
No DDC member may participate for a trust: • if a grantor or spouse was a grantor • If member or spouse is a beneficiary • If member or spouse has a duty to support a beneficiary	Same restrictions to DDC Provides for an Amendment Committee • Make changes to the DDC or Org. Docs. • Change who controls personnel decisions A majority of Amend. Com. must be independent; committee acts by maj.
Personnel decisions made only by officers or managers of entity	
Reciprocity prohibited	
Shareholders of PTC can't change the DDC	organizational document provisions

What do we know from Notice 2008-63?

PTC Governed by State Statute	PTC Governed by Org. Documents Only
Family Tree: A & B are H & W; three children: C, D & E	
A, C, & D are board members A, C & D are officers A, C & D constitute the DDC	A, C, D, F & G are board members A, C & D are officers A, C & D constitute the DDC A, F and G are amend. com. members
THIS IS OK FOR GIFT AND ESTATE TAX B/C:	
• As DDC members Grantors/Beneficiaries can't participate in exercising hot powers	• Same
• Control of DDC not attributed to a family member b/c of power to control the PTC (statutory restriction on shareholders)	• Same (document restrictions regarding amend. com.)
INCOME TAX RESULTS UNCLEAR AT THIS POINT	

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PTC Operational and Practical Considerations

- There are established norms and customs informing how to manage a financial institution - it’s all about PROCESS
  - New client intake processes
  - Periodic client file review
  - Client decision making
  - Audits of the company’s fiduciary business
  - Memorialization of all important decisions, even if a “no”
- Other Operational Issues: Compliance
  - Bank Secrecy Act (OFAC, red flags, suspicious activity, $ transactions)
  - 13F securities reporting and threshold reporting
  - Privacy
  - On-shore and offshore: FATCA/FBAR/other IRC reporting
- U.S. FOs do not necessarily avoid these requirements

Distributions –Process is Sina Qua Non

- Distribution authority derived from:
  - Entity's documents (Articles, Bylaws, LLC Agreement, etc.)
  - State Law (statutory and common) to the extent not over-ridden
  - Trust Documents - exact language, as well as overall context and purpose, inferences, etc.
- Other considerations in the decision: tax consequences, effect on the portfolio, needs of beneficiaries, who may participate
- Location of distribution decisions – raises issues of taxation (both nexus and foreign status) and of regulated activities
- Need to memorialize

The Distributions Committee is really about much more than merely distributions

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Other Considerations with a PTC Structure

- Liability of Directors
  - Duty to act in best interests of company and where directors breach that duty, company would action directors
  - No duty owed directly to shareholders or beneficiaries of underlying trusts – “dog-leg” claims difficult to construct and pursue

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Fiduciary Duties of Management

- Take reasonable steps to ensure that the PTC fulfills its responsibilities as trustee
- Perform the specific responsibilities set forth in the trust company's policy manual
- Overarching fiduciary duties of management (owed to the company):
  - Loyalty
  - Care/Attention/Supervision
- Keys to limiting management's risk
  - **Be informed:** know the core duties and responsibilities of a trustee and apply that knowledge to one's own actions and supervision of the exercise of fiduciary powers
  - **Provide adequate supervision:** devote reasonable time to exercising adequate supervision and control over company's affairs
  - **Avoid misconduct:** neither be neglectful nor condone unsafe or unsound business practices
  - **Qualify for Business Judgment Rule protection:**
    - Adequately informed and
    - Free from undisclosed and unwaived conflicts of interest
  - **Actually make the decision and record it**

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