Is the Trust Industry a Declining Business Line?
or
Can It Be a Fee Income Driver for a Thriving Community Bank?

By

[Author’s name removed to preserve confidentiality]

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EXECUTIVE SUMMARY

Is the Trust Industry a Declining Business Line?
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The purpose of this paper is to analyze [Bank name removed to preserve confidentiality] ("Bank") current trust offering and explore opportunities to grow the business increasing fee income. This paper will examine the current state of the trust industry, market opportunities and strategies for Bank to implement and grow its trust business. Although Bank's trust department has been profitable, its growth has lagged the bank's overall growth. Increasing the bank's fee income is a major focus of the Board. [*Confidential Bank information omitted*.]

The issues explored and findings from this paper will be used to set the 2014 and 2015 trust department business priorities.

The following **issues** were addressed to determine the business priorities for Bank's trust department going forward:

- Industry Trends and Demand
- Current Trust Offering
- Fee Generation
- Market Opportunities
- Trust Officer Roles and Responsibilities

Sources of information included interviews with other trust professionals, in-market attorney survey, various trust industry publications and articles. Trust industry data was obtained from Fiduciary Earnings & Expense and Trust Performance Report, Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile, as well as findings from Kehrer Saltzman & Associates Annual Wealth Management Survey. Additionally, [name removed to protect confidentiality] from Keher Saltzman was interviewed to glean greater insights on industry trends and best practices.

My research led to the following **findings** regarding the trust industry**:**

- Trust departments with fewer than $500 million in assets under management ("AUM") are growing faster than the industry as a whole.
- Large institutions are limiting their trust offering opening the door for community bank trust departments to capture the business of the underserved clients.
- Fee enforcement is a key driver of increased revenue.
- Unique asset administration is critical to growth.
- Trust departments must foster an active sales culture to grow the business.

My **recommendations** to enhance and grow Bank's trust department are:

- Focus efforts on underserved clients with $500,000 to $5,000,000 net-worth.
- Develop a flexible service model to exploit market demand.
- Market and promote local administration and decision making authority.
- Market and promote unique asset administration.
- Reduce fee exceptions and update fee schedule annually.

This paper will be of particular interest to Bank's executive management team as well as the Board. However, other thriving community banks can use it as a roadmap to grow their offering as well.

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I. INTRODUCTION

This paper will not go in depth on the overall wealth management movement, but will focus specifically on the trust industry and its role within wealth management. Banks have offered trust services to individual clients since the late 1880s with U.S. Trust and Northern Trust leading the way. Over time, large financial institutions formalized their wealth management offering by limiting trust services to high-net worth clients to control the high-costs of delivery. Private bankers became the gate keepers and generally only those clients with a specified net-worth qualified for trust services. Due to their size, community bank trust departments have struggled with client segmentation and clearly defining the scope of their trust offering. That being said, as the larger institutions continue to limit their offering, community banks trust departments are uniquely positioned to serve these disenfranchised clients and grow their business.

Traditionally, trust departments functioned as stand-alone business lines. The independence was a function of regulatory requirements and the specialized nature of the business. Trust administration is a high-touch business that is generally delivered by highly compensated subject matter experts. Although many trust departments have been profitable, their margins are very thin due to the delivery model. This makes the business hard to scale and challenging to grow if not properly managed.

The 2008 financial crisis drastically changed the banking landscape. Margin income is depressed and banks are searching for fee income to boost their bottom lines. The push for reoccurring fee income has put the trust industry in the spotlight. In 2011, trust industry assets reached an all-time high of $93.5 trillion with revenues of $32.5 billion.[1] Since reaching that

[1] Trust Performance Report, Volume 13, Number 4, May 2012. http://trustupdates.com

peak, the industry has not looked back. For fourth-quarter 2013, the FDIC's Quarterly Banking Profile reported that trust industry assets grew 10.8% in 2013 and 11.2% in 2012 (does not include non-depository trust companies).[2] Small firms, those with less than $500 million in AUM, are leading the charge. They grew on average six times as fast as the industry as a whole.

Table #1: Average Annual Asset Growth

AVERAGE ANNUAL ASSET GROWTH: 2006-2011[3]	
PEER GROUP	**AVE. ANNUAL**
1. Greater than $100 billion	10%
2. $10 billion-$100 billion	4%
3. $1 billion-$10 billion	6%
4. $500 million--$1billion	5%
5. Less than $500 million	34%
Cumulative Average	**10%**

The trust industry is becoming more efficient as it grows, requiring fewer and fewer assets to generate a $1 of revenue.[4] Again, small institutions are leading the industry with annual revenue growth of 12% versus the cumulative average of 4%.[5] Small institutions tend to focus on personal trust administration and report an average return on assets ("ROA") on gross revenue of .53% versus weighted industry average of .41%.[6] The industry reported total gross income of $6.55 billion in 2013 and personal trust assets accounted for $4.66 billion of the total.[7]

[2] Federal Deposit Insurance Corporation Quarterly Banking Profile, Fourth Quarter 2013.
[3] Trust Performance Report, Volume 13, Number 4, May 2012. http://trustupdates.com..
[4] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.
[5] Id.
[6] Id.
[7] ABA Trust Letter, "Healthy Bank Trust Industry Profiled in FDIC Report", April 2014.

Table #2: Average Annual Revenue Growth

AVERAGE ANNUAL REVENUE GROWTH: 2006-2011[8]	
PEER GROUP	**AVE. ANNUAL**
1. Greater than $100 billion	3%
2. $10 billion-$100 billion	8%
3. $1 billion-$10 billion	7%
4. $500 million--$1billion	8%
5. Less than $500 million	12%
Cumulative Average	**4%**

All of these trends indicate that the trust industry is growing, and that it can be a strong fee income driver for banks of Bank's size.

[*Confidential Bank information omitted*.]

[8] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.

Table # 3: Non-Interest Income as Percentage of Operating Revenue[9]:

[Confidential Bank information omitted.]

Peer Holding Companies

	YTD Mar-13	YTD Jun-13	YTD Sep-13	YTD Dec-13
Non-Interest Income	4,775,320	9,765,180	14,214,190	18,486,340
Operating Revenue	16,733,500	33,888,680	50,896,150	67,240,090
	29%	29%	28%	27%

[9] Comparison and Chart provided by [name redacted to protect confidentiality]

CHAPTER II: STATE OF THE TRUST INDUSTRY

Historically, trust departments were the catchall for individual banking services and investments. Over the last decade, banks have fine-tuned their wealth management offering and segmented client services based on net-worth parameters. Trust services remain an integral part of wealth management, but it is no longer the lead product. Additionally, trust is no longer viewed as a loss leader simply offered to consolidate a client's balance sheet. Loans and deposits are still the primary focus of banks, but generating reoccurring fee income is now a must. A robust trust offering can be an important source of reoccurring fee income adding significantly to a bank's bottom line.

On average, a trust account generates $6,489 in annual revenue.[10] Industry experts conservatively estimate that a trust account is open for roughly 12 years.[11] In comparison, the risk weighted average maturity for a commercial bank loan is 934 days or just over two and a half years.[12] Based on these assumptions, it is not surprising that banks are focused on growing their trust business.

The lion's share of trust industry growth has occurred in institutions with AUM less than $500 million.[13] These departments typically do more with less and report greater ROA than their larger peers.[14] Smaller institutions tend to limit their offering to three or fewer products lines and focus heavily on personal trust administration. Personal trust assets generate 6 to 10 times more revenue than custody assets.[15] On average, it takes $6,122 of custody assets to generate $1

[10] Kehrer Saltzman Wealth Management and Private Banking Survey Prospectus. www.KehrerSaltzman.com.
[11] [Information redacted to protect confidentiality]
[12] Y Charts US Commercial Bank Loan Average Maturity Chart: http://ycharts.com/indicators/us_commercial_banks_loans_with_other_risk_weightedaverage_maturity
[13] Trust Performance Report, Volume 13, Number 4, May 2012. http://trustupdates.com.

[14] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.
[15] Id.

of gross revenue versus $812 of personal trust assets.[16] Although asset growth in the industry is being led by custody assets, it is personal trust administration that is driving revenue growth. Personal trust assets account for only 13% of total assets but 48% of all revenue.[17]

Furthermore, small institutions are leading the way in profitability and their ROA on net income is holding steady.[18] These are all positive trends and support the notion that trust services can be a fee income driver for Bank.

Table #4: Return on Assets

RETURN ON ASSETS—NET INCOME[19]		
PEER GROUP	**2011**	**2010**
1. Greater than $100 billion	< .01%	.01%
2. $10 billion-$100 billion	.03%	.04%
3. $1 billion-$10 billion	.08%	.07%
4. $500 million--$1billion	.17%	.15%
5. Less than $500 million	.15%	.013%

[16] Trust Performance Report, Volume 13, Number 4, May 2012. http://trustupdates.com.
[17] Id.

[18] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.
[19] Id.

CHAPTER III: BANK'S CURRENT OFFERING

[*Confidential Bank information omitted*.]

CHAPTER IV: WHO IS THE IDEAL TRUST CLIENT?

There is no shortage of articles on client segmentation and the ideal trust client. As financial institutions fine tune their trust offering, client profitability and account size are driving the decision making process. Every institution wants to capture a larger share of their ideal client's wallet and trust plays a critical role in attracting and retaining clients. For this paper, client segmentations will be defined by the following thresholds[24]:

Table # 5: Client Segmentation Thresholds:

SEGMENTATION	**LIQUID ASSETS**
Mass-Affluent	$100,000 to $1M
High Net Worth	$1M to $10M
Ultra-High Net Worth	$10M plus

Larger institutions are moving up stream and limiting trust services to clients with roughly $3.5M in investable assets and above.[25] This line in the sand excludes the mass affluent as well as a large percentage of high net worth clients. Mass Affluent households make up 19% of all U.S. households, spend roughly $1.72 trillion a year and control roughly 37% of America's liquid assets.[26] Furthermore, industry data indicates that the average size of a managed trust account is $839,000.[27] As larger institutions push out the mass affluent and high net worth clients, they are opening the door for smaller institutions to grow AUM and increase revenue.

[24] McStowe, Barbara, Discover Network White Paper for Issuers, "Making the Most of the Affluent Customer Segment," April 2008. www.discovernetwork.com.
[25] Regional Trust Manager of large national bank with total AUM of roughly $3.2 billion. Participant did not want name or firm used in paper. March 18, 2014.
[26] McStowe, Barbara, Discover Network White Paper for Issuers, "Making the Most of the Affluent Customer Segment," April 2008. www.discovernetwork.com.
[27] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.

Although large firms are moving upstream, industry data clearly indicates that small account are profitable. The average ROA for banks with less than $1 billion in trust AUM is roughly 15% higher than firms with $1 billion to $10 billion in assets and 39% more than firms with trust AUM greater than $10 billion.[28] Smaller institutions are reporting higher profits with ROA of .33% versus .22% for institutions with $1 billion to $10 billion in assets.[29] This further supports the notion that big is not always better and that Bank's trust department can be a profitable business line driving fee income to the bottom line.

The mass affluent and high net worth clients with $500,000 to $5 million in investable assets are the ideal trust clients for Bank. The [State name omitted to protect confidentiality] economy has recovered nicely and [City name omitted to protect confidentiality] is [information redacted to protect confidentiality] growing large city in the country.[30] [State name omitted to protect confidentiality]'s strong economy coupled with Bank's financial strength create the perfect opportunity for the firm to expand its trust offering.

[28] Correia, Margarida, Want More Revenue from Trust Assets? Keep Account Size Small, February 21, 2014. www.bankinvestmentconsultant.com.
[29] Trust Performance Report, Volume 13, Number 4, May 2012. http://trustupdates.com.
[30] [Information redacted to protect confidentiality]

CHAPTER V: COMPETITIVE LANDSCAPE

As demonstrated above, Bank is well positioned to capture trust business that the larger institutions are turning away. However, the competitive landscape is changing and bank trust departments are not the only game in town. Independent trust companies, CPAs and attorneys are entering the marketplace as well. Often times these competitors are subject to fewer regulations and less onerous supervision than bank trust institutions.[31] Due to their lower risk management and regulatory costs, they can often undercut bank trust departments' fees. That being said, bank trust departments are better positioned to grow and expand their business than independent trust service providers. Bank trust departments can leverage their firm's client base and reputation to promote and grow their business. Furthermore, they can be more profitable because their shared infrastructure costs.

The major headwind bank trust companies face is shifting client demand. Clients and their advisors expect more from trust companies than they did in the past and are looking to alternative providers to meet those demands. In the survey of eight local attorneys, the two most important factors in recommending a trustee were:

1. Local administration and decision making authority, and
2. Flexibility around asset management.[32]

First and foremost, local administration and personal relationship with the trust officer were a must. Every respondent was concerned that clients would be pushed off to a call center.

Additionally, the attorneys surveyed all indicated that the bank reputation and financial strength played a major role in the referral process. Bank has been headquartered in the [State name omitted to protect confidentiality] market for over 50 years and the firm has experienced exceptional growth since 2008.

[31] McDonald III, Joseph F., "Emerging Directed Trust Company Model", Trust & Estates Journal, February 2012.
[32] See Table 6 summarizing interviews with eight estate planning attorneys in [City] Metro Area. Participants did

not want names or firms used in paper. February 4-17, 2014.

Bank consistently outperforms its peers and the market and its stock value has increased 78.3% since March 2012.[33] The trust group needs to leverage the bank's local presence and strong financial position to become the leading trust service provider in [State name omitted to protect confidentiality].

Graph III: Bank Stock Price Comparison:

[Information redacted to protect confidentiality]

[33] [Information redacted to protect confidentiality]

Table # 6: Attorney Interview Summary

	TRUST SERVICES QUESTIONAIRE & INTERVIEW TOPICS	Scale	Additional Comments
1	How important are the following factors when recommending a corporate trustee to assist you and/or your clients? Use scale of 1 to 10 (1 = least important ; 10 = most important.		Bank investment products are not primary driver of selecting trustee. Local presence and **unique asset administration** are top factors.
	Private Banking Products	**3**	
	Lending Products	**2**	
	Insurance Products	**2**	
	Unique Asset Administration	**8**	Clients rarely have liquid estate and trustee must be able to handle all assets
	Mineral Oil Gas Management	**6**	
	Real Estate Management	**6**	
	Local Decision Making Authority	**9**	Do not want to be pushed off to call centers or out of market decision makers.
	Dedicated Trust Officer/Relationship Manager	**10**	Most important factor to all surveyed. Wanted a trust officer that is in market and can work with the client.
	Investment Performance	**7**	
	Fees	**7**	
	On-line Account Access	**6**	
	Account Statements	**5**	
2	How fee sensitive are you and or your clients when looking to engage corporate trustee? Use scale of 1 to 10 with 1 being least sensitive and 10 being most.	**7**	Looking for trustees to handle smaller accounts at fair price.
3	How important are the following factors re:bank's profile when selecting corporate trustee? Use scale of 1 to 10 with 1 being least sensitive and 10 being most.		
	National or Multi National Bank	**3**	
	Community Bank	**4**	
	Size of Bank	**5**	
	Bank's Reputation	**9**	When using community bank it is important that the institutions is financially sound
	Investment Platform of Bank	**5**	
4	What is the most important factor in choosing a corporate trustee for your clients?		Local Management Fees
5	What is the primary service corporate trustees are failing to provide to your clients?		Local presence/authority Unique asset administration Servicing small accounts Responsiveness and communication

CHAPTER VI: ASSET MANAGEMENT OPPORTUNITIES

When it comes to asset management, the attorneys surveyed said it was important to find a trust department that had both the expertise and willingness to handle unique assets.[34] Furthermore, they were not inclined to recommend a trust department that was singularly focused on in-house asset management.

Community bank trust departments have to think outside the box and move away from the all or nothing model. Clients and their advisors want a trust provider that will partner with them and support the multi-party administration model.[35] Although the regulatory landscape makes this departure a challenge, those trust departments that adapt will be the industry leaders of the future.

a. Unbundled Multi-Party Administration:

Unbundled or multi-party administration is the hot new industry trend.[36] Mass affluent investors reject the notion that bank trust departments are always the best investors.[37] They want flexibility when it comes to investments and they do not buy into a one-size fits all strategy. In 2010, Greycourt & Co released a whitepaper concluding that the number one problem with trust business is that it is operated to benefit the bank and not the beneficiaries.[38] The perception in the market is that bank trust departments tend to have limited investment offerings and utilize proprietary products versus open architecture investments.[39] This is unappealing to clients and their advisors.

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[34] See Table #6
[35] Curtis, Gregory and Moore, Thomas R., Greycourt & Co., Inc. White Paper No. 48- Best Practices Trusts. March 2010. www.greycourt.com.
[36] McDonald III, Joseph F., "Emerging Directed Trust Company Model", Trust & Estates Journal, February 2012.
[37] Id.
[38] Curtis, Gregory and Moore, Thomas R., Greycourt & Co., Inc. White Paper No. 48- Best Practices Trusts. March 2010. www.greycourt.com.
[39] Id.

Clients want an unbundled service model that provides greater flexibility and investing options that the rigid service model that combines fiduciary administration and asset management as a single in-house offering. All across the banking industry traditional service models are crumbling and the trust industry is no exception. Mass affluent clients reject the notion that the bank trust department can be a jack of all trades. These clients are unwilling to accept the traditional service model and will look to other providers that offer more flexibility. Those firms that are willing to adapt their offering to meet these demands will rise to the top.

In the past, trust departments rarely considered unbundling services and the legal and regulatory landscape supported the bundled trust model. However, laws in a handful of progressive trust jurisdictions are opening the door for unbundled services.[40] These jurisdictions make it permissible to separate fiduciary duties and liabilities from investment duties and liabilities.[41] Multi-party administration or unbundling can come in two forms:

1. Directed Trusteeship, or
2. Trustee partnership with outside advisors.[42]

In the directed trusteeship model, the named trustee serves as administrative trustee and its duties are limited to: taking title and ownership of assets; maintaining trust accounting records; preparing and signing tax returns; preparing and sending statements; making discretionary distribution decisions; and ensuring the trust document is followed.[43] In this model, the trustee is only liable for not following the direction of the empowered party or for willful misconduct.[44]

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[40] Id.
[41] Id.
[42] King III, Al W. and McDowell III, Pierce H. Delegated vs. Directed Trusts: Know the differences between these two instruments. Trusts & Estates: www.trustsandestates.com.
[43] McDonald III, Joseph F., "Emerging Directed Trust Company Model", Trust & Estates Journal, February 2012.
[44] King III, Al W. and McDowell III, Pierce H. Delegated vs. Directed Trusts: Know the differences between these two instruments. Trusts & Estates: www.trustsandestates.com.

If a trustee is not in one of the progressive jurisdictions, they may not be able to serve as a directed trustee, but they can partner with outside advisors to accommodate client demand. In the partnership model, the trustee delegates its investment duties to an outside asset manager through a contractual relationship. In this case, the named trustee remains fully liable for the investments and must closely monitor the process.[45]

Due to its size, Bank does not have in-house portfolio managers; rather it contracts with an outside investment firm for asset management. Although the outside firm provides the investment strategies, Bank's internal investment committee is responsible for overseeing the process and executing the recommended strategies. In this arrangement, Bank remains fully liable for the investment decisions of the outside firm. This type of arrangement is commonplace for firms of Bank's size and can be a competitive advantage in the changing marketplace.

Bank already has policies and procedures in place for outside manager oversight. Since this framework is in place and has passed regulatory scrutiny, Bank could partner with additional asset managers going forward. That being said, each relationship would need to be carefully scrutinized and evaluated on an on-going basis.

Bank is a [State name omitted to protect confidentiality] chartered trust company and [State name omitted to protect confidentiality] is not a progressive trust jurisdiction. Accordingly, Bank can only serve as a directed trustee if the trust instrument contains directed trustee provisions.[46] If the trust provides for a directed trustee relationship, then Bank would be able to work with an outside advisor and only incur liability for deficient execution of direction or willful misconduct.[47]

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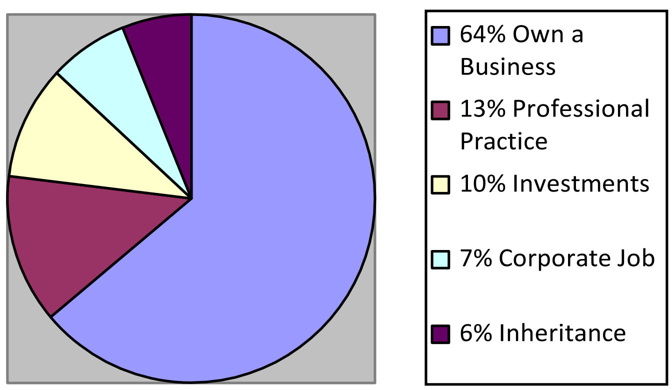
[45] King III, Al W. and McDowell III, Pierce H. Delegated vs. Directed Trusts: Know the differences between these two instruments. Trusts & Estates: www.trustsandestates.com.
[46] Nenno, Richard W., "Directed Trusts: Can Directed Trustees Limit Their Liability?" Wilmington Trust Company, 2001.
[47] Colo. Rev. Stat. §15-1-307 (2014). www.cobar.org.

Bank should proactively partner with local attorneys to incorporate directed trustee provisions into their documents to facilitate directed trustee relationships. This provides a great marketing opportunity for Bank to differentiate its services from its competitors.

b. Unique Asset Administration

Unique asset administration is becoming more and more important. Mass affluent clients rarely accumulate their wealth in purely liquid assets. Per *The Millionaire Next Door*, 64% of Americans accumulated their wealth by owning a small business.[48] With small business ownership, wealth is accumulated in closely-held stocks, partnership and LLC interests, real estate, insurance policies, farm interests, mineral interests and other illiquid assets.[49]

Graph IV: Wealth Accumulation Statistics



To remain competitive, community bank trust departments have to offer unique assets administration, appropriately market their capabilities and ensure they charge a reasonable fee to compensate for the risk. Unique asset administration is highly scrutinized by the regulators. The

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[48] The Millionaire Next Door (Stanley & Danko, Pocket Books, 1996) & Davidson, Brad, Spardata Whitepaper, "Sundry Assets: Opportunities and Threats." www.spardata.com.
[49] Davidson, Brad, Spardata Whitepaper, "Sundry Assets: Opportunities and Threats." www.spardata.com. & Office of the Comptroller's Handbook, Unique and Hard-to-Value Assets, August 2012. http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/index-comptrollers-handbook.html

Office of the Comptroller of the Currency (OCC) released a 65 page guide for fiduciaries handling unique assets.[50] This guide provides a good road map for trustees to follow and can be used to develop clear policies and procedures for administration.[51] Unique asset administration can be profitable and rewarding business, if the trustee has strong risk mitigation measures in place. The staff must adhere to all policies and procedures on the front end to avoid surprises and unforeseen losses that will erode profits.

Large institutions are not interested in unique asset administration because their primary focus is asset management. Often times, they will not accept appointment if a trust is predominantly comprised of unique assets.[52] Attorneys surveyed were extremely frustrated with the larger firms' unwillingness to handle all components of their client's estate.[53] The attorneys felt these institutions were singularly focused on investments and asset administration and not true trust administration.[54] Bank has a history of handling unique assets, and this is another competitive advantage for the firm. Focusing on this type of service is not without risk, but Bank can build on its strong foundation and reputation to fully develop this niche service.

In summary, the market place is changing and trustees must look for ways to differentiate themselves. Banks of Bank's size are uniquely positioned to adapt their service model and become the premier trust service providers in their markets.

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[50] Office of the Comptroller's Handbook, Unique and Hard-to-Value Assets, August 2012. http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/index-comptrollers-handbook.html
[51] OCC Handbook pg. 3 OCC requires fiduciary to review all assets prior to accepting them and to proactively determine the department has expertise and resources to properly manage the account.
[52] Trust manager interviews.
[53] Table 6
[54] Id.

CHAPTER VII: FEES, FEES, FEES…

It is now time to analyze how trustees are compensated. As the industry grows and competition increases, fees become more and more important. Clients want to pay the lowest fee possible and trust departments must charge a high enough fee to cover their risk, the costs of administration and generate profit. In the attorney survey, it was clear that fees and costs are major factors clients weigh when choosing a trustee.[55]

Typically, a corporate trustee collects annual fees between 50 and 125 basis points depending on the trust size and fiduciary responsibilities involved.[56] Smaller institutions offer breakpoints at lower thresholds making their overall fee more attractive than larger institutions. Generally, large institutions offer a fee breakpoint after the first $1 million in assets versus $500,000 at smaller institutions. Although smaller institutions charge lower fees, they are the most efficient in generating revenue due to their focus on personal trust administration. Across the industry personal trust assets comprise only 13% of all trust assets, but generate 48% of gross revenues.[57]

Although fee revenue is rising, trust departments struggle with enforcing their published fee schedules. Historically, trust departments offered fee discounts as an accommodation to secure loans and deposits. However, the discounts granted were rarely revisited or adjusted over time. Additionally, trust departments rarely enforce their special service fees. Industry consultants estimate that fee schedule implementation and enforcement within the industry is as low as 30%.[58]

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[55] Table 6 & Interviews with eight Estate Planning Attorneys in [City name omitted to protect confidentiality] Metro Area. Participants did not want names or firms used in paper. February 4-17, 2014.
[56] McDonald III, Joseph F., "Emerging Directed Trust Company Model", Trust & Estates Journal, February 2012.
[57] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.
[58] Id.

Of the 1500 participants in the 2012 Trust Performance Report, 27% indicated they would raise their fees by year end.[59] Furthermore, nine out of ten participants indicated they were being more vigilant with respect to policing and enforcing their current schedules to increase revenue.[60] Small institutions indicated they would be the most aggressive in both raising fees and policing existing schedules.[61]

[Confidential Bank information omitted.]

The outside trust managers that were interviewed confirmed Bank's fees for routine administration as well as unique asset administration were below market.[65] They both indicated their top tier percentage was 1.30% on the first $1 million of assets. Additionally, they enforced account minimums of at least $4,000.[66] *[Confidential Bank information omitted.]*

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[59] Trust Performance Report, Volume 6, October 2012. http://trustupdates.com.
[60] Id.
[61] Trust Performance Report, Volume 13, Number 4, May 2012. http://trustupdates.com.
[62] Graph II
[63] Davidson, Brad, Spardata Alternative Investment Survey: Fees Trust Companies Charge to Hold Their Customers' Alternative Investments. January 29, 2014. Interim results available only to survey participants and full study will be published by year end 2014. www.spardata.com.
[64] Id.
[65] Trust Manager Interviews.
[66] Id.

Table # 7: Bank 2014 Fee Increase

[Confidential Bank information omitted.]

Although Bank's fees are below market and need to be adjusted, they are in a good position to raise revenue and remain competitive. Raising fees needs to be a top priority of Bank's trust department. Currently, the department is not being adequately compensated for its services and risk associated with those services.

CHAPTER VIII: TRUST OFFICER ROLES & RESPONSIBILITIES

The industry already expects a lot from trust officers and those in small institutions wear multiple hats. A trust officer's primary responsibility is to ensure the terms of the trust are being followed and that their accounts are being properly administered.[67]

Due to the specialized nature of the business, compliance will always be a major component of the role. However, marketing and sales are becoming more and more important. Historically, trust officers were not required to participate in bank wide sales process. Primarily they focused on servicing existing accounts. New business development efforts were limited and trust officers tended to rely on a handful of external referral sources for business.

It is clear that the existing trust sales model of waiting for opportunities to come to the bank based on its reputation and experience is outdated. Trust officers need to actively market their services and differentiate themselves. They must build internal partnerships as well as foster external relationships to drive business to the bank. By building partnerships with local attorneys, financial advisors and CPAs, trust officers can market their services and create a pipeline for current and future appointments.

Industry experts and consultants are advising trust departments to focus on taking away business from other providers.[68] Many trust consumers are unhappy with their current provider's fees, investments and the lack of personal service.[69] Many trust clients have never met their trust officer in person and have to call a 1-800 number for distributions and information regarding

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[67] Federal Deposit Insurance Trust Compliance Manual. http://www.fdic.gov/regulations/examinations/trustmanual.
[68] Sterne Agee, "Take-Away Trust Strategy: Trust Sales Concept", April 2009. http://www.capital-invest.com/pdffiles/TakeAwayTrustStrategy.pdf.
[69] Id.

their account. The attorneys interviewed confirmed that their clients are dissatisfied with current industry practices and are very open to moving their relationships.[70]

All of this bodes well for Bank's trust department. By building alliances with attorneys and CPAs, Bank's trust officers can exploit these market opportunity and take business away from their competitors.

[70] See Table 6

CHAPTER IX: CONCLUSIONS & RECOMMENDATIONS

After reviewing industry data, current practices, market demand and opportunities, it is clear the trust industry is changing. Small institutions are uniquely positioned to grow their business if they proactively alter their current service models to meet market demands.

The trust industry hit an all-time high in 2011 and has not looked back posting double digit AUM growth in 2012 and 2013. Trust departments with fewer than $500 million in AUM are growing faster than the industry as a whole. Although large institutions have the greatest AUM, they are continually limiting access to their services opening the door for small institutions to capture greater market share.

Fee revenue is steadily increasing across the industry and smaller institutions are growing faster than their larger competitors. Additionally, they are reporting higher ROAs due to their focus on personal trust administration. Small institutions are filling a much needed niche for mass affluent and high net worth clients that larger institutions are unwilling to offer. This is all positive and supports the notion that trust services can be a fee income driver for Bank.

Unbundling is driving market demand. Firms of Bank's size are in a better position to adapt their service model than their larger competitors. Generally, smaller institutions are not singularly focused on investment management, and in most cases already partner with outside advisors. Accordingly, they can build upon their current service model and offer the flexibility of administration clients want. Furthermore, with their focus on personal trust administration, they have the expertise and the willingness to handle unique assets. The flexibility firms of Bank's size offer is exactly what the market is demanding.

Lastly, but maybe the most important competitive advantage Bank has is its local presence. Bank's clients have a dedicated trust officer in-market with decision making authority.

Larger institutions are consolidating offices, utilizing call centers and raising account minimums. As the mass affluent segment continues to grow, they will ultimately drive the demand for trust services and Bank is well positioned to serve these disenfranchised clients and grow their business.

Despite these positive trends, some argue that the trust industry will begin to contract due to estate tax law changes. The belief is that clients will be less inclined to use trusts if there are no tax savings associated with the restrictive planning. However, three major demographic trends are driving demand despite the tax changes. First, there are more blended families that need independent trustees to administer their estate plans in an unbiased manner. Second, people are living longer and the aging baby boomers need estate settlement and trust services. Third, families no longer all reside in the same geographic areas. Parents do not want to burden the next generation with these administrative duties, and quite frankly the next generation does not have the time or desire to do it. Despite the estate tax law changes, these demographic trends support the need for independent trust administration for the foreseeable future.

Bank is a thriving community bank operating in the economically viable [State name omitted to protect confidentiality] market. The bank is financially stable, has a loyal customer base and is rapidly growing. The department has been in existence for over 85 years and has built a strong reputation around personal trust administration. There are fewer institutions in [State name omitted to protect confidentiality] competing in this space that have the same breadth of experience as Bank. *[Confidential Bank information omitted.]* With the Board's continued support, the trust department is well positioned to grow AUM and drive additional fee revenue to the bank's bottom line.

2014 RECOMMENDATIONS

Given Bank's size, capabilities and marketplace, the following action items will deliver measurable results. Incorporating these recommendations into the 2014 and 2015 trust department business plans will make it possible for the group to reach the Board's goal of growing fee revenue by 25%.

1. **Comprehensive Fee Review and Increase:** A comprehensive review of Bank's fee structure was completed in 2013. Based on that analysis, a two-phase fee increase should be implemented over the next two years. Anytime a firm raises fees careful consideration must be given to client retention, firm reputation and the competitive landscape. That being said, Bank's published fee schedules were well below market rates and the proposed increases will not erode Bank's competitive advantage. The first phase was implemented January 1, 2014 and resulted in first quarter fee increase of 20.3% over what the firm collected in the first quarter of 2013. Additionally, no clients complained or moved their accounts as a result of the increase. The second phase will take effect January 1, 2015. This phase will result in another fee bracket adjustment, but the biggest impact will come from restructuring Bank's unique asset and special administration fees. Bank must carefully scrutinize its special administration fees and proactively work with clients to implement the increases by January 1, 2015. These increases have to be carefully managed to maintain client retention and firm reputation. That being said, even with the increases Bank will remain very competitive and often times will remain the best option for current and future clients.

[Confidential Bank information omitted.]

2. **Formalize Unbundled Service Model:** Bank can be a leader in providing unbundled trust services. Because Bank does not have in-house portfolio managers, it is not singularly focused on investment management. Additionally, Bank already has policies and procedures in place for hiring, managing and overseeing outside investment advisors. This process has been tested regularly by internal auditors and external examiners and no deficiencies have been noted. Accordingly, I recommend Bank hire outside counsel by the end of the second quarter to provide a formal opinion detailing how Bank should proceed to expand this service. Streamlining this process does have upfront costs, but the long-term benefits and business development opportunities justify the initial investment.
3. **Promote and Market Unique Asset Administration:** Bank has the expertise to handle unique assets including real estate, mineral, oil and gas interests as well as closely held partnerships and business entities. Due to its size, the firm can provide adequate oversight to comply with regulatory requirements. Bank's auditors and examiners have found no deficiencies in the firm's policies and procedures. That being said, in order to effectively expand this offering, I recommend that Bank develop its own comprehensive policy manual for unique asset administration based on the OCC's handbook.

Additionally, I recommend that Bank charge a reasonable fee that covers its costs and risks as it expands this business line. To market and promote these services, the trust officers will need to work closely with local attorneys and COIs to generate new business. Unique asset administration can be profitable and rewarding business if Bank properly manages risk.

4. **Foster Proactive Sales Culture within Trust Services:** [*Confidential Bank information omitted.*] The trust offering is not well established inside or outside the bank. Historically, the legacy trust officers were not required to participant in joint sales calls or held accountable for referrals. Bonus compensation was tied to account retention with little focus on new business generation. Bank needs to make the following adjustments to the trust officers' incentive plan to foster a proactive sales culture and grow the business:

    i. **Measurable Business Development Activities:**

        1. Each trust officer must make at least one presentation to external COIs in their target market per quarter.
        2. Each trust officer must make at least three referrals per quarter to internal banking partners.
        3. Each trust officer must make at least one presentation per month to internal business partners.
        4. Each trust officer must attend at least one outside trust industry presentation or function per quarter.

ii. **New Business Development Goals:** Bank needs to set new business revenue goals for each trust officer. In the past, the department did not break out goals and all officers shared in revenue production. This can work for high-functioning sales teams, but it is not effective when trying to develop a robust sales culture.

iii. **Targeted Event Sponsorship:** The trust department needs an annual marketing budget of roughly $15,000 to sponsor trust industry specific events. Although the bank has great name recognition, the trust department is relatively unknown. The trust group should partner with other business lines in sponsoring events as well, but the following events are a must to create brand recognition for the trust department:

1. Title Sponsor for [State name omitted to protect confidentiality] Bar Association Estate Planning Retreat

2. Title Sponsor for [State name omitted to protect confidentiality] Bar Association Elder Law Section

3. Sponsor trust officer membership in various estate planning counsels within market

The recommendations above require upfront investment costs and on-going Board commitment. However, they are targeted initiatives that can deliver measurable results and increase fee revenue for years to come.

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