

Trust planning

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YourMONEY MATTER\$

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How trusts work

At their beginning, in the 14th century, trusts were used to convey real estate, a mechanism to defeat the rigid rules of primogeniture (property passing to the oldest son), as well as the taxes then imposed when land passed by intestacy. As the nature of wealth has changed, so has the nature of trusts. This has given rise to what some call the modern “management trust,” a tool for managing financial assets, such as stocks, bonds, mutual funds, insurance contracts, pension and annuity interests, and bank accounts.

Among the types of trusts most commonly used by affluent families today:

- Living trusts provide asset management and protection in case of disability of the grantor (and the grantor's spouse, if there is one);
- Marital trusts protect a surviving spouse for life and are sheltered from federal estate taxes;
- Bypass trusts expand family protection from death taxes;

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Anatomy of a trust agreement

Assets

Usually stocks, bonds, mutual funds, or other portfolio elements, although real estate and even fine art may be placed in a trust

Grantor

The creator of the trust

Beneficiaries

The grantor may be the first and foremost beneficiary for a revocable, living trust — or the grantor and spouse. Otherwise, other heirs are named, whose interest will vest at various times, specified in the trust.

One or more trustees

An individual may be chosen, or a corporate fiduciary, such as us.

Instructions

In a written trust agreement — or, if it is a testamentary trust, in your will — the trustee is given instructions about the management of the trust and the distribution of income and principal.

Decoration of the Camera degli Sposi (Camera Picta), by Andrea Mantegna, painted 1465-1474, fresco and dry tempera. Italy. Lombardy. Mantua. Ducal Palace. Northern wall also known as the fireplace wall. The Court. Detail of the Gonzaga family. © Photoservice Electa / SuperStock

- Qualified Terminable Interest Property Trusts (QTIP trusts) balance the interest of a surviving spouse and children in a blended family situation;
- Inheritance protection trusts can be used to preserve a legacy for heirs for the long term;
- Charitable trusts meet both philanthropic and private financial objectives.

See “What a trust can do” below for more details. All of these trusts have something in common. They have assets that require careful management, and that job falls to the trustee. For the key elements of every trust, see “Anatomy of a trust agreement” on the previous page.

Introducing modern portfolio theory

The earliest trustees were amateurs, but the prototypical modern trustee is a fee-paid professional whose business is to enter into and carry out trust agreements. These professionals, such as ourselves, bring expertise in investment management, trust accounting, taxation, regulatory compliance, and fiduciary administration to this important job.

One hundred years ago, trustees tended to focus on low-risk, low-return investments. In fact, some states prescribed narrow ranges of acceptable trust investments through “legal lists.” This gave way to the “prudent man” rule, in which trustees had more discretion in asset management. Then modern portfolio theory emerged in the 1970s and 1980s as the accepted best practice in managing trusts. These changes were legally codified with a new Uniform Prudent Investor Act.

The thrust of the new rules is to move away from evaluating the appropriateness of individual portfolio components and to examine instead the overall risk and reward characteristics of the entire trust. The key is total return.

A three-step process

When a new trust is accepted for administration, today’s trustee uses a well-defined process to get started properly:

1. Identify the goals and objectives of the trust and its beneficiaries. For example, is income for current beneficiaries more important than asset growth for future beneficiaries? How much income is adequate? Are there special tax considerations that provide a constraint on investment decisions? Does the grantor, or do the beneficiaries, have special concerns about trust investments (for example, no tobacco stocks, or no high-risk bonds, or no derivatives)?

2. Formulate an investment policy and an asset allocation model for the trust. This model will set a benchmark for expected risk and reward, consistent with the trust’s objectives. It also must take tax and liquidity considerations into account. High concentrations in particular stocks normally will be avoided as inconsistent with sound diversification principles.

3. Select and monitor investments consistent with the investment policy. The trustee may draw upon internal expertise or may supervise implementation of the investment policy by others, as appropriate.

Would you like to know more?

The central features of the management trust are professional asset management, conducted under fiduciary safeguards, in a segregated vehicle, which is bankruptcy-remote from the manager. This is what we do. How could a thoughtful trust plan improve the financial security of you and your family? We’d be pleased to explore that important question with you in more detail, at your convenience. □

What a trust can do

Given the flexibility that comes with trust planning, no single vocabulary has emerged for describing the different types of trusts. The same trust with the same function can go by different names because different estate planners have created multiple monikers. Here is an introduction to some of the types of trusts that you might want to explore.

If you need to provide for:	Look into the:	Benefits:
Yourself, or yourself and your spouse	Revocable living trust	Professional asset management, continuous financial protection upon incapacity
Your spouse, after your death	Marital deduction trust	Estate tax deferral; spouse receives all income at least annually
Your noncitizen spouse, after your death	Qualified Domestic Trust (QDOT)	Marital deduction; spouse receives all income at least annually
Your children, after your death	Family trust	Trustee may be given discretion over trust assets, protecting them from creditor claims
Your spouse and children from an earlier marriage	Qualified Terminable Interest Property Trust (QTIP trust)	For “blended families,” preserves everyone’s inheritance
A disabled individual	Special needs trust	May provide for enhanced quality of life while permitting continued government benefits
Yourself or other individuals for some time, and a charity in the future	Charitable remainder trust	Income interest may be a percentage of the trust’s value or a fixed dollar amount; income and gift tax savings possible



on estate planning for married couples



As the new year begins, it's a good time to pause to reflect upon whether one's estate plans might need an update. Here are the questions that we get most often from married couples on this subject.

How much wealth does a couple need before estate planning becomes necessary?

Couples of any and every wealth level need to plan their estates and execute their wills. There is a common misconception that estate planning is for "the rich" and that it is primarily about planning for estate and inheritance taxes at death. That's not so. Many important nontax issues come up at lower wealth levels, including guardianship of minor children, beneficiary designations for retirement benefits and life insurance, and the disposition of property and personal possessions.

At what wealth level do the "death taxes" kick in?

There is no simple answer to that question. "Death taxes" refers to inheritance taxes (the privilege of receiving property from someone who has died) and to estate taxes (the privilege of transferring property after death). The amount of an inheritance tax depends upon the identity of the heir and the size of the inheritance, while the estate tax is determined based upon the value of the estate as a whole.

At the federal level, the estate tax exemption this year is \$5.12 million. Next year, under current law, the exemption falls to \$1 million. State laws vary. A majority of states have dropped death taxes as revenue raisers. Those that have kept the tax have widely varying exemptions.

How does the "marital deduction" work?

In general, estate transfers to a surviving spouse are entirely exempt from the federal estate tax, whether they are outright transfers or transfers in trust, whether they are \$5 million or \$5 billion. There is an exception when the surviving spouse is not a U.S. citizen. In that case, the marital deduction is allowed only for transfers to a Qualified Domestic Trust (QDOT).

For optimal tax results, a two-trust plan traditionally has been used to manage the wealth of a married couple. When the first spouse dies, a "credit shelter trust" is created to take full advantage of the federal estate tax exemption, and a "marital deduction trust" receives the balance of the estate. With such a plan, most federal estate taxes will be deferred until both spouses have died, regardless of the size of the estate.

What is a "QTIP" trust?

A Qualified Terminable Interest Property (hence, "QTIP") trust is one in which the surviving spouse has all of the rights to trust income but no rights to the principal and no power to adjust what happens to the trust assets when the trust terminates. Such trusts are especially appropriate in "blended family" situations, where the objective may be to secure a deferred inheritance for children from an earlier marriage.

How does "portability" work?

The December 2010 tax compromise that extended the "Bush tax cuts" for another two years included a brand-new estate tax provision for married couples. What happens is that a surviving spouse will inherit any estate tax exemption that is not used up by the estate of the first spouse to die.

Simplified example: Sam and Janet own \$8 million worth of assets. At Sam's death with a simple "all to spouse" will, everything passes to Janet outright. Sam's estate hasn't used any of its exemption, so Janet inherits that also. At Janet's later death, her estate will be completely free of federal estate tax up to \$10.24 million because she gets to use both exemptions.

Caveat: Under current law, both Sam and Janet must die in 2012 to take advantage of this tax break. It disappears on January 1, 2013, unless Congress acts.

What's the alternative to portability?

Sam could have created a "credit shelter trust" for a portion of the couple's wealth. That trust would not be taxed at his death, thanks to the federal exemption, and it would not be included in Janet's taxable estate either, even if she received income payments from the trust.

What other benefits flow from the credit shelter trust?

The fact that the benefits won't be lost if Congress is gridlocked in 2012 is benefit enough for many couples, but in addition a credit shelter offers:

- creditor protection;
- estate freezing;
- provisions for other heirs, including children and grandchildren; and
- administrative convenience.

Should you choose a corporate fiduciary, such as us, as the trustee of your credit shelter trust, this approach comes with professional asset management built in. □

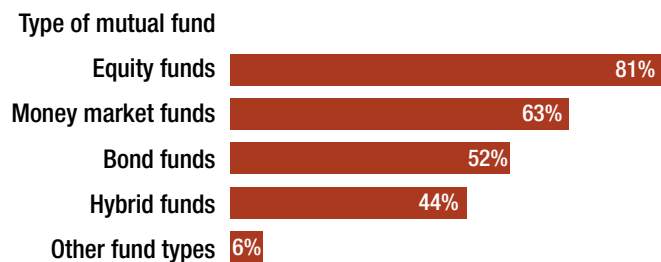
Who owns mutual funds?

There are 90.4 million mutual fund investors in the U.S., reports the Investment Company Institute. These investors represent an estimated 52.3 million households, 44.1% of all U.S. households. The data are from the ICI's *Annual Mutual Fund Shareholder Tracking Survey*.

Divide the population into three age groups: those born before the end of World War II; the baby boomers (born from 1946 through 1964); and Generations X and Y, born after 1964. As one might expect, according to the survey, the boomers own most of the wealth, comprising 55% of total mutual fund assets. The older generation owns 19%; the younger ones, 26%. However, when one looks at the percentages of households that own mutual funds, as opposed to the value of the holdings, a different picture emerges, one of consistent levels of participation in mutual fund ownership over time. Some 42% of boomers own mutual funds, and 41% of the younger generations do as well.

As shown in the graph below, stock funds are the most popular, widely owned funds.

Percentage of U.S. households that owned mutual funds in 2011



Source: Investment Company Institute Annual Mutual Fund Shareholder Tracking Survey

Mutual fund owners have become somewhat more risk averse, the survey reveals. In May 2008, 36% of households owning mutual funds reported that they were willing to take above-average or substantial risks with their investments. That figure fell to 30% a year later, and it remained at that level into 2011.

Household Internet access is available to 91% of those who own mutual funds, and these investors overwhelmingly rely upon the Internet for some portion of their financial management. Some 82% of them use the Internet to access their bank or investment accounts, compared to just 57% of those who do not own mutual funds. However, only 19% bought or sold investments online.

The most encouraging data point in the survey is that mutual fund investors are confident about meeting their financial goals, and this confidence is growing. In 2009, 72% expressed confidence; in 2010, 79% did; and in 2011, 82% were confident about meeting their financial goals (21% were "very confident"). If the financial markets perform well in 2012, that confidence will be justified. □



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