Investing with omnibus custodians, independent trusts

Omnibus custodians and independent trust companies offer a variety of benefits to investors. When choosing an institution in which to hold assets, they can offer advantages such as a diverse portfolio, customized investment choices, personal attention and more.

Michael Joyce

Given the highly complex nature of the markets, building a partnership between your financial adviser and either an omnibus custodian or an independent trust company (or a combination of all three) will ensure more personalized attention in order for investors to meet their financial objectives.

First, it might be helpful to explain that a custodian holds custody of assets for safekeeping and invests them as directed by an investor or his or her financial adviser. The custodian itself does not make investment choices.

It is recommended that investors use an omnibus custodian, such as TD Ameritrade, Fidelity or Schwab, for example, since it can hold a wide variety of investments.

Using an omnibus custodian makes investing in nonlocal markets affordable and manageable – since they have the expertise and systems in place to manage local matters. Directed by a client's financial adviser, an omnibus custodian enables clients to be more diversified, which, in turn, can lead to greater returns on investments and long-term financial security.

LEGALLY BOUND

Another asset-holding alternative for investors is working with an independent trust company. Generally, a financial adviser and an independent trust company will work together to appropriately service a client.

Whether the trust company manages the trust's assets or relies on the financial adviser for asset management, the client will get sound advice.

A Registered Investment Adviser and a beneficiary's trustee are both legally bound to work as fiduciaries (that is, in their client's best interest).

Consequently, a client should not experience any conflicts of interest when working with either type of entity and can rest assured that his or her assets are invested in the best possible investment vehicle.

INVIDUALIZED RECOMMENDATIONS

An additional benefit of working with an independent trust company is that it oversees fewer trusts than a trustee at a larger, corporate entity might be required to manage. This allows the trustee to make individualized recommendations to his or her clients.

> Taking into consideration the specific characteristics of a trust's beneficiary is instrumental to ensuring that the trust is optimally structured and invested for a client.

Taking into consideration the specific characteristics of a trust's beneficiary is instrumental to ensuring that the trust is optimally structured and invested for a client.

An independent trust company would customize the portfolios of different trust beneficiaries – such as an 80-year-old living in California and a 30-year-old living in Pennsylvania, for example – so that each could optimize his or her investments.

Like many smaller professional service providers, an independent trust company values the client relationship and offers services customized to meet the client's specific needs.

FEE ARRANGEMENTS

Omnibus custodians and independent trust companies have differing fee structures – which might help determine which type of asset-holding institution is right for you.

Custodians usually charge quarterly custody fees based on aggregated holdings. A custodian will only charge on the assets it holds for you.

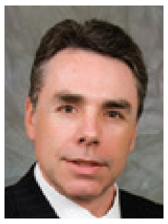
Something to keep in mind is that an independent trust company may charge fees on the value of the entire trust, which may include nonliquid assets such as personal property.

Beneficiaries should be sure to understand the fee structure and take into consideration what assets are held in your trust.

Michael Joyce, founder and president of JoycePayne Partners of Bethlehem and Richmond, Va., is responsible for overall investment strategy, management of investment portfolios and financial counseling services. He can be reached at mjoyce@joycepaynepartners.com.

INSURING YOUR COMPANY'S MOST VALUABLE RESOURCE

If you're a business owner, you may have wondered whether your company needs to provide life insurance to cover the loss of a key person should he or she die unexpectedly.



Rob McFarland

Consider the example of a 15-employee equipment-parts distribution business. Of six regional salespeople, one – Jack – was responsible for 40 percent of new business each year.

When Jack unexpectedly died, the company's revenues dropped by 25 percent the following year.

Jack was clearly a key person for the business, one whose loss had a severe negative financial impact on the company. Many businesses rely on people like Jack, employees whose value to the company would be difficult or expensive to replace.

For a restaurant, it may be the chef; for a legal practice, the rainmaker. For almost every small to medium-sized business, the key persons include the owners.

FAILURE OR SURVIVAL

Insuring a key person can spell the difference between the failure and survival of a business.

Take another example: Tom and Art were partners. When Art died, his wife Betsy took over his share of the business.

Because the business did not provide key-person insurance, Tom could not buy out Betsy. Their constant disagreements created an unpleasant working atmosphere and they lost almost half of their employees – and clients.

Eventually, Tom let Betsy buy him out at a far lower value than he would have received at the time of Art's death, had they both been covered.

HOW MUCH COVERAGE?

There are a number of valuation techniques to determine how much key-person insurance is appropriate. No one method is best; a business owner may want to use a combination of methods. Here are two popular techniques:

- **Method No. 1:** Multiple of salary valuation.

The key employee's value is estimated based on a multiple of current compensation. Frequently, a multiple of three to five times his or her salary is used. If the key person's salary is $75,000, the amount of insurance might be $375,000 ($75,000 times five).

- **Method No. 2:** Replacement cost.

First, figure out how much additional salary is being paid to the executive above the compensation for the routine duties of the position. For example, if the salary is $80,000 but the routine part of the job amounts to about $25,000, the additional skills are then worth about $55,000.

Second, estimate how many years it would take to find and fully train a replacement to handle these extra duties. Assume two years and add in the recruiter's fee – generally about 25 percent.

Third, add the above factors – recruiter's fee and additional skills ($13,750 plus $55,000).

Fourth, multiply the above factor ($68,750 times two years equals $137,500 of life insurance).

- **There are other valuation techniques.** Your insurance professional can help determine the best method. Because it is straightforward and sensible, some business owners consider simply insuring one year's profits.

MONEY AND TIME

Key-person life insurance can help a company survive by helping to minimize the organizational loss and fiscal strain that can follow the death of a key employee and by helping to assure that:

- Business loans or investments can be repaid. When a key person dies (especially an owner), a lender may have the right to call the loan. Life insurance proceeds can help pay off that loan.
- Credit can be maintained. At the death of a key person, lenders may become reluctant to lend new money to the business or refinance outstanding loans.

The life insurance can help the firm maintain its credit rating by allowing it to pay bills in a timely manner in spite of the death. It also may demonstrate to the lender that the firm is well managed.

- A replacement can be recruited and trained. Months may pass before a qualified candidate can be found. Then it may take time to train him or her to the point where the replacement is as competent as the predecessor.

There also may be a recruiter's fee to pay. So, life insurance proceeds buy time for the business.

- The business can help offset lost sales and profits. Insurance proceeds can help offset the future loss in revenue that probably will occur, at least temporarily, when a key person dies.

The key employee can be repurchased with the insurance proceeds. This can enable a partner to buy out a deceased partner's share.

WHO NEEDS KEY-PERSON INSURANCE?

With key-person life insurance, the business owns the policy, pays the premiums and is the beneficiary. Many businesses buy permanent (cash value) life insurance, although term policies also are used.

As with any insurance, premiums will vary based on the age, physical condition and health history of the insured.

Does your company need key-person insurance?

That depends on your company's structure and business continuation plan, as well as the amount of financial hardship potentially faced without a key person.

LARGE COMPANIES

Not all businesses need key-person insurance. In large companies, there may be less likelihood that a single individual or small group is indispensable to a company's continued success.

In one-person firms, however, the business almost certainly will not survive without the principal, no matter how much money is available.

Some partnerships, such as a medical practice, most likely will have a greater need for key-person coverage during their early years. As the partners' pensions, profit-sharing and net worth grow, insurance may become less necessary for the practice's survival.

WHAT WOULD HAPPEN?

For businesses primarily concerned about

please see **McFARLAND**, page 23