

AFOA 2009 CONFERENCE

Effective Trust Management in Difficult Times; Strategies for Coping

Thursday February 26, 2009

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Agenda

The Theory and the Reality

- Background – Using a Trust
- What is a Trust Officer
- Who are the people you need: what skill sets and training should they have
- Key components of a Trust Agreement to survive and thrive in difficult markets
- Managing income flow in volatile markets
- Suggestions and Best Practices



Background - Using A Trust



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What Is A Trust ?

“A right of property, held by one person or group of people, for the benefit of another person (or group).”

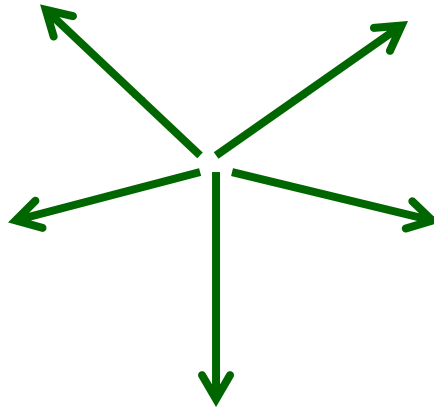


5 Key Elements

SETTLOR
First Nation
Creates the Trust

PROPERTY
*Money or assets
placed in the Trust*

*A Trust has
been created*



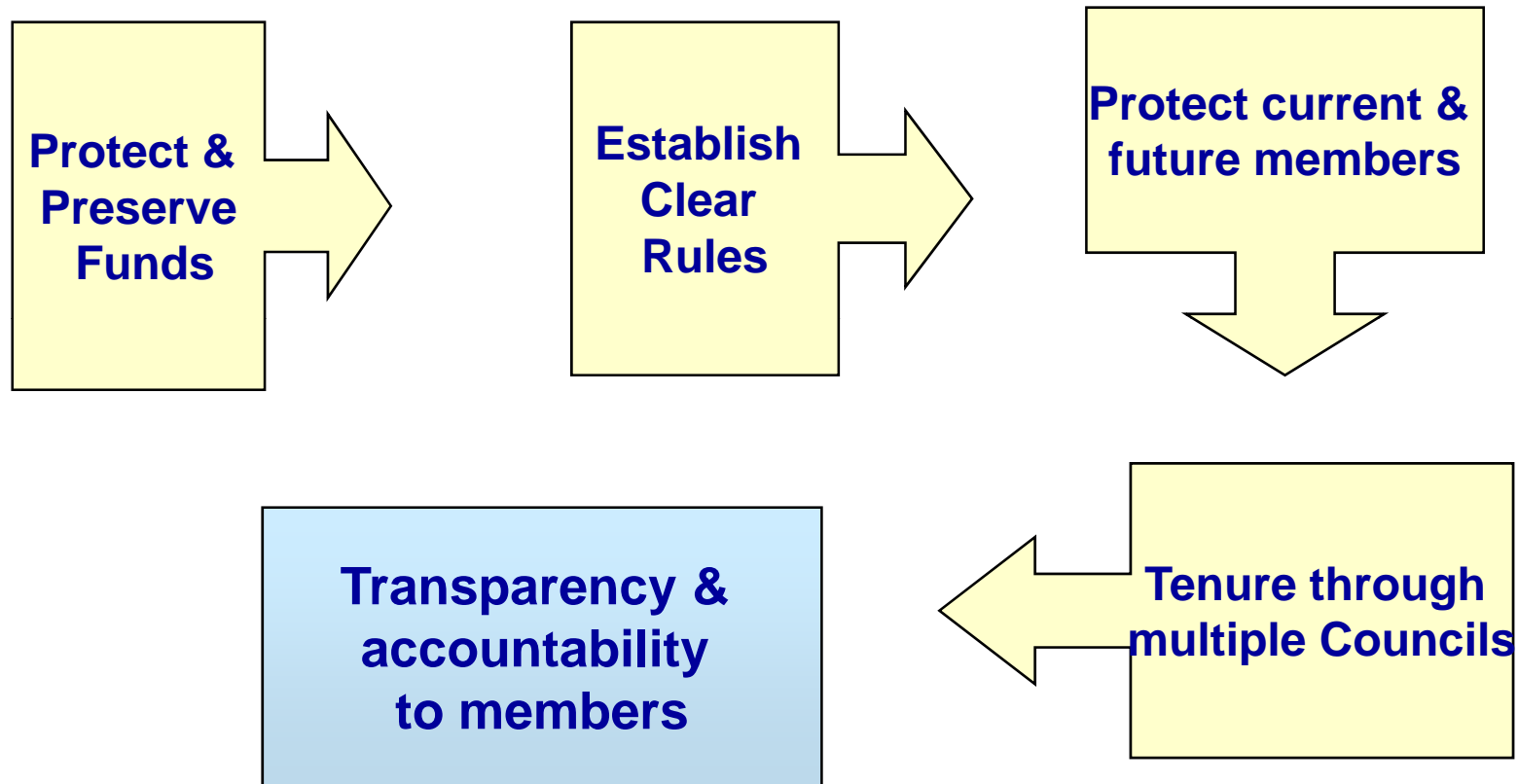
Trustees
Protect & Manage the Trust

BENEFICIARIES - Members
Benefit from the Trust

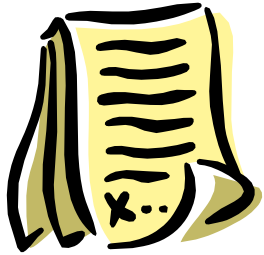


RULES
Trust Agreement
Terms & Conditions

There are many reasons to use a trust



What's in a Trust Agreement



- Confirmations by all signatories
- Terms and Definitions
- Purpose and Uses of the Trust
- Trustee requirements
- Investment provisions
- Reporting requirements
- Amending provisions



Role of the Trustees

Powers & Duties

A “**duty**” is a mandatory task which must (“*shall*”) be completed.

A “**power**” is permissive and “*may*” be done or need only be done if it is in the *best interests* of the Trust and the beneficiaries.



Duties and Powers

- **Some Key Duties**

- Safe keeping, control and segregation of Trust assets
- Keep accurate records
- Disburse funds only as authorized
- Hire Agents as required by Trust Agreement
- Avoid Conflicts

- **Some Key Powers**

- Pay Authorized Expenses
- Make Rules for operating the Trust
- Hire agents as appropriate





Main Duty of Trustees

- ❖ Adhere to the terms of the Trust Agreement
 - ❖ Carry out term honestly and in good faith, with a view to the best interests of the beneficiaries
- ❖ Ensure that trust assets are ***only*** used as set out in the Trust Agreement



Fiduciary Duty

- The settlor and beneficiaries place their Trust, confidence and faith in the Trustees, and the Trustees must, in good faith, act for the long term benefit of the beneficiaries. They must ***always*** put the interest of the beneficiaries ahead of their own personal interests.
- Trustees have a fiduciary duty to use all the skill, care and diligence at their disposal when acting on behalf of the beneficiaries.



The Even Hand Rule



The Trustees must treat all beneficiaries equally and fairly and cannot benefit one group of beneficiaries to the detriment of another group.



Trustee Liability



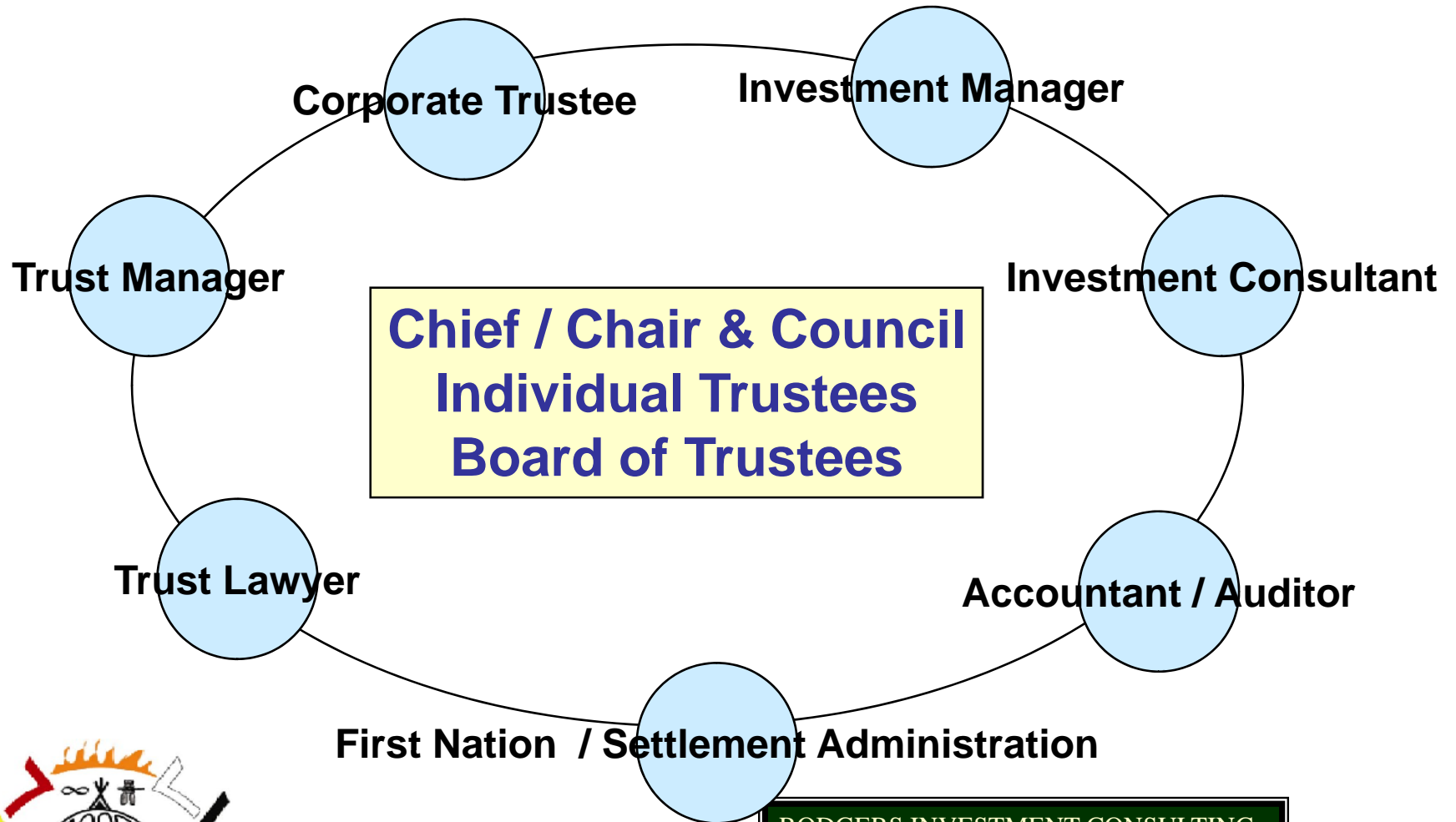
- Trustees can be held personally liable for acts that adversely affect the Trust or the beneficiaries.
- Most Trusts contain terms that forgive minor mistakes made by Trustees acting in good faith or any other matter except willful fraud or wrongdoing.



What is a Trust Officer?



Trust Officer: Someone who has decision making authority or specific responsibilities



Why are they a Trust Officer?

- They each have a duty to the beneficiaries and must act in the best interests of the beneficiaries
- They have specific responsibilities or authorities specified in the Trust Agreement or in their contract or job description



Specific Responsibilities - Examples

Trustees

- Make decisions required by Trust Agreement
- May determine Annual Disbursement amount

Chief / Chair & Council

- May appoint Trustees
- May have authority to determine spending allocation

Staff

- Provide input & knowledge Needed for Decisions
- Ensure the books are in order

All have a role to play to ensure a well managed trust



Specific Responsibilities - Examples

- Corporate Trustee / Institution / Custodian
 - Hold the assets in safekeeping
 - Determine amount of annual income available for spending
 - Maintain all records
- Lawyer
 - Draft Trust Agreement
 - Advise on interpretation of clauses and if proposed actions comply with Trust Agreement
- Accountant
 - Ensure the books are in order and implement decisions
 - Research to provide background information needed in decision making



Specific Responsibilities - Examples

- Accountant

- Advise on how to maintain the records
- Filing of tax returns
- Audit the Trust Accounts

- Investment Experts

- Advise on investment structure and framework
- May also want to sell investment products to Trust
- May provide evaluation on investment performance of trust assets
- Potential for conflicts of interest that can be detrimental to Trust



Who are the People you need and what are their skill sets?



Skill Sets From Membership

Honest, Ethical, Trustworthy and Curious

- + Willing to ask questions and learn
- + Will work hard to understand duties and responsibilities
- + Willing to work as part of a team for the **WHOLE** community

= **Future generations benefit from a well managed Trust**



Skill sets of Trust Manager / Trust Liaison

Understand the Terms of the Trust

+ Honest, Ethical, Trustworthy and Curious

+ Willing to ask questions and learn & recognize when to call in experts

+ Understand duties and responsibilities & strong communicator

+ Familiar with investments and the issues of withdrawal levels

= **Trust management & handling is transparent, accountable and competent**



Outside Professionals

- Legal
 - Strong knowledge of trust law
 - Willing to work with other professionals and learn from them
- Accounting
 - Understand the Trust Agreement and particularly the income clauses
 - Willing to work with other professionals and learn from them



Skill sets & attributes of investment team

Knowledge of trusts in general and the specifics of your trust

+ Experienced professional with appropriate credentials

+ Willing to work with other experts as part of team

+ Advice should be independent of product sales

+ Separation of Policy advice and implementation of the advice

= **Well managed investment portfolio
that matches Trust objectives**

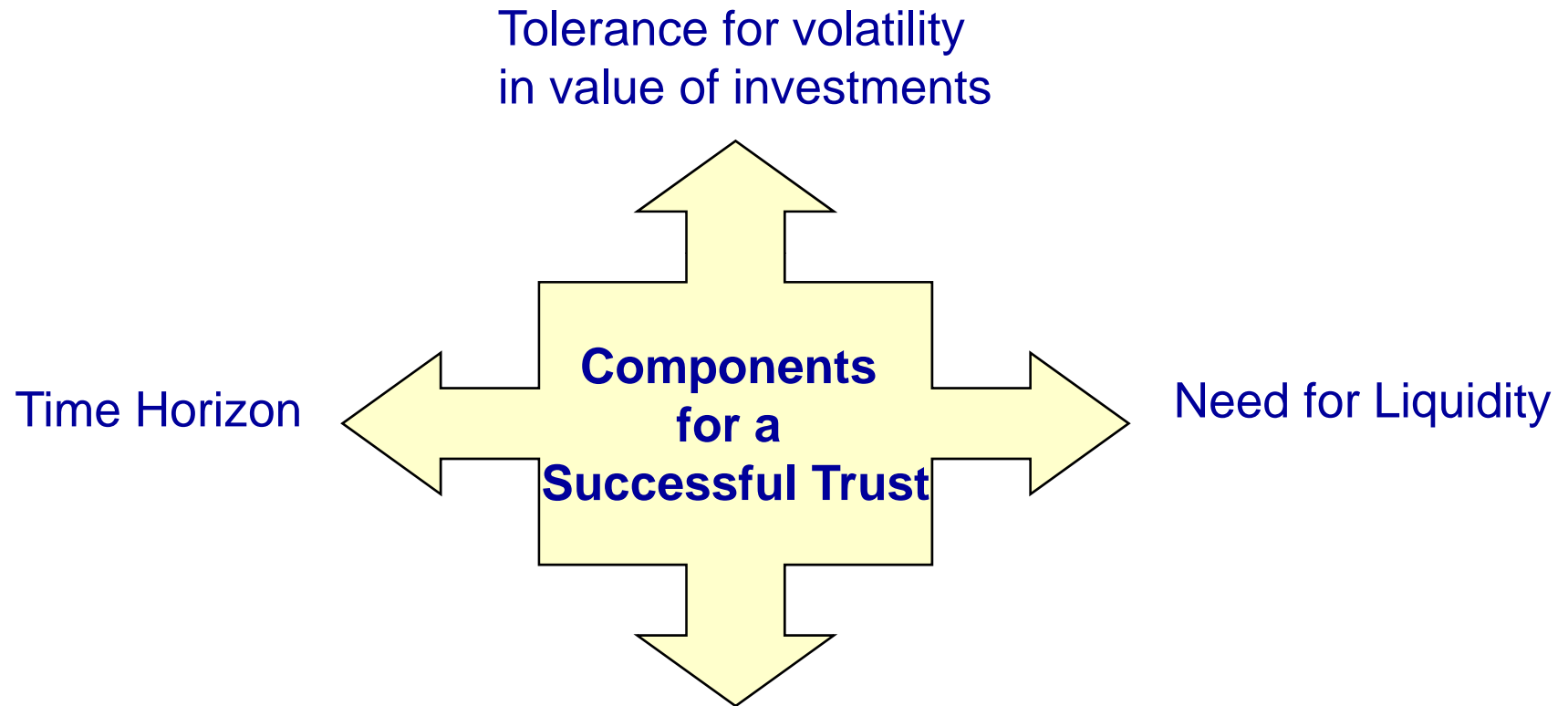


Key Components of the Trust Agreement to Survive and Thrive in Difficult Markets

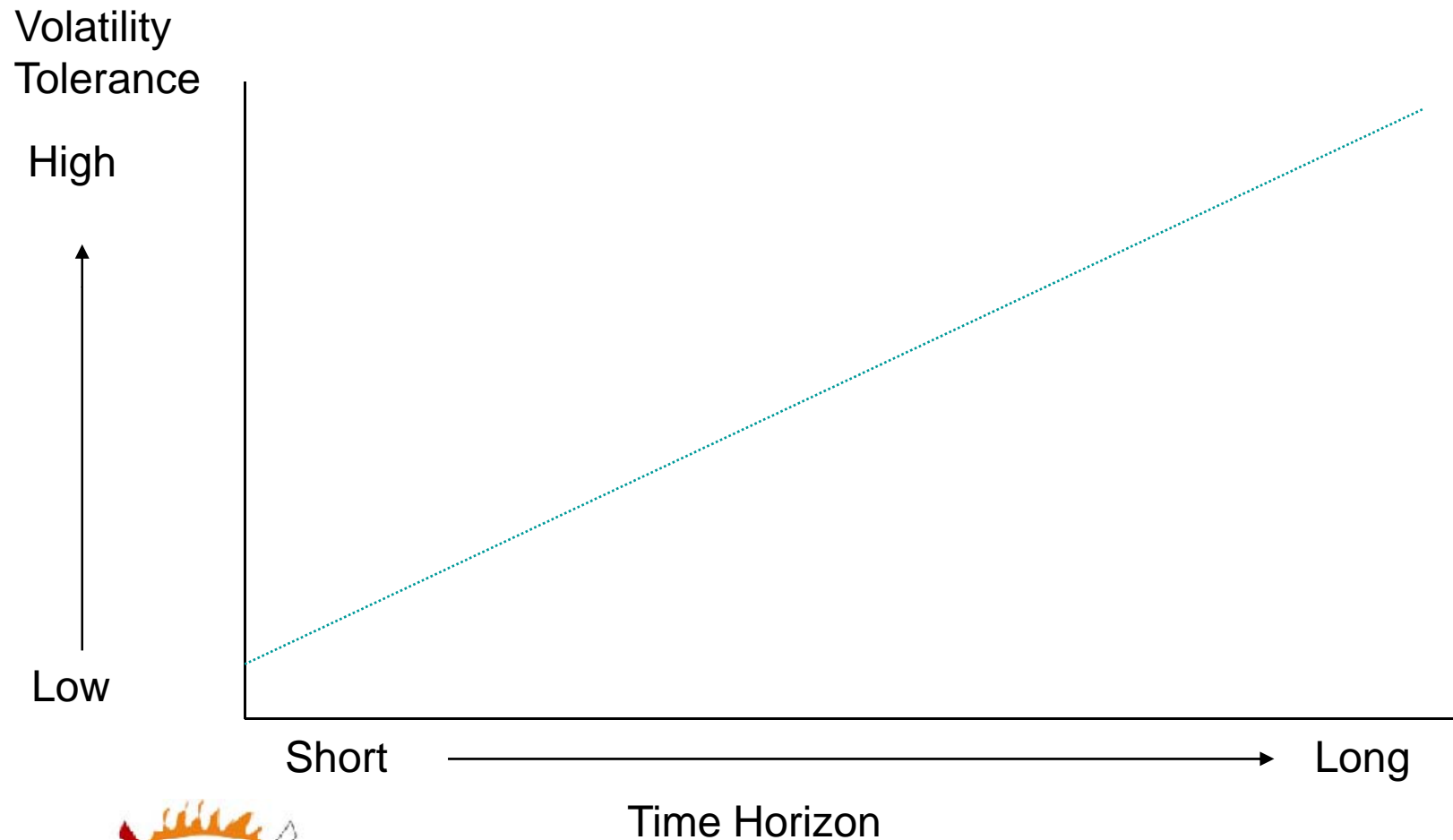


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Back to Basics – what is the fundamental purpose of the trust?



Focus on fundamental purpose and time horizon



Key components of a Trust Agreement

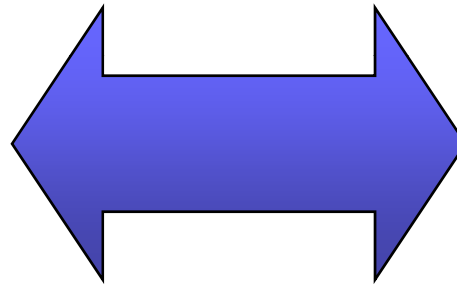
- For long term sustainability the investment and income clauses are critical
- When designing the Trust you must understand the impact of volatility on income and returns
- Make sure your whole Team is working together
- Critically examine the potential outcomes – what if's?
- Can you live with the potential 'worst case' scenario?



There are two key issues for long term Trusts

Long Term Investment Strategy & Plan

- ✓ Build investment plan to match time horizon of Trust



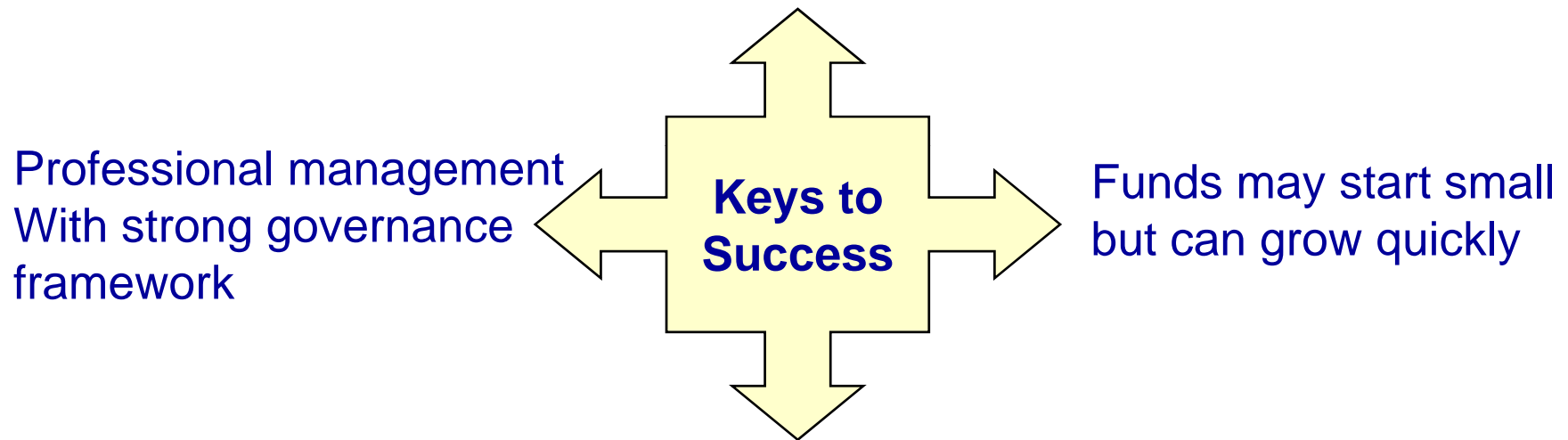
Long Term Spending Plan

- ✓ Forgo or minimize Immediate spending to ensure long term sustainability



Long Term Investment Strategy

Must include an element of SAVINGS
to build for future and compensate for inflation



Managing Expectations within Community important



Forego Current Spending

- If the funds are spent they cannot be invested
- Community Pressure for immediate benefits
 - Members see a settlement or activity and want benefits
 - Needs are high in the community
 - Initially funds are low (no earning have been realized when the funds are received)
- Risk of continual re-interpretation of original plan
 - Memories can be flexible when needs and wants are high



Forego current spending to increase total spending

Spend more now & less later

- Benefits current members
- Once spent it's gone



Spend less now & more later

- Benefits future members
- If invested income can be spent every year

Less total spending over time

More total spending over time

Remind everyone of the plan and the long term benefits



How To Build A Trust And Endowment



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Building the Trust & Endowment

- The two cannot be separated
- To be successful the Trust framework and investment framework must work together



What are the key questions for building the Trust

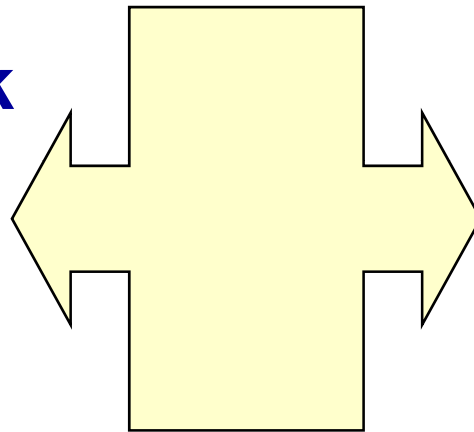
- What will the Trust do?
- How will the Trust do it?
- Why will the Trust do it?
- What will the rules be?
- How will the Trust operate?
- What will it cost?



Key Issues to Consider

Trust Framework

Trust as an
financial vehicle
or operating vehicle



Community Capacity

Consider both human
resources and
financial
resources



Trust Framework

- **Trust as a Financial Vehicle**
 - The role of the Trust is to receive monies, earn income and pay that income to the First Nation, Settlement or Community government
 - The Trustees and Trustee have no role in determining how funds are spent in the Community
 - Some Trusts have Community Approval Process or Community Input requirements for spending purposes
- **Trust as an Operating Vehicle**
 - The Trust receives monies, earns income and disburses that income directly
 - The Trustees determine how the funds are expended within the community, within the rules of the Trust Agreement



Things to Think About

- All Trusts are custom designed
- Never accept an 'off the shelf' template
- How will Community Capacity be prioritized and allocated
- What are the priorities and long term objectives
- For existing trusts is the current framework working or does it need to be modified

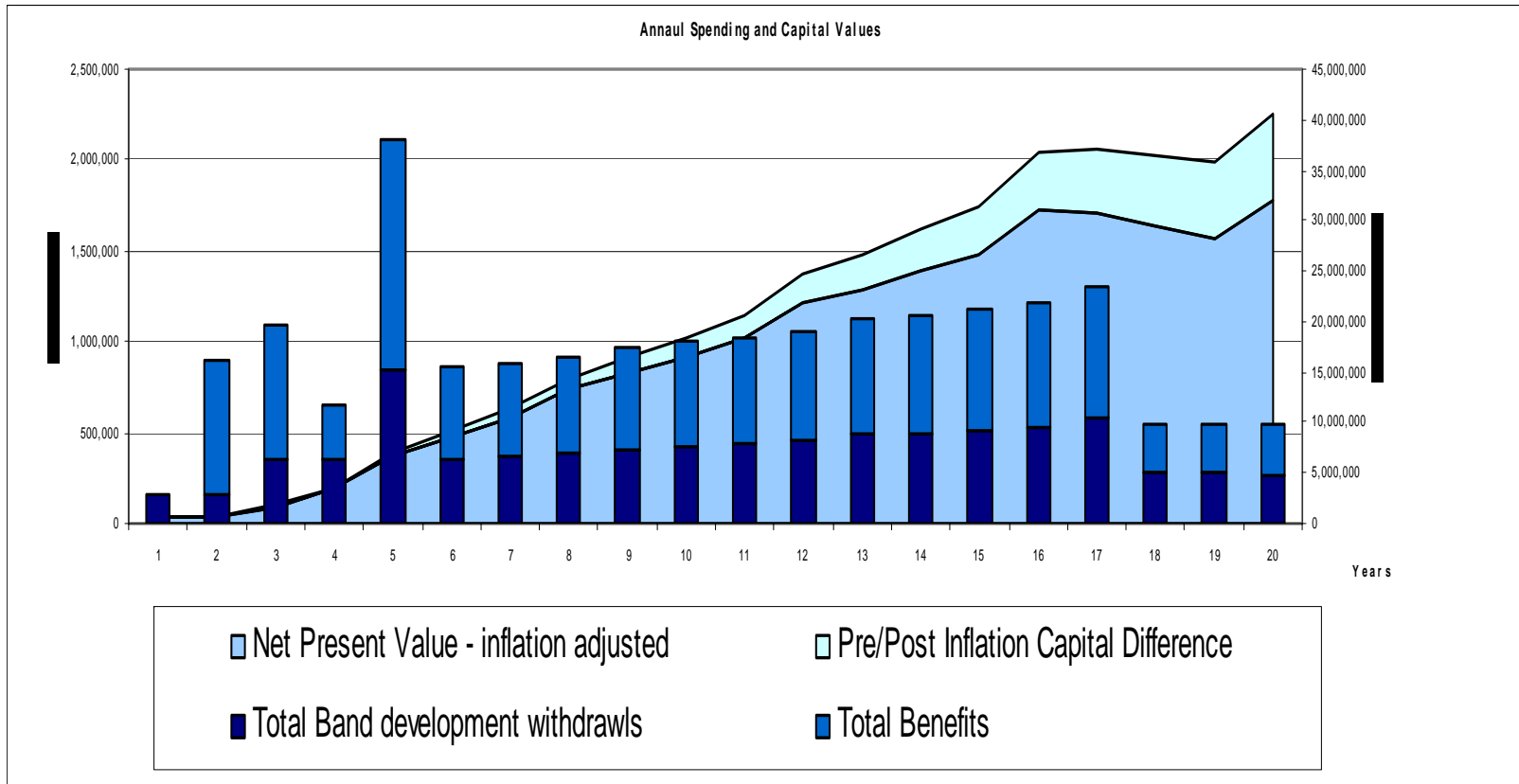


Building an Endowment

- It will be a slow process
- Trade off of spending today versus spending tomorrow
- Think in 20 year horizons not 2 year horizons



Building an Endowment – An Example



Building an Endowment – An Example

Total Cumulative spending	after 5 years	after 10 years	after 15 years	after 20 years
Capital contributions	\$ 13,500,000	\$ 31,000,000	\$ 48,500,000	\$ 53,500,000
Capital Value	\$ 6,989,089	\$ 18,536,818	\$ 31,287,285	\$ 40,420,700
Member Benefits	\$ 3,052,865	\$ 5,739,355	\$ 8,887,100	\$ 11,116,791
Community Development	\$ 1,852,865	\$ 3,789,355	\$ 6,187,100	\$ 8,116,791
Total Cumulative Spending	\$ 4,905,730	\$ 9,528,709	\$ 15,074,201	\$ 19,233,582

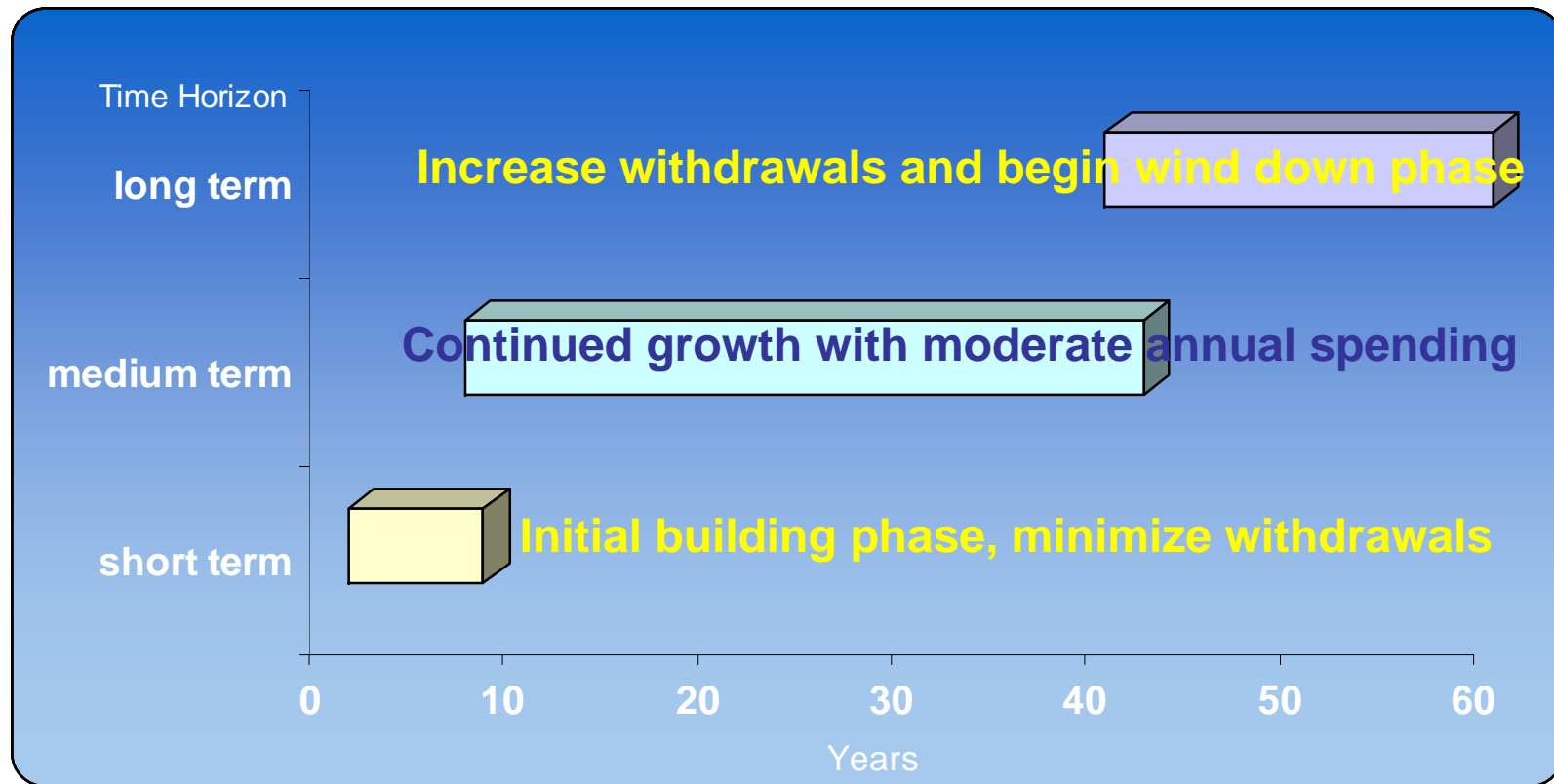


Key Issues

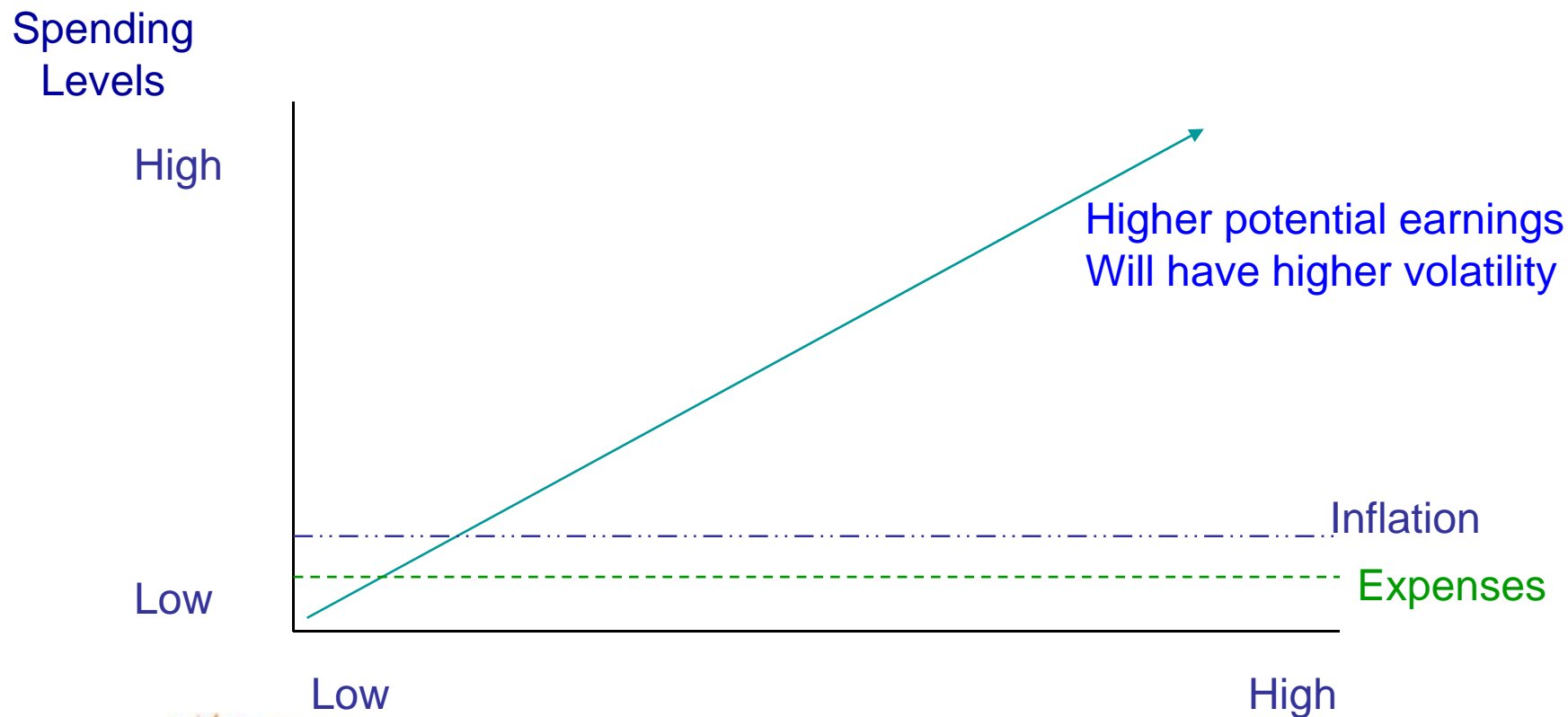
- Time horizon of the investments and Trust
- What withdrawal levels are necessary
- Prudent Investor framework for investment portfolio
- Identifying the right type of firm for managing the investments
- Smoothing mechanism for annual disbursements



There may be 3 distinct time horizons for a trust



Withdrawal Rates are single biggest factor affecting long term sustainability



Withdrawal Rates

Example – Budget-Oriented

Asset Mix: 65% S&P 500, 35% Ibbotson Intermediate Gov't Bond

Time Period: 1926 – 1998 (73 years)

Av. Annual Return: 9.4% (US\$)

Av. Annual Inflation: 3.75% (US\$)

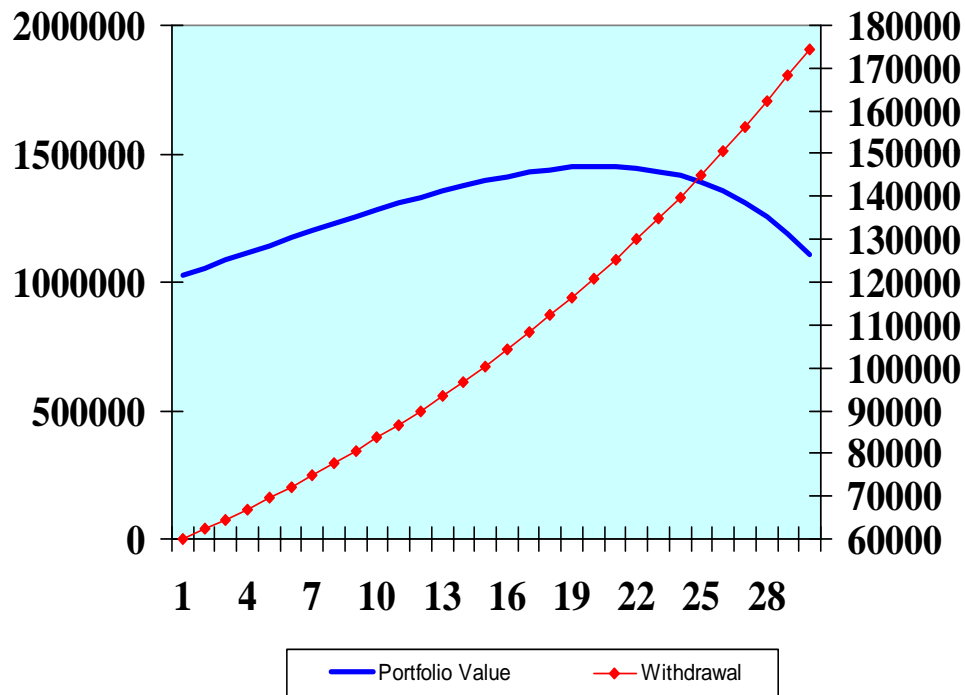
Initial Portfolio Value: \$1 million; assume no additional contributions

Initial Spending Requirement: \$60,000 (6%), increasing at rate of inflation

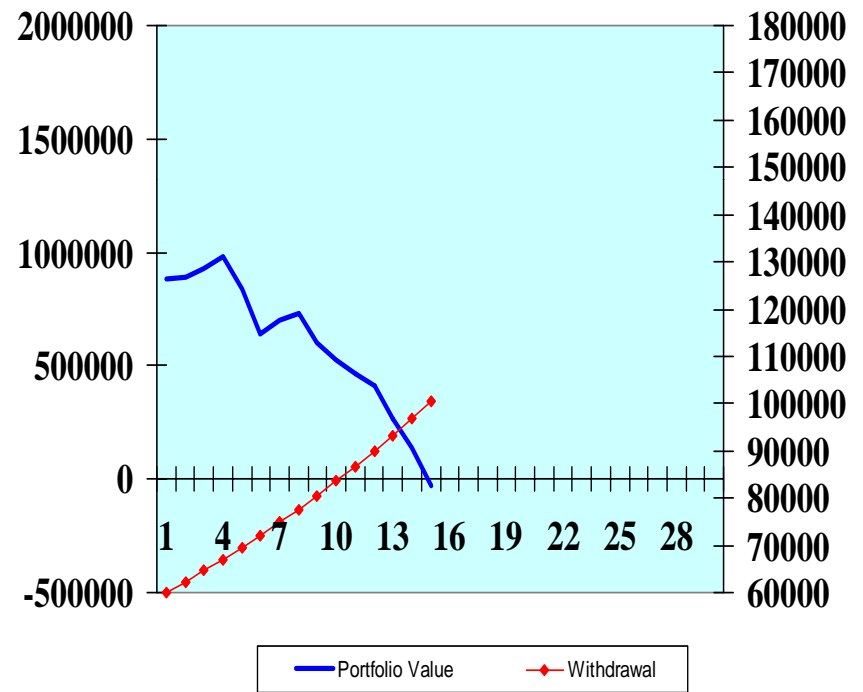


Withdrawal Rates

Theory



Reality – 1969-1998



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Withdrawal Rates

...other 30-year time frames with portfolio depletion (red)

TIME FRAME	ENDING VALUE	TIME FRAME	ENDING VALUE
1926-1955	2,228,934	1948-1977	3,885,582
1927-1956	4,787,887	1949-1978	4,404,998
1928-1957	(39,378)	1950-1979	3,864,482
1929-1958	(927,465)	1951-1980	3,316,542
1930-1959	(788,839)	1952-1981	2,637,573
1931-1960	(143,085)	1953-1982	2,402,184
1932-1961	4,413,979	1954-1983	3,403,107
1933-1962	4,153,155	1955-1984	336,475
1934-1963	548,761	1956-1985	(894,581)
1935-1964	1,414,653	1957-1986	(811,663)
1936-1965	(1,038,966)	1958-1987	402,431
1937-1966	(1,711,700)	1959-1988	(1,355,311)
1938-1967	827,383	1960-1989	(1,568,054)
1939-1968	(1,183,291)	1961-1990	(1,634,346)
1940-1969	(1,032,274)	1962-1991	(2,283,204)
1941-1970	223,828	1963-1992	(2,099,305)
1942-1971	3,721,823	1964-1993	(2,587,557)
1943-1972	4,087,269	1965-1994	(2,955,006)
1944-1973	2,485,501	1966-1995	(3,178,645)
1945-1974	1,472,796	1967-1996	(3,297,507)
1946-1975	75,439	1968-1997	(3,297,507)
1947-1976	3,147,303	1969-1998	(3,358,813)



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Withdrawal Rates

Every Decade is Different.....

Average Annual Return by Decade, (US markets, US Dollar)

Asset Class	2000's To Date	1990's	1980's	1970's	1960's	1950's	1940's	1930's
Large -Cap Stocks	-0.3	18.2	17.6	5.9	7.8	19.4	9.2	-0.1
Long Term Government Bonds	9.0	7.1	12.4	5.5	1.4	-0.1	3.2	4.9
Inflation	2.4	2.9	5.1	7.4	2.5	2.2	5.4	-2.0



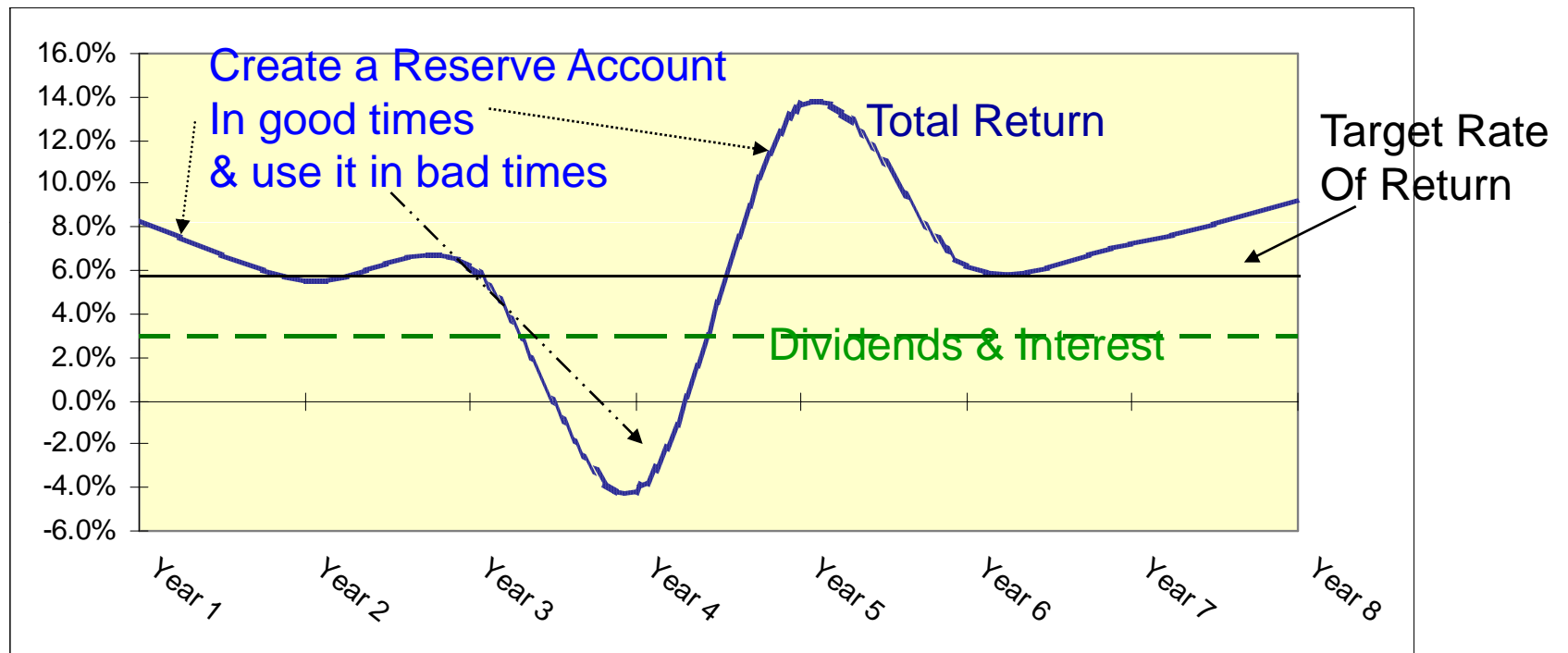
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Create Volatility Tolerance through smoothing of annual disbursements

- If there is no income available in any year to provide benefits to Members, the Trust is failing
- Trust Agreement needs an Alternate or Minimum definition of Income or Minimum Annual Distribution
- Must make sure that alternate definition does not slowly deplete capital
- Trust Agreement Income Clauses and Definitions must create Volatility Tolerance
- Dividends are important



Smoothing of Annual Disbursement for Existing Trusts



Volatility Tolerance, example

Trust Initial Value \$32 million	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Capital Value	32,000,000	32,800,000	33,128,000	33,691,176	32,781,514	34,518,935	35,036,719	35,737,453
Dividends and Interest (3%)	960,000	984,000	993,840	1,010,735	983,445	1,035,568	1,051,102	1,072,124
Realized Capital Gain (Loss)	2.8%	1.5%	1.5%	-4.5%	5.3%	1.7%	2.2%	3.7%
	896,000	492,000	496,920	-1,516,103	1,737,420	586,822	770,808	1,322,286
Unrealized Capital Gain (Loss)	2.5%	1.0%	1.7%	-2.7%	5.3%	1.5%	2.0%	2.5%
	800,000	328,000	563,176	-909,662	1,737,420	517,784	700,734	893,436
Total Investment Return	8.3%	5.5%	6.2%	-4.2%	13.6%	6.2%	7.2%	9.2%
Annual Trust Expenses (1%)	320,000	328,000	331,280	336,912	327,815	345,189	350,367	357,375
Total Net Investment Return	1,856,000	1,476,000	1,722,656	-505,368	2,720,866	1,622,390	1,821,909	2,394,409
Net Annual Income	1,536,000	1,148,000	1,159,480	-842,279	2,393,051	1,277,201	1,471,542	2,037,035
Income carry-forward	0	0	-164,000	-329,640	-2,720,866	-206,028	-309,585	-239,511
Distribution to First Nation	1,536,000	1,148,000	995,480	-1,583,485	1,081,790	1,071,173	1,161,957	1,797,523
Minimum Distribution 4%	1,280,000	1,312,000	1,325,120	1,347,647	1,311,261	1,380,757	1,401,469	1,429,498

Smoothing of Annual Income provides Volatility Tolerance



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Volatility Tolerance, example

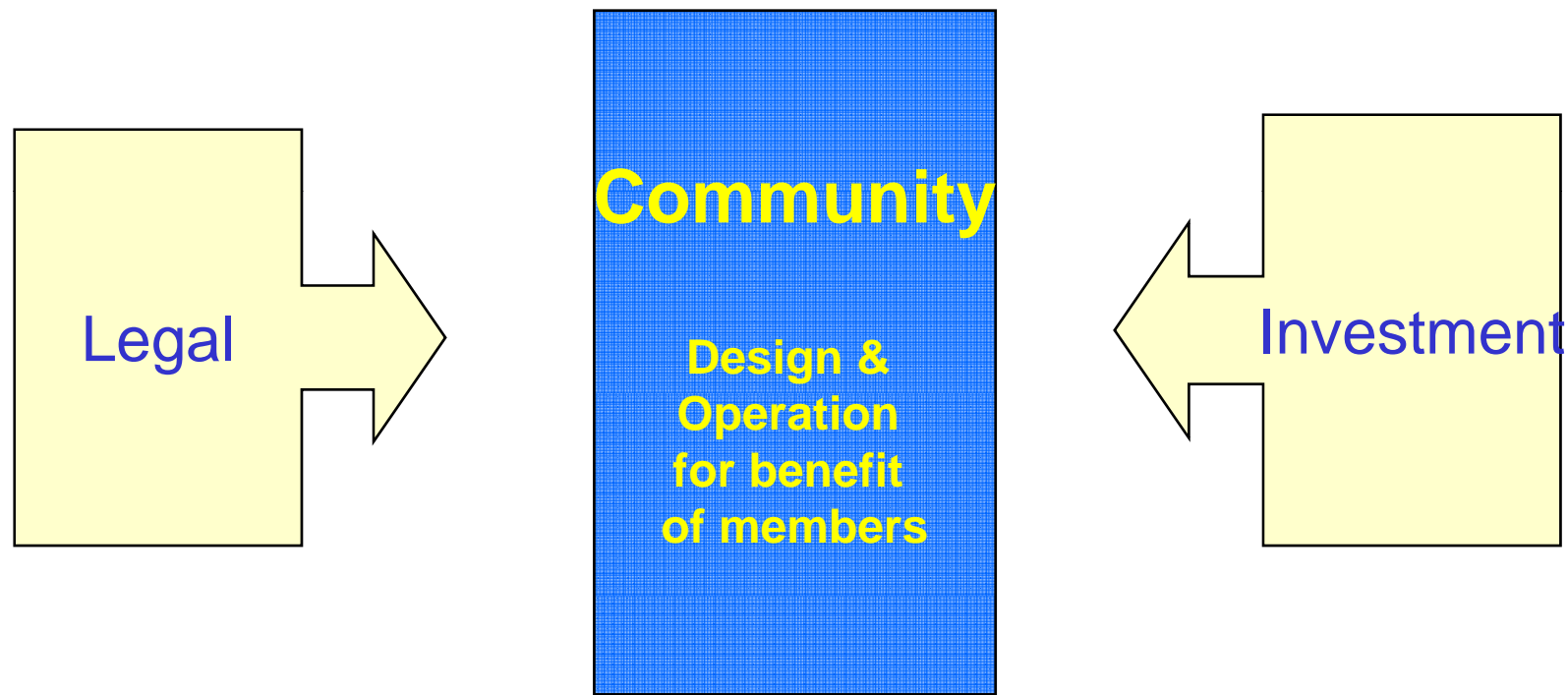
Trust Initial Value \$32 million	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Capital Value	32,000,000	31,136,000	31,447,360	31,981,965	32,781,514	34,518,935	35,036,719	35,737,453
Dividends and Interest (3%)	960,000	934,080	943,421	959,459	983,445	1,035,568	1,051,102	1,072,124
Realized Capital Gain (Loss)	-4.5%	1.5%	1.5%	2.8%	5.3%	1.7%	2.2%	3.7%
	-1,440,000	467,040	471,710	895,495	1,737,420	586,822	770,808	1,322,286
Unrealized Capital Gain (Loss)	-2.7%	1.0%	1.7%	2.5%	5.3%	1.5%	2.0%	2.5%
	-864,000	311,360	534,605	799,549	1,737,420	517,784	700,734	893,436
Total Investment Return	-4.2%	5.5%	6.2%	8.3%	13.6%	6.2%	7.2%	9.2%
Annual Trust Expenses (1%)	320,000	311,360	314,474	319,820	327,815	345,189	350,367	357,375
Total Net Investment Return	-480,000	1,401,120	1,635,263	1,854,954	2,720,866	1,622,390	1,821,909	2,394,409
Net Realized Annual Income	-800,000	1,089,760	1,100,658	1,535,134	2,393,051	1,277,201	1,471,542	2,037,035
Income carry-forward	0	-2,080,000	-2,235,680	-2,392,917	-1,119,369	-229,471	-333,027	-262,954
Distribution to First Nation	-800,000	-990,240	-1,135,022	159,910	1,081,790	1,047,730	1,138,515	1,774,081
Minimum Distribution 4%	1,280,000	1,245,440	1,257,894	1,279,279	1,311,261	1,380,757	1,401,469	1,429,498

Smoothing of Annual Income provides Volatility Tolerance, even when there are losses at the beginning of the investment program



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Designing & managing a trust for long term sustainability is a complex and continuing process



Suggestions and Best Practices



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Suggestions

- Don't rush the process
- Allow time for experts to educate Leadership and Community Members
- Allow for sufficient Community Consultation
- Ensure there is an adequate budget for development



Suggestions

- Utilize experts who have actual experience
 - Not every expert has the actual experience
- Ask other Communities for help
 - Other Communities are usually happy to share their experience and learning
- Don't skimp on this part of the budget
 - It is much more difficult and expensive to fix later than it is to get it right at the beginning



Best Practices

- ✓ Obtain independent legal, tax and investment expertise before an agreement is finalized
- ✓ Spend time with all stakeholders identifying objectives, needs and risk tolerance
- ✓ Determine whether the Trust is a financial vehicle or operating vehicle
- ✓ Circulate draft Trust Agreement to selected experts for comments and suggestions
- ✓ If Agreement is already in existence identify weaknesses and get expert advice on how to improve the operation



Best Practices, continued

- ✓ Define acceptable suppliers for Investment services
- ✓ Require that an Investment Policy Statement be developed and regularly reviewed
- ✓ Require periodic independent reviews of investment framework and investment performance
- ✓ Require periodic Passing of Accounts when appropriate
- ✓ Develop a smoothing mechanism for annual income that will not erode capital over the long term and has a sustainable withdrawal rate



Best Practices, continued

- ✓ Pay attention to the expense side of the Community consultation and Annual Meeting process
- ✓ Ensure that any approval process for annual spending is not unfair to Members living out of the home community
- ✓ Ensure that expense reimbursement to First Nation or Settlement for their duties and responsibility is clearly stated and not left open to interpretation
- ✓ Require regular training for Community Trustees and Council Members
- ✓ Build in good governance practices and requirements that are consistent with the First Nation's or Settlement's governance practices
- ✓ Separate the Trustee functions and the Investment functions



Resources

- Education and Training
 - NATOA – National Aboriginal Trust Officers Association www.natoa.ca
 - 2009 Aboriginal Trust and Investment Workshop May 26-28 Edmonton www.aboriginalTrustandinvestment.com



Thank You



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