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> "We're a little more sophisticated than people give us credit for."
> *—Pierce McDowell*
> *South Dakota Trust Co.*

ployment at not even 100. That's not a lot, even in a small state like South Dakota. But trust company employment has grown 80 percent since 2009. Trust companies also contract for attorneys, accountants, marketing firms and other labor, rather than putting them on payroll. Much of the work related to trusts—whether by a trust company or contract labor—tends to be highly skilled and well compensated. In a place like Sioux Falls, home to more than 50 trust companies, the cumulative effects on employment and business vitality can be considerable. Similarly, there are nine trust firms in Pierre, a city of just 13,000, which gives this small city a little financial cachet.

One might think that being in the middle of flyover county far from the affluent coasts would be a huge hurdle for new trust firms. McDowell, from South Dakota Trust Co., acknowledged that "it takes a lot of work to spread the word" that South Dakota is the locus of smart-money trusts. "I go into board rooms today, and there are a lot of people that are still provincial" in their decisions about where to go for trust services. "You kind of accept it and move on."

In the past, if you mentioned South Dakota, "you'd get laughed out of the board room," McDowell said. "But quietly, we're making great inroads. If someone is achieving success, someone else is going to see it. We're a little more sophisticated than people give us credit for."

Lust agreed that not being close to either coast "is somewhat of a barrier. … You're a long, long way away" from big client pools and many of the financial firms that ultimately manage trust assets. But wealthy individuals "depend on their experts" to tell them where to do business, and that's why South Dakota can compete with other trust-friendly states like Delaware and Nevada, according to Lust.

Given that location is not an insurmountable obstacle, the surprising part might be that other states are not competing for this business. "It's probably a function of [state] culture" and the environment that state lawmakers choose to create for any type of business, said Lust. The best places for trusts and businesses in general, he said, "are usually one and the same." f

Money, and more money: Public and private trusts

South Dakota sees a strong increase in public trust companies that provide noninvestment services

Strong privacy rights for trusts and trust companies make it difficult to deduce much from the robust growth in these firms in South Dakota. But one notable trend surfaces from their mere registry with the state: In recent years, there has been a notable increase in public trust firms.

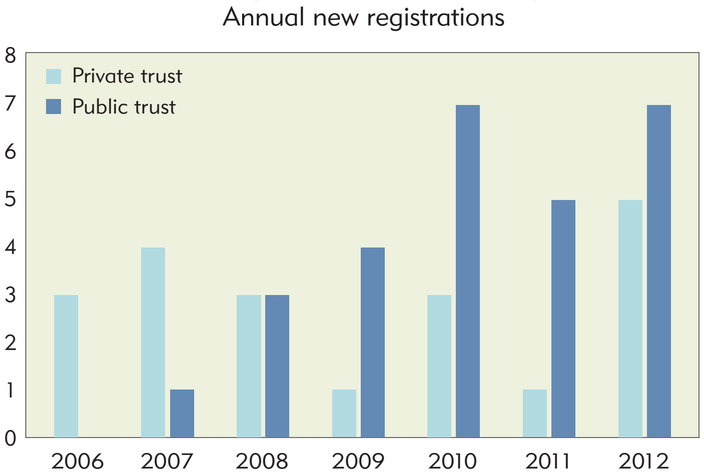
Trust companies come in two basic forms: public and private. In a nutshell, private trust companies are family-based and have been the core of trust business until fairly recently. They are limited to a single family lineage, but often include multiple generations. A private trust company does not act for unrelated families or accept outside business. In general, these companies are not required to provide as much regulatory capital as public companies and do not have to establish the same in-state presence so long as the trust company allows state trust regulators to conduct efficient examinations.

The circumstances surrounding the creation of a private trust are many, and they are often unique to the family. In terms of the wealth required—well, as the saying goes, if you have to ask how much money you need, you don't have enough.

"The general rule of thumb I have heard several times is that a family needs $200 [million] to $250 million in assets to make a [private] trust company worthwhile from a cost perspective," said Bret Afdahl, director of the South Dakota Division of Banking. "Having said that, we do have families with less assets that chose to establish their own [private] trust company for other reasons," many of which are specific to South Dakota's regulatory environment for trusts (see main article).

A public trust company, in contrast, resembles a traditional bank trust department in some ways; it solicits and accepts new accounts from unrelated families or individuals who typically have much less wealth. Think of it as the retail trust business.

Public vs. private trust companies
Annual new registrations



Source: South Dakota Division of Banking

Public trust charters have increased dramatically since 2007 (see chart) and now represent 60 percent of all trust companies in South Dakota. But rather than replacing private trusts (which have continued growing), public trust companies appear to be carving an entirely new niche.

Many of these public trust companies are serving people interested in self-directed independent retirement accounts, according to Afdahl. These financial vehicles allow an individual to make his or her own investment choices for a retirement plan. However, the Internal Revenue Service requires that a qualified trustee or custodian hold the IRA assets on behalf of the IRA owner.

Enter public trust companies, many of which are playing administrative and custodial roles for individual trusts and do not invest or otherwise manage trust assets. "We have had a lot of interest from groups interested in doing [this] work," Afdahl said.

He added that self-directed IRAs also allow individuals to invest in nontraditional assets such as real estate, precious metals, business ownership and other assets that cannot be held in traditional retirement accounts and have become more common since the financial crash in 2008.

This custodial role distinguishes independent, public trust companies from many bank trust departments, which typically manage assets and offer a full slate of other services. "They [banks] want to manage assets. They don't want nonmoney assets," according to Pierce McDowell, co-CEO of South Dakota Trust Co., a public trust company in Sioux Falls that provides administrative trust services. The firm administers more than $9 billion in assets, but it does not invest or otherwise manage those assets. "In our world, I don't see a lot of banks competing with us."

And it might be hard to imagine, but Afdahl said—and the South Dakota market is showing—that new public trust companies are serving a previously neglected class of customers a cut below the uber-wealthy.

"We consistently hear from applicant groups that the larger institutions do not provide the same level of customer service to people in certain net worth categories," said Afdahl. Big trust companies and banks "want the ultra-high-net-worth customers, but do not show as much interest in or provide the same level of customer service to those below the very upper crust. This has provided an opportunity for smaller companies" to pursue clients in different markets nationwide from their headquarters in South Dakota.

—Ronald A. Wirtz