THE LEGACY AND ESTATE PLANNING ISSUE: SPRING 2021

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Nationwide Retirement Institute® contributors

Kristi Rodriguez
rodrik7@nationwide.com

Roberta S. Eckert
eckerr1@nationwide.com

Julie Ragatz Norton
norj857@nationwide.com

Namara Dafney
dafneyn@nationwide.com

Thomas H. Duncan
tom.duncan@nationwide.com

Shawn Britt
britts@nationwide.com

Chuck Rolph
rolphc@nationwide.com

Ryan Patton
pattor1@nationwide.com

We always welcome input and suggestions for our publications. Please direct comments to:

Chad Queen
Thought Leadership Marketing Consultant
phone: 614-249-5178
email: queenc3@nationwide.com

View this issue and other Nationwide Retirement Institute content online at nationwidefinancial.com.

Advanced Consulting Group
1-800-321-6064
Option 9, Ext. 677-6500
ADVCG@nationwide.com

Institute Planning Team
1-877-245-0763
nriplanning@nationwide.com

Leader Notes

Kristi Rodriguez

Even in the face of tremendous adversity, fear or even grief, this past year has taught me that there's always a glimmer of hope and optimism to help us overcome challenging times. The theme of this issue is legacy and estate planning but perhaps it should be "hope springs eternal." This is the spring issue after all.

Thinking through the experiences of the pandemic, I'm optimistic that the obstacles we've faced collectively have taught us the importance of perseverance and an expectation of brighter days to come. I'm hopeful that we'll be able to continue planning for our futures and avoid worrying about the day-to-day.

That's what the Nationwide Retirement Institute does. We help financial professionals and their clients prepare for their future through timely insights about retirement topics and financial planning. But if we don't address the unique challenges clients are facing right now, we'll have a hard time living our mission of protecting people, futures and businesses with extraordinary care.

Roberta Eckert shares a powerful article in this issue (pg. 6) about the struggles women in particular have dealt with over the past 12 months. Nationwide wouldn't be the industry standard in thought leadership if we ignored how women have been disproportionately affected by the pandemic. While it's known that women have long played many roles, the past year has shown how such demands can amplify the personal impact of a crisis. The ripple impact on a woman's (and her family's) financial future can be astounding. I invite you to read Roberta's article and then ask yourself if you have a female client who's had to pause or alter their planning recently. How has her retirement outlook changed? Are you prepared to help your client modify her plan through the lens of the new realities she faces?

When working with any client, it is necessary to have those worthwhile conversations. On page 8, Julie Ragatz Norton writes about trust and empathy and using it effectively when working with clients. The best client relationships start with listening, grow through empathy, and result in trust.

Stories such as Roberta's, along with vast resources from the Nationwide Retirement Institute, can support financial professionals as they help clients navigate similar challenges. Nationwide has a unique opportunity to focus on topics such as legacy and estate planning because we've rounded out our thought leadership with insights and tools that can help bring optimism to the most difficult of situations.

Kristi Rodriguez

SVP, Nationwide Retirement Institute

The pandemic has left Black caregivers facing physical, emotional and financial challenges.

Financial professionals have an opportunity to use these insights — and empathy — when working with their Black clients.

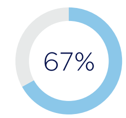
A Nationwide survey shows the effects COVID-19 has had on Black caregivers, and how it has changed their attitudes toward long-term care and legacy planning.

In much of the Black community there is an expectation that younger generations care for elders in their golden years, and this care is often done at home. The already large burden on (mostly unpaid) Black caregivers has been exacerbated by the COVID-19 pandemic.

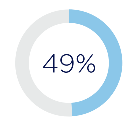
Tips for financial professionals

The pandemic has shown a need and created an opportunity for financial professionals to introduce long-term care costs in their planning discussions. Consider these tips when working with your clients.

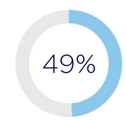
1. Start a conversation around health care in retirement. NRI's white paper can help.
2. Talk to your clients BEFORE they become caregivers so that you can help them put a plan in place and prepare.
3. Listen to your clients carefully and try to empathize when they communicate the difficulties of providing in-home care.
4. Simplify the complexities of long-term care planning. The Nationwide Health Care/LTC Cost Assessment tool can calculate personalized estimates of potential costs.



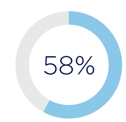
67% of Black caregivers are worried that they can't protect their loved one from getting sick and yet 54% feel that they can't take a day off.



49% feel the pandemic has prevented them from providing the care they once did. 44% say that the pandemic has made it nearly impossible to complete their caregiving duties.



49% say the pandemic has impacted their financial ability to provide care.



Only 58% say that they are prepared financially for current or potential caregiving responsibility (vs. 77% of all caregivers).

WHAT THIS MEANS FOR YOU:
48% of Black caregivers say that they are working with or are interested in working with a financial professional as a result of the pandemic.

Financial professionals can learn more about Nationwide's Black caregivers survey at nationwidefinancial.com/ltcinsights.

The Nationwide Retirement Institute's Black caregiver survey was conducted among 313 adults by The Harris Poll on behalf of the Nationwide Retirement Institute. Respondents for these surveys were selected from among those who have agreed to participate in our surveys. Because the sample is based on those who agreed to participate in the online panel, no estimates of theoretical sampling error can be calculated. Data are weighted where necessary by age, sex, race/ethnicity, region, education, income, marital status, and propensity to be online to bring them in line with their actual proportions in the population.

HOW A GLOBAL VIRUS CAN WREAK HAVOC ON A WOMAN'S RETIREMENT

Roberta S. Eckert, CRPC®, CHSA®, CLTC®, RICP®, RCC™
Vice President, Insights & Solutions Field Team

For years, there's been talk of how women's retirement planning needs are evolving. From a longer life expectancy to the gender pay gap to periods of time out of the workforce due to family responsibilities, women have shown that when it comes to retirement planning, one size does not fit all. **When COVID-19 hit, it served as an accelerant to the problems women face, fanning a fire that has been steadily burning and now is roaring out of control.**

While almost everyone was affected during COVID — economically, physically and emotionally — women have been disproportionately impacted. We don't have many historical situations to compare this to, but the outcomes have been far more dramatic than in other economic downturns, our closest proxy.

During the recession triggered by the pandemic, women's unemployment rate rose by 12.8 percentage points in just a three-month period, which was almost 3 percentage points higher than that of men. In contrast, the five previous recessions were all considered "mancessions" due to the larger rise in unemployment for men.

This flip can be attributed to a perfect storm of compounding factors. First, the industries women tend to work in — restaurants, retail, health care, hospitality — have been harder hit by the effects of the pandemic. More expense pressures, narrower margins and far less flexibility for telecommuting all contributed to job instability and, at times, industry instability.

Second, mothers employed outside the home were already juggling the majority of family caregiving responsibilities while balancing their careers. Initial lockdowns shut down schools and took away their source of child care — whether that be day care, grandparents serving as babysitters or, later, summer camps — serving as a gust of wind to mothers' carefully crafted house of cards.

22%

of females have jobs that allow telecommuting vs. 28% of males

If telecommuting wasn't an option, they were forced to choose between family care and their income — a gut-wrenching decision that more dramatically affects single mothers. Even if telecommuting was an option, the daily pressures of trying to fulfill job responsibilities while home-schooling children, chasing after toddlers or caring for aging parents became a near-impossible feat.

Lastly, women hold more jobs at the low end of the pay scale compared to men.[1] Whether that be in the service-oriented industries mentioned earlier or just toward the bottom of a company's scale, they enjoy fewer benefits associated with higher-paid jobs, such as adequate time off and resources for mental health support — both critical benefits during COVID-19.

Overall, the unemployment experienced by women could be permanent or, at a minimum, lead to difficulty finding a comparable job. This is particularly troubling during a tight job market that is shifting in unknown ways as our now-accelerated digital society reconsiders a virtual vs. traditional workforce.

According to the U.S. Bureau of Labor Statistics publication Monthly Labor Review, "the current economic downturn resulting from the COVID-19 pandemic is disproportionately hurting women's employment, with ramifications that could be long-lasting." The authors estimate that 15 million single mothers in the U.S. will be the most severely affected.

We know the importance of retirement planning at 20 to 30 years prior to retirement.[2] The challenges women face in their earnings shortage now will likely have a domino effect in years to come. The outcomes may extend into their earning potential, their ability to contribute adequately to their retirement plans, and to the opportunity cost of the portfolio growth they should have experienced. If women need to turn to accumulated savings in order to take a hardship withdrawal, that impact is even more dramatic. One Australian study found that women accounted for nearly 80% of pandemic hardship withdrawals.[3]

"The long-term effects of job loss on earnings can have significant implications for retirement security by reducing future Social Security benefits and savings."

SSA.gov ("Research, Statistics & Policy Analysis")

Having conversations now with your female clients about how they've been affected by the pandemic will help them refocus their efforts and help you recalibrate their plan early enough to get back on track or go in a different direction.

The Nationwide Retirement Institute has carefully crafted the Women and Retirement program to service this need. This program gives financial professionals insights into the evolving place of women in the workforce and the challenges they may face in retirement.

I invite you to explore our Women and Retirement resources so that you can get an edge on serving the growing need of this client segment. Reach out to us in the Nationwide Retirement Institute or ask your wholesaler about the Women and Retirement Planning program.

Contact the Insights & Solutions Field Team

nriplanning@nationwide.com | 1-877-245-0763 | nationwidefinancial.com/nri

[1] www.americanprogress.org/issues/women/reports/2020/03/24/482141/quick-facts-gender-wage-gap.
[2] www.nytimes.com/guides/business/saving-money-for-retirement
[3] thenewdaily.com.au/finance/superannuation/2020/06/19/young-women-losing-retirement.

Understanding trust
and deepening client relationships

Julie Ragatz Norton,
Ph.D., Director, Nationwide Retirement Institute

In order to engage in productive, meaningful legacy planning conversations, a financial professional must take on a more significant, immersed role. We refer to this role as the "trusted partner" — one who moves beyond the identification and implementation of tactics in the financial planning process to conversations that elicit the "deep goals" of the client. These deep goals reflect the values-based motivations that drive wealth accumulation and legacy planning decisions.

Because deep goals are identified in community with others, the trusted partner develops close relationships with the people in the client's inner circle. The trusted partner is also at the nexus of the client's professional relationships. In essence, they become the "keeper of the vision," coordinating the efforts of others, such as an attorney or CPA, who also support the client.

Elevation to the role of the trusted partner is a process that may require increasing current levels of trust. Given trust's importance, we want to look beyond what we think we know about trust and get a more empirical understanding of the concept. Let's explore the nuanced "anatomy" of trust and its value to future client interactions. Supported by recent research, these insights will enable us to build a road map that financial professionals can use to effectively build and maintain client trust.

The anatomy of trust

Trust involves vulnerability
The thread that runs through every form of trust is vulnerability. When we trust someone, we make the decision to reveal ourselves in some way with the belief that the other party will not take advantage of us or exploit any weakness we may have.

We can make ourselves vulnerable to others in two ways:

- When we give them access to important information, things and people
- When we give them control to act on our behalf

Giving others access to important information about ourselves is the form of vulnerability that is the basis of the trust we have with our partners, families and close friends.

Giving others access to important information about ourselves is the form of vulnerability that is the basis of the trust we have with our partners, families and close friends. We reveal information about our hopes and dreams, our fears and insecurities, our values and beliefs. We show people who we are.

We also make ourselves vulnerable when we give others access to things we value, such as loaning your car to a friend. Perhaps less obviously, we risk vulnerability when we provide others with access to people we value — which is why referrals are a form of trust. When clients refer friends to a financial professional, they are "putting themselves out there" by endorsing the financial professional's skills and integrity. That endorsement is a building block of trust in the new relationship — and it is much easier to build trust when that stone is in place. We most certainly make ourselves vulnerable to others when we cede control to another person to act on our behalf. A relevant example is the discretionary authority a client can give to their financial professional. The client is vulnerable in that they do not have a line of sight into the actions the professional is taking on their behalf and, in addition, may lack the ability to assess whether those actions are in their best interest.

This information asymmetry is nobody's fault. It's simply due to the professional having knowledge that the client does not. Most of our professional relationships involve this level of information mismatch, as anyone who has tried to read their medical results can attest to. Efforts in the financial services industry toward greater disclosure of information are designed to increase transparency and client trust.

Trust is indicated by client behavior

Nobel Prize-winning economist Paul Samuelson famously said that we truly know people's preferences only by what they choose, not by what they say. The insight is that the presence of trust within a relationship should lead to different behavior patterns than would occur in its absence. Generally, people understand that trust varies by degrees. Trust can be increased by either "going broader" or "going deeper." As trust deepens, the client is willing to be more vulnerable in the relationship with a trusted partner. A deeper level of trust could drive client action such as sharing more personal information. Conversely, trust is broadened when a client is willing to expand the scope of the relationship. A broader level of trust might involve the client entrusting their financial professional with a greater portion of their assets or allowing more discretionary authority to act on their behalf.

Trust does not happen in a vacuum

It is certainly possible for an individual to risk vulnerability with a person they don't know well enough to trust. For example, we may freely hand over sums of cash to a bank teller or disclose private information to a medical assistant. We typically feel safe doing so not because of confidence in that particular person but because of confidence that there is an effective system of "checks" in place. In other words, we trust the system rather than the person. Within the financial services industry, the trust-building process is influenced by a client's perceptions. What are their views regarding the trustworthiness of the financial professional's firm? How do they perceive the financial services industry as a whole? Do they have confidence in the set of institutions designed to protect their interests?

Both private institutions (such as financial services firms) and public institutions (such as regulatory organizations) attempt to reduce the level of trust required for a client to make that leap of faith. They design rules to help ensure that financial professionals do not exploit their clients. These rules operate as deterrents, increasing the consequences for those who harm their clients. However, the amount of trust required of a client is reduced only if they believe that the institutions and deterrents are effective in protecting their interests.

Our research, based on previous work by Johnson and Grayson,[2] focused on the difference between "cognitive trust" and "affective trust," which we can think of as "head trust" and "heart trust," respectively. It is important to remember that both types of trust focus on why clients make the decision to trust.

A client's pathway to trust is also affected by a variety of factors that are unique to that individual. These factors affect both their level of willingness to build trust and how they build trust — this is their "trust-building mode." As trust increases, clients then feel more comfortable to express their deep goals and take the next step in the partnership.

A road map to trust

Now that we've explored the anatomy of trust, what can financial professionals do to deepen the trust in their client relationships? Nationwide Financial engaged in proprietary research[1] that offers novel and interesting insights that can guide you.

Nationwide broadened the earlier research with the addition of an "empathy" construct. We looked at three cognitive factors (service provider expertise, product performance and satisfaction with previous interactions) and three affective factors (empathy, similarity and firm reputation) to determine which was the most impactful in driving future client interactions. Our research allowed us the opportunity to distinguish between "similarity" and "empathy" to determine the effect each had on the presence of trust.

A new standard: Performing empathy
Most successful financial professionals are deeply empathetic people in that they care to understand the worldview and perspective of their client. In fact, figuring out how people tick is often a primary motivator that leads individuals into a career in the advisory business. However, it is not enough to merely be empathetic. It is necessary to be able to communicate empathy in a way that is understood and perceived as such by the client. We call this performing empathy, where the client consciously experiences the financial professional as being empathetic. The skill is to be able to demonstrate that you are someone who both understands their point of view and cares about them as well as their family.

Trust — the sort of trust that causes a client to continue the relationship — is primarily driven by the client's belief that their financial professional cares for them. When empathy is performed and care is detected, the client believes that their point of view is seen and their concerns are understood.

Finding a balance

There may be a temptation to look at these findings and conclude that because of the importance of affective trust, we should de-emphasize the focus on cognitive factors that drive trust.

But doing so would be a mistake. Both forms of trust make up the reasons why people make that leap of faith.

Recall that this research measures the intention to engage in future interactions. We can view the cognitive factors of product performance, expertise and satisfaction with previous interactions as "table stakes." Clients presume a foundational level of competence, meaning that cognitive factors matter a great deal. It is the affective factors, however, that motivate clients to continue to work with their financial professional in the future.

Explore more from the Nationwide Retirement Institute® at
nationwidefinancial.com/nri

Conclusion

Financial professionals hope to have long and fruitful relationships with their clients — ideally lasting decades. When successful, those relationships create zones of safety where legacy planning can be discussed. It's a delicate topic, though, and may require the financial professional to operate on a different level — as a trusted partner.

Even the strongest client relationships may have room to grow through affective trust. This article revealed that performing empathy is the key to developing that trust.

The challenge for financial professionals is to honestly assess where they could enhance their affective trust. The Nationwide Retirement Institute's Legacy Essentials program can help you on your journey with relevant insights and a range of helpful tools and resources.

[1] "Advisor Trust," conducted by Socratic Technologies Inc. on behalf of the Nationwide Retirement Institute (2019). The survey was conducted online within the United States throughout August 2019, among 1,807 adults ages 18 and older.
[2] "Cognitive and Affective Trust in Service Relationships," Journal of Business Research (April 2005).

Meet the team

Doug Ewing

Doug Ewing, JD, CFP®, RICP™
Vice President, Insights & Solutions Field Team

Doug started his career at Nationwide in 2019 with more than 15 years of industry experience. He serves the western region for the Nationwide Retirement Institute, educating financial professionals, clients, plan sponsors and plan participants about the latest in retirement income solutions.

Prior to Nationwide, Doug was with Transamerica Capital Inc., where he was responsible for developing and delivering consultative sales content for annuity, retirement, mutual fund and life wholesalers.

An accomplished public speaker with extensive main-stage, breakout and national webinar presentation experience, Doug covers topics such as health care, long-term care, Social Security benefits and tax-efficient retirement income.

Doug was admitted to the Massachusetts Bar Association in 1990 and got his start in the financial industry in 2003 as a financial professional with Legg Mason Wood Walker. He has earned both CFP and RICP designations and is FINRA Series 7 and 66 licensed.

Connect with Doug

LinkedIn: click here

Email: ewingd5@nationwide.com

Phone: 617-721-9488

Check out

what's new in the Nationwide Retirement Institute®

Contact the Nationwide Retirement Institute® for access to these items, and find out which presentations are available for continuing education (CE).

NRI papers

- The Paycheck Protection Program reopens: IRS and SBA guidance
- The impact of the Biden administration's regulatory freeze on retirement plans
- Additional coronavirus relief under year-end package
- A look at the DB(k) arrangement
- DOL final regulations on financial factors in selecting retirement plan investments
- QDOTs: Estate tax planning for non-U.S.-citizen spouses
- The Securing a Strong Retirement Act of 2021
- U.S. gift and estate tax planning for non-U.S. citizens living in the United States
- SEPs, MEPs and PEPs: Compared and contrasted
- Succession planning for family businesses
- Nonqualified retirement plans for tax-exempt organizations
- Compensation considerations for the financial professionals working with retirement plans

NRI podcast

"Clarifying the Complex" from Nationwide. Listen now or share on social media.

- Retirement stories: Building trust with empathy with Julie Ragatz Norton and Jamie Hopkins
- Fiduciary guidance and defined contribution plans with Chuck Rolph
- Wealth transfer opportunities and Roth conversions with Desiree Buckner
- Navigating it all: How COVID-19 and caregiving are affecting women's retirement goals

NRI presentations

- Post-election tax planning
- Rules affecting the ERISA investment advice fiduciary in 2021
- Nonqualified retirement plans for tax-exempt organizations
- Qualifying longevity annuity contracts - QLACs
- SEPs, MEPs and PEPs: Compared and contrasted
- Retirement and estate planning for business owners

NRI program materials

Medicare

- Podcast—Medicare 101: Facts and common questions
- White paper—Preparing your clients for health care expenses
- Client guide—Medicare overview
- Client seminar— Medicare: Start the conversation. Learn about your options

TERI (Tax-Efficient Retirement Income)

- Financial professional tax resource page
- Retirement Savings Worksheet: Are your clients diversifying their retirement savings?
- 2021 Tax Quick Reference Guide

Health Care in Retirement Planning

- Incorporating Health Care into Retirement Planning

Creating habits to achieve your goals

Namara Dafney, M.A., CMBC
Senior Consultant, Sales Development & Coaching

Looking back on 2020, have you wondered why some people were successful despite all the challenges and uncertainty? Most successful people have good habits in place. Habits such as reading, journaling and practicing gratitude are a few habits that Bill Gates, Warren Buffett, and Oprah Winfrey employ. Someone once said, "We are what we repeatedly do. Excellence, then, is not an act, but a habit." What habits can you create this year that will help you to not only survive, but thrive?

Habits are routines or behaviors that are repeated regularly, to the point where they become subconscious. Research tells us that over half of our daily activities are influenced by habits. Activities such as brushing your teeth, drinking your first cup of coffee and watching the news are habits typically done without thinking.

Ask yourself these questions to understand and create positive habits that will impact both your professional and personal life.

What goal do you want to strive to achieve next?

Every habit should begin with a specific goal in mind. Your goal is what you want to accomplish, and it is, ideally, your end result. When you think about your practice, what goal will be the most impactful to you and your clients?

Why do you want to achieve your goal?

Understanding why your goal is important to you is key to creating sustainable habits. When willpower fails, your "why" will inspire and motivate you to keep moving forward. Your why is your purpose — and the driving force behind your actions.

What actions will help you reach your goal?

When creating habits, focus on one or two actions that are easy and important, because you will be more likely to do them. Think of them as low-hanging fruit.

When creating habits, focus on one or two actions that are easy and important, because you will be more likely to do them.

What does your habit system look like?

A system for creating habits is needed to help you stay on course and make progress. This system consists of three things needed for a habit to be successful:

- **A reminder:** The cue or trigger that tells your brain to take action. A specific time or location are two examples of reminders.
- **An action:** The routine or behavior you want to adopt. It also leads to the reward.
- **A reward:** The payoff. The reward needs to be meaningful enough so you will want to repeat the action.

How will you hold yourself accountable?

In addition to putting your habit system into place, you might want to identify an "accountability partner." This can be a trusted friend or family member who is interested in your progress and will encourage you along your journey.

What mini-habits can you put in place?

Start small and build up. If you want to complete a marathon, start small by walking one mile. In other words, make the mini-habit so small that you can't say no to it. Starting with mini-habits makes creating a larger habit more manageable and less overwhelming.

What are some habits you can stack together?

Author James Clear refers to this as habit stacking in his book "Atomic Habits." Habit stacking involves bundling activities you're prone to skip with routine activities you are already doing, e.g., jogging in place while you wait for your morning coffee to brew.

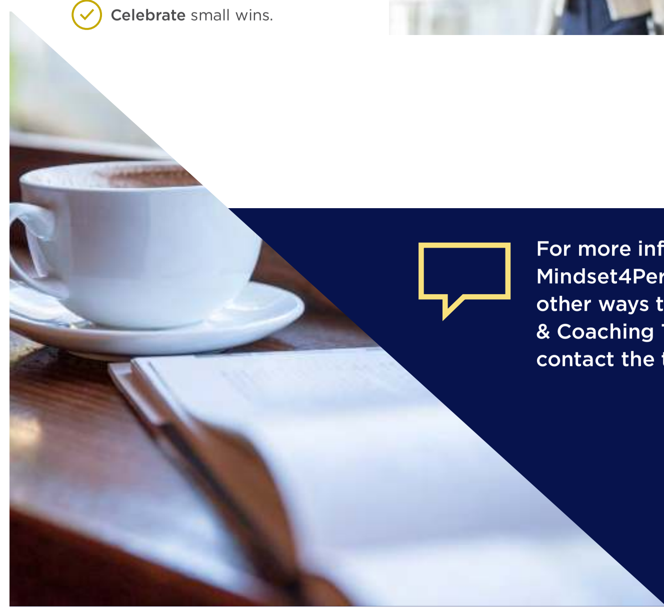
Here are some Tips for Success to keep in mind as you begin to create your habits:

- **Plan your day** the night before and include a specific time for your new habit.
- **Manage your distractions** by establishing time limits for each of them.
- **Write down your goal** and keep it visible.
- **Keep track** of your progress.
- **Celebrate** small wins.

As financial professionals, what goal do you want to achieve this year? What habits can you put in place to help you reach your goal? Maybe it's becoming a better listener or asking your clients better questions, or prioritizing. Whatever your goal is, habits are a key element for success.

The Sales Development & Coaching Team, powered by Nationwide Retirement Institute®, provides centralized consultative sales training on subjects such as habits. They do this through systematic coaching that helps sales teams hone their selling skills. Habits4Performance℠ is a component of the Mindset4Performance suite of offerings, all aimed at identifying and working toward desired sales outcomes.

These sessions give financial professionals the tools to better serve their clients and meet their sales objectives.



For more information on Mindset4Performance or to learn the other ways that the Sales Development & Coaching Team can help your business, contact the team at kinled1@nationwide.com.

Ask the specialist

STEVE HAMILTON, JD, CLU®, ChFC®

Legacy planning when children with special needs are involved

For some clients, legacy and estate planning includes providing for children with special needs.

Q Is there urgency in planning for families who have a child with special needs?

A Yes. No one knows what tomorrow will bring, but you do know today. When it comes to planning, "tomorrow starts today." By waiting too long to plan, parents may lose certain options that are critical to the length and quality of the child's life. Parents must plan for the time when they may not be capable of caring for their child.

Q What should parents consider when planning for the welfare of their child?

A They need to ask questions such as:

- What government and private programs are available that may benefit us and our child?
- What are the child's anticipated future needs?
- Who will provide care, now and in the future?
- How can family assets benefit the child without causing a loss in government benefits?
- What changes need to be made to the estate plan?

Answering these questions can provide a good starting point for a plan.

Q What are the government benefit programs?

A Three types of government programs may apply to children with special needs: need-based, non-need-based and cost-of-care programs.

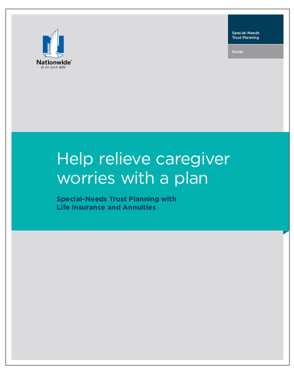
- In need-based programs, individuals must meet strict eligibility requirements; Supplemental Security Income (SSI) and Medicaid provide monthly income and medical assistance
- Non-need-based programs provide benefits to selected groups without regard to income or assets; The Social Security Disability Insurance (SSDI) program provides benefits to disabled individuals who are unable to earn income or wages
- Cost-of-care programs seek reimbursement from assets available to the child; the best example is a state residential care facility where the cost would be determined by financial ability

Q To prepare for the possibility that the child outlives them, what should parents consider when planning for the welfare of their child?

A Parents need to consider how they can replace the support — emotional, physical and financial — that they have been providing. Their children are benefiting from advancements in medicine and technology that have created new educational and vocational opportunities allowing for greater independence and more typical living arrangements. These advancements and more individualized living arrangements, along with the accompanying longer life spans, come at a cost.

Parents need to enable their children to take advantage of private and public programs to provide the necessary support. In addition to taking advantage of the available programs, parents will often consider the use of "special needs trusts" and setting aside financial support, often in the form of life insurance, to provide for a child's care or to supplement what is being provided.

Legacy planning for children with special needs can involve complex planning concepts. Read the Advanced Consulting Group's white paper, "Planning for children with special needs" and check out the new "Special Needs Planning Guide." Help clients today by asking your wholesaler for copies of these pieces.



Farm succession planning when illness strikes

Brought to you by Land As Your Legacy

> Imagine what the farm would say if it could express what it feels is best for itself moving forward.

Few farmers and ranchers enjoy talking about or planning a farm ownership transition. But the pandemic has exposed a need to accelerate discussions around farm transition (or succession) planning.

An illness or medical event can arise at any time, and while farmers and ranchers can pride themselves on being prepared for all events as it relates to their operation, many lack preparedness in the event that something happens to them.

A change in one's health can happen in an instant, and farm and ranch owners need to make sure they have concrete transition plans in place — especially in the event that a stakeholder would be unable to make important management decisions.

Plan for a transition that may happen faster than anticipated

A planning conversation with a farming client should happen now to ensure that your client's financial house is in order in case a sudden illness creates the need for an abrupt transition. That's especially true if it's a family succession.

"The transition of a business to the next generation generally begins with the gradual transfer of labor and income. That's followed by handing over management responsibilities. The transfer of assets and land is the last step," says Nationwide Retirement Institute® Technical Director Ryan Patton, JD, MBA. "The family element can make it more complicated than just pure economic considerations."

Beyond the transfer of management responsibilities, a strong farm transition or succession plan accounts for overall financial standing. That includes all parties' cash flow needs and how to best set up the successor to thrive in the long term. Land and machinery are big parts of that transition plan.

Choosing the right transition strategy

Take the financial needs of both the predecessor and successor into account when determining the best way to transfer those big-ticket assets. There are different strategies for transferring ownership of assets such as machinery and land. Each has its own specific implications to cash flow and financial standing, both during and after the transition. The goal should not be to make everything exactly equal but rather to be equitable or fair to the family as a whole.

Families can consider these options when determining what is right for them:

- Asset gift
- Asset sale/gift
- Gradual sale
- Installment sale
- Lease
- Lease with purchase option

As with machinery and equipment, how land is transferred can have considerable financial implications for both the predecessor and successor. These options may be right for your client:

- Partnership
- Reserve a life estate
- Transfer by combined sale/gift
- Transfer by contract
- Transfer by co-ownership/tenancy in common
- Transfer by gift
- Transfer by will

Preparing clients to make tough decisions

A healthy exercise that has guided farmers through these decisions, and can be recommended to your clients, is this: Imagine what the farm would say if it could express what it feels is best for itself moving forward. This simple exercise may help remove any emotion from decisions and allow clients to think clearly about what is truly best for the operation.

The results of those decisions may not make everyone happy, but they often put the farm or ranch in the best position for the future.

"It may be wise to consider the personal side as farm stakeholders seek to preserve their family legacy," Patton says. "Recognizing this, the senior generation who owns the operation and the land is likely to have to make certain sacrifices or contributions to help the successor get started. Whether retaining business debts, devoting your time in mentorship or stepping back from key business decisions you used to make, a successful transition involves different levels of commitments for each farm family."

A team approach

Transition planning for farming and ranching clients is a complex task. Tax, legal, family and financial considerations are just a few elements that go into a successful transition plan. When you start to work with these clients, lean on the Land As Your Legacy® program from Nationwide to provide you with tools and guidance to develop an effective plan that will leave your client feeling secured.

For more information about the Land As Your Legacy program or to connect with your local relationship consultant, visit us at nationwidefinancial.com/yourag.

Estate planning

and

nonqualified annuities

Thomas H. Duncan,
JD, CLU®, ChFC®
Senior Director, Advanced
Consulting Group

Nonqualified annuities are common assets for individuals to own and have specific characteristics that make planning for their distribution at death necessary.

Why plan an estate?

Estate planning is the process of creating a master plan for the disposition of assets at death. When creating an estate plan, consideration is given to:

- Limiting tax liabilities
- Determining who receives the assets, when and how
- Facilitating timely payment of estate obligations and taxes
- Limiting costs of administration

Estate planning is a process not just for the wealthy, but for anyone owning property. If the owner fails to establish how distribution should occur at death, state intestacy laws will determine distribution of the property. Intestate distribution frequently does not match the owner's intent. Establishing an estate plan can help provide certainty to the owner and safeguard his or her assets for the benefit of heirs.

Annuities in an estate plan — probate avoidance

The at-death distribution requirements of nonqualified annuities depend on whether the death of the owner occurs before or after annuitization begins.

A) If the death of the owner occurs before annuitization, the entire contract value must either be:

1. Distributed within five years from the date of the owner's death. IRC Section 72(s)(1)(B).

2. Distributed, via a systematic withdrawal, over a period no longer than the beneficiary's life expectancy, with payments to begin no later than one year following the owner's death (this is the so-called nonqualified annuity stretch option). IRC Section 72(s)(2).

3. Annuitized over the designated beneficiary's life, or a period no longer than the beneficiary's life expectancy, with payments to begin no later than one year following the owner's death. IRC Section 72(s)(2).
Note: If the designated beneficiary is the surviving spouse, he or she has the additional option to continue the contract as the new owner. This is called spousal continuation. If continuation of the contract is elected, no distributions are required during the surviving spouse's life. IRC Section 72(s)(3).

B) If the death of the owner occurs after annuitization, any remaining periodic income payments must be made at least as rapidly as prior to the death of the contract owner. IRC Section 72(s)(1)(A).

Please note that distributions of gain taken by nonspouse beneficiaries are not subject to the premature distribution tax (aka the 10% penalty tax) even if the designated beneficiary is under age 59½. Distributions taken by a surviving spouse, who has made the contract their own, will be subject to the 10% premature distribution tax if the surviving spouse is under age 59½ at the time of the distribution.

Post-death distribution strategies

Spousal beneficiaries

A married couple may consider the use of the spousal continuation provision to help meet the tax-efficiency goal of an estate plan. Spousal continuation allows the annuity to remain tax deferred, and no distributions are required to be taken from the annuity at the death of the first spouse who owned the annuity.

All that is required to implement this strategy is to name the spouse as beneficiary of the annuity and then, at the death of the first spouse, for the surviving spouse to make the election to "re-register" the contract into their own name.

Nonspouse individual beneficiaries

Stretch option

If a nonspouse individual is named as the beneficiary of an annuity, the nonqualified annuity stretch concept may be considered as a payout option by the beneficiary. With the nonqualified annuity stretch concept, the beneficiary takes at least minimum, life-expectancy-based, systematic withdrawals — not annuitization payments — each year. This limits their income tax liability in any one year versus taking the entire annuity value, and potentially increases the total distributions paid to the beneficiary during their lifetime through market participation and/or interest crediting of the amount that remains in the account. The beneficiary may also take more than the minimum withdrawal at any time. With the stretch option, the first minimum, life-expectancy-based withdrawal must be taken within one year of the date of the owner's death. This concept can be put in place using a beneficiary restriction by the original annuity owner, or can be left to the beneficiary to implement upon the annuity owner's death. Distributions under the nonqualified stretch option come first from gain and are thus taxable in the year distributed and then from investment in the contract.

With a stretch option, the first minimum, life-expectancy-based withdrawal must be taken within one year of the date of the owner's death.

Annuitization

If a nonspouse individual is named as the beneficiary of an annuity, then annuitization may be considered as a payout option by the beneficiary. With annuitization, the beneficiary can elect to take equal payments over their life or a term certain that is less than or equal to their life expectancy. The payments from the annuitization receive exclusion ratio treatment, meaning a portion of each payment is return of investment in the contract and a portion is taxable gain. Exclusion ratio treatment lasts until the beneficiary has reached the age of their life expectancy; any payments received thereafter are fully taxable.

Nonspouse, nonindividual beneficiaries

Please be aware that if an entity such as a trust, an estate or a charity is the beneficiary of the nonqualified deferred annuity, that entity is not able to use life-expectancy-based payments to take out the required distributions from the annuity. Instead, an entity has only the five-year rule as a distribution option.

Conclusion

Deciding to use either the nonqualified stretch concept, annuitization or spousal continuation provisions can be tax-efficient strategies to consider when the owner of a nonqualified annuity passes. When one of these strategies is implemented in conjunction with an overall estate plan, the case is that much stronger for a predictable, cost-effective and tax-efficient disposition of a person's assets at death.

Using long-term care riders in estate planning

Shawn Britt, CLU®, CLTC™
Director, Long-Term Care Initiatives

Long-term care (LTC) planning continues to be a hot topic in the financial services industry as the population of the United States continues to age. The potential need for LTC is something that should be seriously addressed when doing retirement and estate planning for clients.

People with moderate wealth, as well as high net worth clients, may be good candidates for long-term care planning. While trust planning may not be necessary for some clients, those individuals have worked hard to accumulate assets and should not have to watch those savings dwindle away due to long-term care expenses.

People with moderate wealth, as well as high net worth clients, may be good candidates for long-term care planning.

More-affluent clients who need formal trust planning should also be analyzing their potential long-term care needs. While the ultra-wealthy may be able to self-fund, they may still want to consider the risk that self-funding can present to their overall estate plan. They, too, should explore other options.

Life insurance, with the addition of an indemnity LTC rider, can provide liquidity for potential estate taxes, tighten up the estate plan by helping reduce the risk of paying unnecessary estate taxes that a self-funded LTC plan could create, and provide additional opportunities and flexibility for the estate plan.

Estate planning and long-term care

Estate planning includes preserving wealth as well as creating wealth. We'll start by discussing preservation of wealth for the more-affluent client. Clients with high net worth will often have a need for liquidity to cover potential estate taxes. Life insurance owned by an irrevocable life insurance trust (ILIT) has long been used in estate planning to provide those funds and keep the death benefit out of the estate. However, when it comes to long-term care, many high net worth clients feel they can afford to self-fund their potential LTC needs. But is self-funding in the traditional sense the most efficient use of their assets?

The downside of the wealthy self-funding their LTC

Let's take a look at potential effects of how self-funding LTC may not be the best solution for many affluent people. In order for the high net worth client to self-fund, they must have assets available to them that are liquid and accessible inside their estate in the event they encounter an LTC situation that needs funding. Let's assume this client sets aside $1 million for this purpose. If the client actually needs LTC and spends most or all of the $1 million, then the self-funding plan worked well enough. However, if the client needs none of or very little of the assets set aside, there is a cost to being "lucky" enough to not need LTC: These funds could be left subject to estate taxation. Assuming

Estate planning includes preserving wealth as well as creating wealth.

a 2021 maximum estate tax rate of 40%, up to $400,000 of the $1 million could be taxed if it was never needed for LTC expenses (assuming holding on to this additional $1 million puts the client's estate over the exempt amount). But there is a way to potentially avoid the financial risk of self-funding inside of the estate.

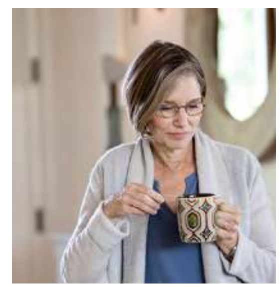
An alternative solution

Traditional LTC policies are intended for clients who are looking only to cover long-term care needs. For clients with potential estate-tax liabilities, there is an alternative solution that may better fit their overall planning strategy. A life insurance policy owned by an ILIT, with the addition of an LTC rider that pays indemnity benefits, may be used to fund LTC needs while maintaining the goal of providing funds for estate tax expenses.

I'll elaborate on that concept momentarily, but first it is important to understand the difference between an indemnity and a reimbursement plan, and why an indemnity plan can work in an irrevocable life insurance trust.

Indemnity vs. reimbursement

Long-term care benefits are generally paid in one of two ways: through an indemnity plan or a reimbursement plan. For illustrative purposes, we will assume the plan in each example has a $5,000-per-month benefit.



Traditional LTC policies are intended for clients who are looking only to cover long-term care needs.

A reimbursement plan is just what it sounds like: It reimburses the policyowner for expenses already incurred. This plan can also allow for direct billing by and reimbursement to the care facility or agency providing care — assuming the care service is willing to participate in third-party billing. Either way, bills and receipts must be submitted each month to the insurance company. Then, the insurance company determines which expenses qualify for reimbursement. In our example, the reimbursement plan may provide a maximum $5,000 LTC monthly benefit, but if the qualifying expenses add up to only $3,000, then only $3,000 is reimbursed.

It is generally believed that a reimbursement plan may not work in an ILIT because bills for the LTC expenses of the insured are submitted to the insurance company by the trustee of the ILIT (which owns the policy), and the insurance company reimburses the trustee of the ILIT for the LTC expenses of the insured. This chain of events may be construed as a violation of IRC Section 2042 by providing a direct link from the ILIT to the grantor/insured, destroying the integrity of the trust.

Indemnity plans, however, pay the full LTC benefit directly to the owner of the policy. Generally, no bills or receipts need to be submitted in order to receive monthly LTC benefits, and the actual LTC expenses of the insured are not considered when paying the LTC benefits. If an insured qualifies for a $5,000 monthly benefit, $5,000 is sent to the owner of the policy each month.

Thus, an indemnity plan can work within an ILIT because the LTC benefit, without regard to expenses of the insured, is sent directly to the owner of the policy, which in the case of trust ownership would be the trust/trustee. The life insurance policy is essentially funding the ILIT with cash via payment of an accelerated death benefit. (Keep in mind that as an acceleration of the death benefit, the LTC rider payout will reduce both the death benefit and cash surrender values.)

It is important to note that the grantor/insured must never have the LTC benefit directly in hand nor can they have claims against the trust for such monies. But from here flexibility exists, and various strategies may be implemented.

How the concept works

An ultimate life insurance trust (ULIT) can be used, which is a type of ILIT used for the purpose of getting LTC rider benefits from the trust. The ILIT is made "defective" for the purpose of being able to access funds from the trust using arm's-length fully collateralized loan provisions. The loan must be legitimate — secured by property pledged by the grantor/insured, with interest charged, and an agreement to fully pay back the debt.

Collateral can be anything that covers the debt: equity in a house, artwork, coin collections, etc., as long as the asset has a legitimate fair market value. Collateral can be pledged all at once or it can be pledged along the way, as long as there is always adequate collateral pledged to cover the full amount of the current loan balance.

The interest rate charged should be at least equal to the guaranteed interest rate charged on the life insurance policy (although in this concept there will be no loan taken against the policy itself). Because a larger interest debt allows for more funds to be paid from the estate to the trust, using an appropriate interest rate on the high side may work best.

Ideally, the loan interest is allowed to accrue, but the loan interest should be paid back prior to the death of the grantor/insured, if possible, as this will avoid income taxation on the interest paid to the trust. Some plans call for the repayment of interest on

a periodic basis to hedge against the risk of all interest being taxable at death, though this will impact the overall accrual of debt. In either case, the taxable estate will be further reduced with the repayment of interest from the estate on the loan transaction created with the ILIT.

The process of taking the collateralized loans

When using a ULIT/ILIT for the purposes of getting long-term care rider benefits from the trust, you may implement the following procedure:

- File a claim for the LTC benefit
- After the policy's elimination period (during which the claim is verified), monthly LTC benefit checks will be sent to the trustee as policyowner
- The grantor, upon pledging property as collateral, borrows money from the ILIT
- Those funds can be used to pay LTC bills or used for a variety of other purposes
- Interest is not repaid immediately, but is allowed to accrue to purposely increase the debt
- Ideally, interest is repaid from estate assets just prior to death — thus remaining tax free to the ILIT
- At the grantor's death, the loan principal is repaid from estate assets; the amount of the accrued interest, as well as the loan principal, has been removed from the estate assets for taxation purposes — leaving a smaller tax liability
- Keep in mind that any interest repaid after death will be treated as taxable income to the trust

Other flexible solutions provided by a trust-owned life/LTC policy

An indemnity LTC rider may also provide flexible solutions for clients who may later find they need to spend down additional assets left in the estate to further control estate-tax liabilities. In this case, the insured would pay their long-term care expenses directly from estate assets, thus lowering the total amount subject to estate taxation at death.

Upon filing a claim, LTC benefits would be paid directly to the trust as previously stated. Assuming the terms of the trust allowed it, the cash assets generated by the acceleration of death benefit could be used for some of the following scenarios:

- Funds could be distributed to beneficiaries by the trustee as a type of "early inheritance"
- Funds could also be held in the trust to be distributed at a future date
- Funds could be reinvested for potential growth of trust assets

LTC riders on survivorship policies

It is now possible to purchase a survivorship policy with LTC rider coverage on one or both insureds. The concept of using arm's-length collateralized loans is virtually identical to what was laid out in the previous examples. However, there are some additional details that should be considered by the client's attorney when planning to use this concept with a survivorship life insurance policy. These considerations include:

- Neither insured can be a trustee of the ULIT/ILIT
- The loan provisions should state that the loan principal is not due for repayment until after the death of the second insured
  - It is important that no principal repayment will be required upon the first death
  - This is to assure that, if desired, dollars generated by the death benefit can be used to repay the loan principal

Keep in mind that all interest should be repaid prior to the second death to keep it from being taxed as income to the trust.

For clients wanting to create or preserve an estate

While moderately affluent clients may have no need for trust planning, such clients may find that using the combination of life insurance with an LTC rider is a good solution for their financial strategy.

A pool of money is generated that can pay for LTC needs during the insured's lifetime through an acceleration of the death benefit, helping to protect other assets from being depleted by long-term care expenses.

If long-term care is never needed, or the LTC benefit is only partially accessed, any remaining money not used for LTC expenses is paid to the beneficiary as a federal-income-tax-free death benefit. For families without trust needs for estate tax purposes, it provides a way to help cover long-term care costs while allowing for the possibility of creating a larger inheritance for beneficiaries. And the "use it or lose it" concern is eliminated, as the policy benefits will ultimately be paid to someone no matter what direction life takes.

Contact the Advanced Consulting Group to check out Shawn's white paper on this topic, which features the formula and other figures that round this concept into form.

ADVCG@nationwide.com

In summary

Long-term care is a subject that should be addressed in insurance needs analysis planning whether a trust is involved or not. Of course, traditional long-term care policies should be discussed as a possible remedy in LTC planning. But for many clients, the purchase of a life insurance policy with the addition of an LTC rider will prove to be an appropriate solution. One of the advantages of using such a rider is that someone is going to receive the benefit, whether it is the policyowner for LTC needs or the beneficiary receiving a federal-income-tax-free death benefit. In addition, many of these policies can be purchased with guaranteed premiums. Whether doing an estate plan for a high net worth client or a moderately affluent client, or doing basic retirement planning for middle-income clients, some form of long-term care planning should be a part of the financial picture.

DOL guidance affecting the ERISA investment advice fiduciary

Chuck Rolph,
JD, MSFS, CFP®, AIFA®
Technical Director,
Advanced Consulting Group

This is an overview of some of the more important guidance emanating from the U.S. Department of Labor during the first quarter of 2021. It governs the investment advisory practice of a financial professional who provides investment advice concerning the assets of a retirement plan subject to ERISA.[1]

Guidance #1 The regulatory definition of "investment advice fiduciary"

ERISA Section 3(21)(A)(ii) makes one a fiduciary who renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of such plan, or has any authority or responsibility to do so. What does it mean to "render investment advice concerning the assets of a plan"? The DOL's five-part test for determining what constitutes "investment advice" was originally issued in regulatory form in 1975. In 2016, the DOL finalized a new regulation that replaced the five-part test for determining what constitutes "investment advice" and added the Best Interest Contract Exemption. The case *Chamber of Commerce of the United States v. U.S. Department of Labor*[2] vacated the 2016 regulatory interpretation of "investment advice." The DOL reinstated the five-part test as of June 29, 2020. The reinstated 1975 regulation's five-part test that determines what constitutes investment advice consists of the following:

The DOL's five-part test for determining what constitutes "investment advice" was originally issued in regulatory form in 1975.

- Render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property
- Do so on a regular basis
- Pursuant to a mutual agreement, arrangement or understanding with the plan, plan fiduciary or IRA owner, that
  - The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
  - The advice will be individualized based on the particular needs of the plan or IRA

Importance of fiduciary status under ERISA as it pertains to the ERISA investment advice fiduciary. One who is an ERISA fiduciary is bound by ERISA Section 404(a), which requires a fiduciary to carry out his or her duties:

- For the exclusive purpose of: (i) providing benefits to participants and their beneficiaries and (ii) defraying reasonable expenses of administering the plan
- With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims
- By diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so
- In accordance with the documents and instruments governing the plan

ERISA Section 406(b) specifies that a fiduciary with respect to a plan shall not:

- Deal with the assets of the plan in his or her own interest or for his or her own account (self-dealing)
- In his or her individual capacity, or in any other capacity, act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries (dual representation or dual loyalties)
- Receive any consideration for his or her own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan (conflicted compensation)

Summarizing ERISA Sections 404(a) and 406(b) for the investment advice fiduciary in practical financial terms, it means that the fiduciary must have level compensation arrangements for his or her investment advice concerning plan assets and that the fiduciary may not receive compensation from third parties. If either or both of those conditions are not met in any particular client relationship, the fiduciary must obtain exemptive relief.

Guidance #2 Field Assistance Bulletin ("FAB") 2018-02

If an investment advice fiduciary's compensation is not level or comes from third parties, he or she may rely on FAB 2018-02. The DOL issued FAB 2018-02 as a temporary enforcement policy in response to the 2018 5th Circuit Court decision that vacated the 2016 regulatory interpretation of what it means to provide investment advice with respect to plan assets. Under FAB 2018-02, from June 9, 2017, until issuance of regulations or other guidance, the DOL will not pursue prohibited transaction claims against investment advice fiduciaries who comply in good faith with the impartial conduct standards of the best interest contract exemption. This means that the investment advice fiduciary must:

- Give advice in the investor's best interest
- Charge no more than reasonable compensation
- Make no misleading statements about investment transactions, compensation, and conflicts of interest

FAB 2018-02 remains in effect until December 20, 2021.

Guidance #3 Prohibited Transaction Exemption ("PTE") 2020-02

This is another source of exemptive relief for the investment advice fiduciary whose compensation is not level or comes from a third party. It allows investment advice fiduciaries to receive compensation, including as a result of advice to roll over assets from a plan into an IRA, and to engage in principal transactions that would otherwise violate the prohibited transaction provisions of ERISA and the Internal Revenue Code. PTE 2020-02 contains four operational components:

- Impartial conduct standards — (i) investment advice must be in the best interest of the retirement investor; (ii) compensation received must be reasonable; and (iii) no materially misleading statements can be given by the financial institution and investment professional
- Disclosure requirements — (i) certain financial disclosures must be made to the retirement investor from the financial institution and investment professional; (ii) written acknowledgment of fiduciary status by the financial institution and investment professional; (iii) written description of services to be provided and disclosure of any conflicts of interest; and (iv) written documentation of reasons for a rollover recommendation
- Policies and procedures of the financial institution and investment professional must: (i) be designed to ensure compliance with the impartial conduct standards; (ii) mitigate conflicts of interest; and (iii) document rollover recommendations and changes from one type of account to another
- Retrospective review by the financial institution: (i) must take place at least annually to determine violations of impartial conduct standards and compliance with the exemption; (ii) must include a written report to a senior executive officer; (iii) must include certification by the senior executive officer; and (iv) must abide by record retention requirements

PTE 2020-02 was finalized by the DOL of the Trump administration and was scheduled to become effective as of February 16, 2021.

Biden White House Regulatory Freeze Memorandum: In a Memorandum for the heads of executive departments and agencies dated January 20, 2021, from Ronald A. (Ron) Klain, White House Chief of Staff, the heads of executive departments and agencies were instructed to place a hold on all recently issued rules and regulations.

The DOL, acting in accordance with the guidance in the Memorandum, announced on February 12, 2021, that PTE 2020-02 was to become effective, as scheduled, on February 16, 2021.

[1] Employee Retirement Income Security Act of 1974, as amended.
[2] 885 F.3d 360 (5th Circuit, 2018).

Four options

for cross-owned policies when the cross purchase terminates

Ryan Patton, JD, MBA
Technical Director,
Advanced Consulting Group

Within a cross-purchase arrangement, business owners typically agree to purchase each other's business interest upon disability, retirement, death, and other triggering events. Life insurance is used in the arrangement to ensure that a business owner will have enough money at the time that he is obligated to buy the business interest of a deceased owner. If the owners use the traditional cross-funding method, then each business owner will own a life insurance policy insuring the other.

Oftentimes, the cross-purchase arrangement terminates for a reason that's not the death of a business owner — such as retirement, if it wasn't a part of the agreement. When that happens, the business owners find themselves with cross-owned policies and a question: "What should we do with these policies?" Here are four options:[1]

1. Keep the policy.
2. Swap the policies.
3. Surrender the policy.
4. Exchange the policy for an annuity.

Option 1: Keep the policy

Something to think about

Unless otherwise obligated,[2] each business owner can continue to own a policy insuring the life of the other business owner. Each business owner will still have the benefits of permanent life insurance, in that any cash value growth will remain tax deferred;[3] withdrawals from the cash value will still be tax preferred;[4] and the owner of the policy will receive the income tax-free death benefit.[5] The potential downside is that because the owner and the insured are not the same, the family of the first to die may become disadvantaged.

Consider this example. If B dies, A receives the tax-free death benefit. A doesn't *need* the death benefit to cover his family's needs because he's still alive and earning an income, so A buys the truck that A has always wanted. B's family, on the other hand, no longer has B's income and did not receive the death benefit. Assuming B's family relied on B's income to cover their necessities, B's family will struggle to meet all of their needs until A's death. Sadly, B's family didn't own a policy insuring B. So, if the owner of the policy is likely to die first or does not own a policy covering his or her own life or is uninsurable and has a death benefit need, then he should strongly consider swapping policies. Swapping policies is not a right, but it can be if included in the cross-purchase agreement.

Option 2: Swap policies

Tax counsel is a must

When the business owners want to own the policy that covers their own life, they can swap policies with each other. When they swap policies, the transaction is treated as a sale and gain in the transaction must be recognized by the owner of each policy.[6]

The gain is determined by (1) *amounts received* (2) minus *basis* (3) equals *gain*.[7] This transaction is calculated as follows: (1) the *amounts received* includes the cash surrender value of the life insurance policy received, plus any loans forgiven or any additional cash or property received; (2) the business owner's *basis* for this transaction is generally the investment in the contract that was transferred away; and (3) *gain* is generally recognized as ordinary income for amounts received up to the cash surrender value of the policy transferred away, then capital gain.[8] Most policyowners do not pay identical premium amounts or experience the same rate of cash value growth, so the value of each policy will probably be different. When the two policies are not equal in value, the business owner receiving less will usually take a policy loan before the exchange or ask for additional cash as part of the exchange.

If the business owner does not need a policy insuring his own life, he can surrender the policy he owns insuring the other business owner.

After the exchange, each policyowner will still receive tax-deferred growth,[9] tax-preferred access to cash value, and an income-tax-free death benefit at their death.[10]

Option 3: Surrender the policy

Caution: Loss of insurance ahead

If the business owner does not need a policy insuring his own life, he can surrender the policy he owns insuring the other business owner. The policy owner will no longer receive the benefit of tax-deferred growth, tax-preferred access to cash value, or the income tax-free death benefit. Upon surrendering the policy, the policyowner will be taxed on all gain in the contract as ordinary income.[11]

Option 4: Exchange the policy for an annuity

Create retirement income

If the business owner has enough death benefit and would like to receive a tax-preferred current or future stream of income, then he could consider exchanging the life insurance policy for an annuity.

Here's an example:
A owns a policy on B. A contacts Nationwide and completes a tax-free exchange of the life insurance contract he owns on B for an annuity. Nationwide issues A an annuity in which A is the owner and annuitant. Immediately or at some time in the future, the contract is annuitized and A receives a stream of income. Exchanging the insurance policy for the annuity is tax free.[12] The annuity owner will receive tax-deferred growth on available contract values, have the option to make and manage their investment choices, and choose a payout option that suits their individual needs. Not only that, but the owner can receive payments from the annuity that are part tax-free return of basis, which can spread out gain over time.[13]

This option can provide a great tax-preferred stream of income for the owner.

Conclusion

Each of these decisions can be propelled by several factors depending on the business owner's specific situation. There are usually compelling reasons to consider each option. Ultimately, the underlying facts and needs of the individuals should be assessed in order to determine the most suitable course of action.

[1] Additional options include selling the contract to a life settlement company and utilizing split-dollar arrangements.
[2] The agreement may determine the parties' obligations with respect to the disposition of the policies.
[3] IRC Section 72.
[4] IRC Section 72.
[5] IRC Section 101(a).
[6] IRC Sections 1001(a) and 1221(a).
[7] IRC Section 1001(a).
[8] Ordinary income that has been earned but not taxed cannot be converted into capital gain by sale or exchange. See, for example, Commissioner v. P.G. Lake Inc., 356 U.S. 260 (1958) (Established the "substitute for ordinary income doctrine"); Gallun v. Commissioner, 327 F.2d 809, 811 (7th Circuit, 1964); First National Bank of Kansas City v. Commissioner, 309 F.2d 587 (8th Circuit, 1962). Accordingly, the amount recognized as ordinary income is limited to amounts that would be recognized if the contract were surrendered under IRC Section 72(e)(5). Because IRC Section 1001 governs this transaction, the amounts received greater than "inside build-up" will be taxed as capital gain. See IRC Sections 61, 64, 72, 1001 and 1221.
[9] IRC Section 72.
[10] IRC Section 72.
[11] IRC Sections 61(a)(10) and 72(e).
[12] IRC Section 1035.
[13] IRC Section 72(b)(1).

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Advanced Consulting Group
1-800-321-6064
Option 9, Ext. 677-6500
ADVCG@nationwide.com

Insights & Solutions Field Team
1-877-245-0763
nriplanning@nationwide.com

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