Welcome to InFRE's October, 2015 Issue of Retirement Insight and Trends

retirement-insight.com/w/

Retirement InSight and Trends is the quarterly newsletter for the International Foundation for Retirement Education's Certified Retirement Counselors® (CRC®s) to help retirement professionals with the practical application of new retirement readiness, counseling, planning and income management concepts for the mid-market. Find out more about the CRC® and InFRE here.

One *free* CRC®, CFP®, ASPPA, and the American College's Professional Recertification Program (CLU ®, ChFC®, CASL)® CE credit (click here to pay $15.00 reporting fee for CFP CE, included for Professional Development Memberships) can be earned upon completion of the corresponding 10-question Continuing Education Exam (see the "Continuing Education Exam" link at right and choose the newsletter issue desired, or click here). An email will be sent to you and InFRE upon successful completion (score of 70% or more) of the CE exam. You are responsible for reporting your CE hours for ASPPA recertification and the American College's Professional Recertification Program (CLU®, ChFC®, CASL).

Looking for additional CE opportunities? Visit the continuing education section of the Retirement Resource Center store to find hundreds of additional professional development and continuing education options by leading experts, the way you want to learn, at the level that's right for you.

October, 2015 InFRE Update: the CRC® Renewal Program

The purpose of the *CRC®* renewal program is to enhance continued competence and ensure an ongoing understanding and compliance with ethical requirements.

The *CRC®* certification carries an obligation of continuing education to help Certificants maintain current understanding and knowledge of relevant retirement planning topics. Like many other professional certifications and licenses, an annual continuing education requirement assures a Certificant's commitment to life-long learning. The one year continuing education requirement is important for professionals working in a dynamic industry with a constantly changing legislative, tax and resources environment.

Continuing Education (C.E.) Requirements for Renewal

In order to maintain active status*,* *CRC®* Certificants must earn and submit **fifteen (15) hours** of continuing education annually. Candidates who pass the *CRC®* Examination but have not yet completed all other requirements for obtaining the *CRC®* certification must also submit their C.E. annually. All continuing education submitted must conform to the *CRC®* Approved Topic List, which can be found here:

http://www.infre.org/Forms/CRCCertificantHandbookApril2015.pdf#nameddest=renewalrequirements

Ethics Continuing Education

At least two (2) hours every two (2) years must be in the subject of Ethics. A Certificant's first two-year ethics requirement must be met with an InFRE-produced ethics course that specifically addresses the *CRC®* Code of Ethics (Exhibit B). InFRE self-study courses or InFRE-sponsored workshops may satisfy this initial requirement.

Approved Sources of Continuing Education

This section outlines approved sources of continuing education. Credit will only be granted for topics on the approved list (see link). Unless otherwise noted, any of these sources may be used to satisfy the entire 15-hour annual requirement. For attendance at live programs (e.g., conferences and workshops), a 50-minute session counts as one hour. Partial hours rounded to the nearest quarter hour will be granted. (e.g., a 70-minute session would count as 1.25 hours; a 65 minute session would count as 1.0 hours).

Certificants repeating coursework may not submit the same course for CE credit over two consecutive CE reporting periods. This includes coursework that contains the same content offered in different formats (i.e., print book and webinar).

Certificants who have purchased CRC exam preparation study materials may not apply these materials toward CE credit for their first CE reporting period after becoming certified.

Conferences, Workshops and Seminars: Continuing education programs sponsored by InFRE or other organizations related to the accepted topic list. Delivery may be face-to-face, audioconference (with or without webcasting), or online synchronous.

Examples include those offered by continuing education providers and other certification-granting entities such as but not limited to state and local Bar associations, CEBS societies, CPA societies and FPA chapters.

Employer-sponsored education programs and in-house training: Continuing education programs sponsored by the Certificant's employer related to the accepted topic list. Delivery may be face-to-face, audioconference (with or without webcasting), or online synchronous.

Participation as speaker, workshop leader, discussion leader, course instructor, author or editor.

Examples include writing an article for a professional journal, speaking to other professionals at an association conference, and reviewing or editing professional publications.

Inclusions/Exclusions:

- Credit will not be granted for:
  - Activities that constitute part of the Certificant's job description (such as preretirement workshops to plan participants), or
  - Activities directed to audiences other than industry professionals (such as the general public, grade school students, etc.)
- A maximum of ten (10) hours per reporting period may be reported.
- For those teaching other professionals, two (2) hours will be granted for every one (1) hour of delivery, up to the maximum of ten.
- Credit will only be granted for the first presentation, but not for repeat presentations.

Self-study groups: Pre-planned learning sessions of three or more professionals that include an in-depth study of a topic on the approved list.

Inclusions/Exclusions:

- Groups must have a topic outline and a designated leader.
- A maximum of five (5) hours per reporting period may be reported.

Self-study programs: Educational materials used for individual, self-paced study, including internet-based courses CDs, DVDs, or MP3s, or printed materials/articles.

Inclusions/Exclusions:

- CE credit will be based on the average completion time of the program. A minimum of 50 minutes of completion time is required for 1 hour of CE credit. Additional half-hour increments will be accepted after the first hour has been completed.
- Program must include an exam/quiz graded by the sponsor and the Certificant must attain a passing grade of 70% or better.
- The exam/quiz must contain at least 10 questions per class hour and 5 questions for additional half-hour increments.
- No credit will be granted for an exam/quiz with less than 10 questions.

Professional licenses, designations/certifications. Certificants may get credit for successfully earning a license or completing a designation/certification program.

Inclusions/Exclusions:

- Only licenses or credentials based on the list of approved topics will receive credit.
- License or designation/certification program must include an examination graded by the sponsoring organization.

- Certificants should contact InFRE to inquire if a license or designation/ certification program qualifies for CE credit and about the number of approved CE hours.
- Separate CE credit may not be earned for both an exam preparation course and passing the exam of the license or designation/certification program in the same reporting period.

Academic Coursework: Course taken for credit at a U.S. regionally accredited college or university, regardless of the delivery (e.g., face-to-face, independent study/correspondence, online).

Inclusions/Exclusions:

- Continuing education credit will be granted on the following basis:
    - One semester credit qualifies for 15 C. E. hours; a 3-credit semester college course is equivalent to 45 C. E. hours
    - One quarter credit qualifies for 10 C. E. hours; a 2-credit quarter college course is equivalent to 20 C. E. hours.

Participation on InFRE committee or other InFRE project. Acceptable activities include authoring of educational or review course materials, writing and updating examination questions, and conducting and/or authoring industry research projects.

Inclusions/Exclusions:

- A maximum of ten (10) hours per reporting period may be reported.
- Hours granted will be determined in consultation with the Recertification Committee.

A 21st Century Connection – Health and Wealth

By [Ron Mastrogiovanni, President and Chief Executive Officer of HealthView Services]

Ron Mastrogiovanni – Health Care Impact Expert

Editor's note:
This presentation was delivered in live webinar format in 2015. Ron's comments have been edited for clarity and length.
You can view a **YouTube** brief of the original presentation here.
You may also choose to take the **full length course** to earn 1 CRC®, CFP®, and/or PACE CE credit.

One of the key questions your clients might have is, "Will Medicare take over where my employer left off?" The answer is no. The reality is that Medicare is not free. As time goes on, we're picking up more and more of those expenses.

What will someone's healthcare costs be in retirement? Is there an effective way to manage those costs? Yes. There's actually a lot we can do to both manage the costs, determine what needs to be saved today, and ultimately for a large percentage of your clients, you can actually help lower those costs. You can do this by not only looking at asset allocation, but also product mix. Product mix today is as important as asset allocation was 10 – 15 years ago.

The Medicare Alphabet

Let's begin by giving covering the basics. Medicare is broken down into five parts.

1. Medicare Part A, which is hospitalization. As advisors we don't need to know much more than this, unless we're in the business of providing clients with insurance coverage in retirement. Very few of your clients will actually be paying for this because we're paying for it now through our FICA tax, so that's prepaid.
2. Medicare Part B covers doctor visits, emergency room visits, tests and things of that nature.
3. Medicare Part D covers prescription drugs.
4. Supplemental policies, or Medigap insurance. Mainly because since Medicare covers about half of someone's medical expenses, future retirees will need to go out and purchase additional insurance to actually cover the remaining costs.

In addition to the general Medigap policies, there's Medicare Advantage, which is a combination of Medicare's Part A, B, and D. There's a lot of variations. The difference between Medigap and Medicare Advantage is that Medicare Advantage is primarily an HMO, where Medigap is primarily a PPO. So that's basically what we need to know as advisors.

As advisors, do we really need to address healthcare? Don't we have enough on our plates? The reality is that affluent Americans are interested in addressing this issue.

When I first started HealthView Services, I thought this would be a mass market type product. We've learned since that there's no correlation between what someone earns, or what someone has in assets, and their level of interest in addressing healthcare costs.

Why All the Fuss about Retirement Healthcare?

When we review the expenditures of people over the age of 60, you'll see that housing, food, and transportation add up to 34 percent, which is basically what we will be spending on healthcare. So when we're looking at the financial planning process, if we're not truly addressing healthcare it is a true void.

I've always thought that Social Security benefits would cover my housing, food, transportation for as long as I can drive, as well as healthcare. The reality is when you're looking at the numbers based upon different levels of monthly income and Social Security, you can clearly see how much healthcare will eat up of our Social Security checks. For example, at age 86, healthcare costs might be around $26,000 in real dollars. However, if someone is at the high end of Social Security benefits, they will also be paying Medicare surcharges. In reality, healthcare will be a lot higher than that $26,000; it could be double. That's an important number to remember and we'll get into that in a little more detail.

Another question that I get quite often is, "I'm a Baby Boomer, so why all this focus on healthcare? My parents really never had much of a problem living on Medicare and Social Security. Why is it such an issue today?" First of all, let's take pensions right off the table. As you know, unless you're in the public sector, pensions are going away.

Let's compare both generations and take an average American couple, where in 2015 they'll generate around $26,000 from Social Security income. The lifetime Social Security benefits for the Greatest Generation were around a $1.1-$1.2 million, and the average COLA was around 4.5 percent. The average projected COLA by the trustees at Medicare going forward is 2.7 percent. We have not seen 2 percent COLA in quite a while, but let's assume that's correct and it's going to be 2.5 percent. That means today's retiree earning the same level of income as the Great Generation will generate a little over $900,000. In other words, we'll have less benefits of around $250,000 comparing one generation to the next.

Secondly, if you have clients from the Greatest Generation, most of your clients did not pay for supplemental insurance. They also didn't pay for drug insurance; they didn't pay those premiums. My dad worked at Raytheon, and he was not a senior manager. He was just an average guy working at Raytheon, and never had to pay for supplemental insurance or prescription drug premiums, because Raytheon picked that up. Today, our clients in the private sector, they're paying those bills out of pocket. If I compare that difference, just looking at prescription drugs and supplemental insurance, I'm looking at additional costs or net less benefits of another $260,000 – $270,000 than what the Greatest Generation received. By the way, I did not take Medicare surcharges into account. Approximately half of your clients will get hit with Medicare surcharges, and that's not accounted for here.

The Key Lifestyle Busters in the Healthcare Industry

As time goes on we will be more and more responsible for our own healthcare expenses.

Deductibles for preretirement commercial insurance have increased by some 50 percent over the last ten years. That trend is also going to impact retirees. Approximately 20 percent of the working population is in a high deductable plan. You're going to start seeing those types of changes in retirement as well. Inflation is probably the biggest killer when it comes to healthcare. We're projecting in 6 – 6.5 percent inflation rate on healthcare.

We're going to be living longer. That will impact our costs, so there's good news and bad news. Many of us use income replacement ratios, whether it's a top down approach or a bottom up approach, but there are issues that we need to address with income replacement ratios because healthcare is not one number. Depending upon where you live, healthcare costs are very different.

States are looking at how they can potentially lower medical inflation rates because of the impact it's having on their economies. This is a critical issue both nationally and within the state that you live in. I'm not sure we have answers to this.

Every year our Social Security income is actually decreasing. For those of us who thought that Social Security would be paying for all our expenses, that may have been the case years ago, but it's not going to be the case today. As a matter of fact, a 65-year-old male retiring a year from now is going to need to allocate over 65 percent of their Social Security check to healthcare alone because of Medicare surcharges. For the average American couple retiring in ten years, it's 73 percent of their check. So your average 55-year-old retiring at age 65 before taxes is going to be paying 73 percent of their Social Security check to healthcare. Over 50 percent of Americans are going to be paying taxes on Social Security income. What's left?

Longevity and Retiree Healthcare Costs

The Society of Actuaries recently concluded that we're going to live a couple of years longer. That's a good thing. If we're going to live a couple years longer, what does that mean in terms of healthcare costs? If we take a 55-year-old living an average lifespan, those two extra years will cost that person $73,000 in real dollars. If I take the net present value of that, you're looking at around $35,000.

When planning, utilizing realistic life expectancies can make a difference in terms of lifestyle. Say we have two 55-year-old males living in Illinois, mirror images of each other. One happens to have Type 2 diabetes, and the other one is healthy. They're both going to retire at the exact same time on the same day. The person with diabetes has a life expectancy of 77, so they're looking at around the $190,000 in total healthcare costs. The 55-year-old healthy individual is going to live ten years longer, and their costs will be over $430,000. You're looking at a $245,000 difference because of those ten years. Then add the impact of compounding that inflation rate at 6 percent a year.

Medicare Means Testing

Probably one of the most important things that we can have an impact on for our clients happens to be Medicare means testing, or surcharges. The system has been designed today to charge for Medicare Part B doctor visits and Medicare Part D prescription drugs based on income level. Income level is defined by Medicare as Modified Adjusted Gross Income (MAGI).

So very specifically, you may have a client that's heavily invested in municipal bonds, and they're not paying taxes on that. Guess what? It does fall under MAGI. So a key number for all of us to be looking at is that MAGI number, because it can impact medical costs by up to 200 percent. So Medicare parts B and D are means tested.

What does that mean? In order to get hit with means testing, an individual has to earn over $85,000. As a couple it's $170,000. An initial response I typically get to that is, "Yeah, that's not gonna be a problem."

Medicare Means Testing Brackets

Present through 2017		
Individuals	Couples	% Change in Cost
<$85,000	<$170,000	
$85,001-$107,000	$170,001-$214,000	38%
$107,001-$160,000	$214,001-$320,000	97%
$160,001-$214,000	$320,001-$428,000	156%
$214,000+	$428,000+	213%

There's one problem with that not being a problem. Back in 1983, a bill was signed into law that taxed Social Security. We all know that if you earn over a certain threshold, you will pay taxes on Social Security benefits. At that time, around 5 percent of retirees paid taxes on Social Security. That threshold was not indexed to inflation. Today well over 50 percent of retirees are paying taxes on their Social Security, and I'm just talking about the general public.

In your client base, the vast majority are probably paying taxes on Social Security. These brackets are not indexed to inflation. So as time goes on, more and more people fall into these brackets.

Congress recently passed a bill called the Doc Fix Bill, which ensured that physicians get paid, which was very important from a Medicare perspective. Buried in that bill were the brackets for Medicare means testing.

Medicare Means Testing Brackets

Beginning in 2018		
Individuals	Couples	% Change in Cost
<$85,000	<$170,000	
$85,001-$107,000	$170,001-$214,000	38%
$107,001-$133,500	$214,001-$267,000	97%
$133,501-$160,000	$267,001-$320,000	156%
$160,000+	$320,000+	213%

For example, the top bracket for individuals starts at $160,000. This begins in 2018. It's currently $214,000. So the brackets are getting lowered. They're going to continue to get lowered as more and more people fall into these brackets because the trust fund is being depleted.

Now let's take an individual earning $40,000 a year, who is never going to earn more than the equivalent of $40,000 a year. When they retire, they will be hit with a 38 percent surcharge on average depending upon which state they live in. So if that person earns one dollar over $85,000, they'll pay a 38 percent premium. A retiree today can be in the first bracket and ten years from now they can be in the third bracket.

How Can Advisors Help Manage Medicare Surcharges?

Let's take an example of a 55-year-old couple retiring at 65. They have a half a million dollars invested with you and they're in a 60/40 portfolio that is generating a 6 percent return. Assume they're going to generate a 6 percent return for the next ten years, or around $400,000 in gains. In less than an hour, you can save that client anywhere between $150,000 and almost $900,000 by managing their product mix around the MAGI thresholds.

Here are some of the types of accounts that are not considered income from a Medicare perspective:

1. Qualified annuities
2. Variable life products
3. A ROTH roll over
4. A ROTH 401K
5. Health saving accounts (HAS)
6. Longevity insurance (deferred income annuity)
7. IRA trusts.

Today it's become part of our jobs to not only look at risk tolerance, time horizon, and the right asset allocation, but also the right product mix because it can generate an additional hundreds of thousands of dollars in disposable income in retirement.

Income Replacement Ratios

Income replacement ratios as we all know, address future costs based on today's costs. While employed, the average American pays 25 percent of the actual healthcare premium costs, and employers pay 75 percent of that cost. Plus we pay all of the out of pocket, like co-pays and things of that nature. In retirement we'll be paying 100 percent, not 25 percent, so it's important even when performing traditional planning to really take into account how much of healthcare you really have covered, and what's that additional gap? We've found that advisors who take this approach and call their clients back in, the client appreciates it because it's such an important issue for them.

Another issue is state of residence. Both supplemental insurance and prescription drugs are coverages are managed by the states. The state determines which vendors can sell those products in that state. They select the products and then negotiate the pricing. If I compare Massachusetts to Hawaii for the exact same product, you're looking at $150,000 difference in out of pocket costs. It's a 50 percent differential for the exact same product.

Let's take it one step further. Let's say I'm in the state of Massachusetts and I'm buying a particular supplemental policy. Let's say I'm buying F, which happens to be the most popular supplemental policy. And let's say there are five firms in the state of Massachusetts selling F. They all have different prices. But guess what? By the law the coverage is exactly the same. There cannot be any difference in coverage. The only difference can be price. The issue arises when you have a client who may own a home in another state; the question becomes, "Where do you live?" Maybe healthcare becomes one of the variables that that particular client would want to consider in making that decision.

The differential between healthcare costs of the last year of employment and the first year of retirement given U.S. averages, ranges from $3,000 to almost $9,000 more in retirement than we had as an employee. The one big difference here is that it's not coming out of our paychecks. We're writing a check.

A Case Study on Funding Retirement Healthcare Costs

Let's take a 55-year-old married couple. They want to retire at 65. The male has a life expectancy of 87. The female has a life expectancy of 89. They're both healthy.

They’re projecting an income replacement ratio income of around $180,000 in retirement. They live in Northern Massachusetts, and they also have a home in Kennebunkport, Maine, which is approximately 40 minutes from where they live. So the question becomes, “Where should they live?” They’re not sure whether they’d want to live in Maine or Massachusetts when they retire. If we just look at the basics, the hospitalization piece is already prepaid. For doctors and tests, it doesn’t matter where you live. It’s run by the federal government and that’s consistent. So Part B is consistent across the country.

It’s important to realize that Medicare premium is directly deducted from Social Security checks; the Feds are not sending us bills. Prescription drugs and gap insurance is run by the states.

So now let’s look at the difference in costs between Massachusetts and Maine for this couple. In Massachusetts they can expect costs of around $885,000 for healthcare in retirement, that’s in future value; and in Maine, $819,000.

So you’re looking at around a $64,000-$65,000 differential. In their case, why pay the differential? They’re just as happy in Maine as they are in Massachusetts. The difference is gap insurance. By the way, at $180,000 they’re in the second income bracket, so there’s an additional surcharge of $87, 000 over time.

For simplicity’s sake, this could be done with an annuity as well as 401(k). In this case the advisor recommends that they convert their traditional 401(k) into a Roth 401(k) and that drops them into the first Medicare bracket. All of a sudden they’ve saved the $87,000, and they saved the $64,000 – $65,000 – just like that!

The next thing for this particular couple is they’ve decided they’re going to sell the house in Massachusetts. They will need to sell that house at least two years prior to retirement because Medicare has a two year look back. All those capital gains from the sale of the house can move someone from one bracket to another because it falls under MAGI.

In sum, what did we find here? The total cost in Massachusetts is $885,000. By moving to Maine, they reduce to cost to $820,000. Converting to a Roth 401(k) lowers the healthcare costs to $660,000. Now we have just lowered healthcare expense from $885,000 to $660,000.

However, $218,000 of what they need will be coming directly out of their Social Security. If they invest $40,000 today at age 55 into an account assuming a 6 percent return during their lifespan, that lowers the cost of healthcare to $285,000.

Additionally, if they allocate $10,000 a year for five years while working in retirement, they’ll lower their savings requirement to around $138,000, based on a 6 percent return.

In this case study we’ve saved this particular client over $224,000, and we’ve increased Social Security income by close to $160,000 because those surcharges will not come out of their Social Security benefits since we moved them from the second bracket into the first bracket. We’ve optimized retirement income and the required savings decreased by $68,000.

Takeaways

From a consumer’s standpoint, a third of what they’re going to spend in retirement is going to go to healthcare. We’re behind the eight ball in our generation in comparison to the previous generation. We need to make that up. The way we have to do it is to save.

I also strongly recommend that investors talk to an advisor as early as possible to begin a program to specifically address healthcare, and don’t forget Social Security optimization. It could mean hundreds of thousands of dollars in additional income.

From an advisor's perspective, folks are interested in healthcare costs and Social Security, and we as advisors need to address it. We need to understand how to overcome some of the roadblocks, such as inflation and limited COLAs. Educate yourself. You don't need a degree from Cal Tech.

Learn the basics and utilize applications such as the HealthView's HealthWealth Link that will help you get to the numbers that your clients need to save. You can lower those healthcare costs through product mix; it's not just asset allocation. It's a mix of insurance and capital market products and optimizing that mix to optimize retirement income.

Click on the following link to get a free trial of HealthView which includes both education and a host of different retirement related applications.

***Ron Mastrogiovanni, President and Chief Executive Officer of HealthView Services**, has more than 25 years of experience in management consulting, financial services and health care software design. Ron is responsible for developing the HealthView software platform, a solution-based planning system that integrates health care cost projections, Medicare means testing, long-term care expenses and Social Security optimization into the retirement planning process.*

Want **Ron Mastrogiovanni** to speak at your event?
Retirement-Speakers-Bureau.com

Ron is President and Chief Executive Officer of HealthView Services, which he has helped guide to strong growth, leading the way to innovative new retirement planning applications. Prior to HealthView, Ron was the co-founder of FundQuest, one of the first fee-based asset management companies that provided financial institutions – including banks, insurance companies, and brokerage firms – with wealth management solutions. Ron's strategic planning, innovative product design and general business experience led FundQuest to become one of the most successful fee-based money management solutions in the industry. Under Ron's leadership, the company accumulated over $12 billion in assets. The company was acquired by BNP Paribas, a global leader in banking and financial services. Previous to co-founding FundQuest, Ron was President of The Parker Company, a management consulting firm specializing in technology startups. Prior to The Parker Company, he held senior sales and marketing positions in the technology industry.

Ron earned his B.S. degree from Boston State College and an M.B.A. from Babson College.

Ron is a widely respected thought leader in the domain of health care costs projections, and has co-authored several white papers on such topics as the 2015 Health Care Cost Data Report and the Impact of Medicare Means Testing on Future Retirees.

Retirement Speakers Bureau

Protecting Your Clients from Financial Elder Fraud

retirement-insight.com/protecting-clients-financial-elderfraud/

By David M. Kessler, Elder Fraud Expert, Protecting the Elderly

Editor's note:
This presentation was delivered in live webinar format in 2015. David's comments have been edited for clarity and length.

You can view a **YouTube** brief of the original presentation here.

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David Kessler – Elder Fraud Expert

There are unknown aspects of elder financial exploitation that most people never understand, unless they actually sit and visit and get to know the elderly victim, or they have an elderly victim in their own personal lives. There are red flags that hopefully you'll recognize.

In all elder exploitation there's some form of undue influence and deception or lies, the pressures that are put upon the elderly victim. The predator of the elderly has the same mentality as the predator who victimizes children for sexual gratification. The same power and control techniques are used with our elderly victims for financial exploitation. These crimes often aren't just random. They're very well planned. They're very well organized. Elderly predators have an attitude that the elderly victim's money or assets is something that they've worked hard to get at, and they're entitled to it.

Unknown Aspects of Elder Financial Exploitation

It's not about the money. First, understand the mindset of the elderly victim, and what a handshake meant in the era in which they were raised. Across the country, gentlemen tell me, "Mr. Kessler, I bought my first house, I did my first business transaction based on a handshake. I didn't need a contract. I didn't need attorneys verifying everything." As we understand the mindset of the elderly victim, we learn that they deal on the premise of a handshake.

Very rarely do I hear from an elderly victim, "Mr. Kessler, are you going to get my money back?" Usually, what I hear is, "Mr. Kessler, how could they have done that to me? I thought they cared about me. I thought this person loved me." What we're really talking about, which you'll never find in any criminal code book across the United States when looking for charges against an offender, is a charge that's titled, "Loss of Dignity or Self Esteem." This is the part of the crime that is very misunderstood, that the elderly victim is highly embarrassed that they were taken advantage of and scammed.

I hear from the elderly victims, "Mr. Kessler, I'm afraid now if tell my family or if my kids find out, are they going to step in? Are they going to want to take over my finances? Are they going to want to think about putting me in a nursing home? Are they going to want to take away my driver's license? Do they think I can no longer live alone?" That is one of the main reasons why that elderly victims do not report or come forward with these crimes, because of what they perceive is going to be the ramifications of their actions when all they are is a trusting, good person who has been taken advantage of because of the era that they were raised in.

I’ve had far too many elderly victims of fraud die early because of the stress and the shame that it’s put on them.

Common RED FLAGS of financial elder abuse

Often times, the reason the money is being stolen from the elderly victim is because of some vice that the predator has. Substance abuse, whether it’s drugs or alcohol, is the number one issue. Gambling is another. There’s always some sort of reason that elderly person is targeted.

In 90 percent of all of the investigations that I get involved in, the predator of the elderly is someone in a very close proximity in trust to the victim, mainly, their family. An elderly victim will be brought in to meet with you to set up their estate planning, to set up their finances. They’ll have their son, their daughter, their granddaughter, or their care provider. With these types of crimes, particularly when it’s their own family, what are we asking them to do, if they get involved in cooperating in investigation? That ultimate goal is potentially putting their family member in prison. Seniors say to me, “Mr. Kessler, I do not want to get my son, my grandson, my daughter-in-law in trouble.”

Isolating the victim from family and friends is a two prong attack that the predator uses when trying to victimize the elderly. They get the elderly victim where they no longer have contact with family, friends, and neighbors because the more isolation, the less likely that someone will observe or get suspicious of the predator’s behavior.

The vast majority of the cases that I investigate occur where the senior is still living in their own home, and they’ve had a family member move into their home. The only interaction that elderly person may have in a day is with the predator themselves, no other outside influence. The elderly victim isn’t even allowed anymore to go to the mailbox and get their own mail because the predator knows that the mail may contain credit card, bank, and insurance statements.

First the predator may do all of the victim’s banking over the internet where the elderly victim wouldn’t even have the ability to get on and check their own finances. The second thing a predator does is take the victim attorney or doctor shopping, once they get involved and get their trust. The third approach is to take the victim financial bank or credit union shopping. Think about the elderly in your own lives. They’ve been going to the same doctors for years. They’ve been going to the same financial institution for years. They’ve had the same family attorney for years. Those people are familiar, and this is an important, they know the victim’s history and family situation because they’ve been dealing with them as clients for years. That’s why it’s very important as financial planners who deal with the elderly that you try to meet them individually or privately so there is no undue influence by the predator. More importantly, make sure they understand the documents and the financial paperwork that you’re going over with them.

If there’s undue influence, it’s already been rehearsed with them; they’ve been told what to say. When they get into your office, they’ve been programmed to answer the questions that they feel will be asked that best benefits the predator who brought them to the meeting. By understanding these red flags, we have certain gut feelings or certain things that set off our warning system. Whenever you get these gut feelings that something just may not be right, these transactions need to be slowed down. You need to have a plan in place.

Make up an excuse why you have to leave the office and get a manager. Explain to the manager that you feel very uncomfortable with this transaction. Allow a manager or a second party to come into the room. All of these things are going to clearly make a statement to the predator that you’re possibly keyed in, that you recognize that there may be some impropriety going on with this transaction. What’s best for the client, in your situation, is to not go through with a transaction if you feel like there’s something wrong.

How do the predators of the elderly locate their victims?

The elderly have probably had the same telephone number for 50 years. Open up your local phone book, and pick the last name of Smith. Look under the name Smith and profile the first names: Stacy, Morgan, or Agnes. Which one is most likely a senior citizen? Most likely, Agnes. What has the phone book just provided you with? Agnes Smith, her address and her phone number.

I’ve had cases of elder exploitation where the predators have looked in the local newspapers targeting obituaries, which often give information such as date and times of funerals, which most likely means the houses are empty. Leo Smith has passed away, so most likely, you have Agnes, a senior, living alone who is very vulnerable. And it’s very easy to locate them.

Predators use a number of techniques to get into our elderlies’ homes and to convince them to give away their money or to allow the contractors or the roofers or the driveway pavers to do work. The No. 1 thing the predators look for on our elderly homes is the American flag flying on the front of the house because, as they tell me, “You know those old people, they cherish the flag.” The elderly have been flying those flags often times since they came back from Vietnam, since they came back from World War II once they returned back from Korea.

No. 2, that’s never taught but the predators know, the number one fear that seniors tell me in their everyday lives is not crime, it’s falling. There’s a myth with the seniors, you fall, you break a hip, and you go to a nursing home. The next thing you know, after the nursing home, it’s possibly in a grave. So when you’re driving down communities, and you’re looking at houses, and you see blue, green, or grey Astroturf carpeting on porches or steps that easily identifies that the person living there is really concerned about falling.

Or, how many of you today have the old style antennas still attached to your chimney or on your roof? Most of us have Direct TV or cable TV, but do not have the old antenna on top of the roof that draws attention that maybe that’s still an older person living in that house. Think about your grandparents or your aunts and uncles who still have the old style aluminum screen doors with the round emblem that has the initial in that round emblem of the people with their last name initial on that door. How many of you have relatives that still have, on their garage door, a big initial representing the last name?

Predators look for bird feeders. I deal with an awful lot of senior citizens that are lonely. They have no family. They’re isolated. Those birds have become their family. Having the seven or eight bird feeders in their yards, filling them up daily and sitting back looking at those birds as their family is very therapeutic. Predators know that those bird feeders, often times, to the elderly, are their only family, giving comfort like the St. Mary’s statues or other religious emblems frequently in front of the homes.

These crimes are planned and organized, not random when elders get the knock at the door. Predators like to start the conversation with the elderly about love of God and love of children. What senior is not sympathetic to a child in need or sympathetic to their faith?

Transient criminal groups often will have three generations, grandfather, father, and son. The son, at 7 or 8 years old, is already trained and conditioned what to do to try to help gain access to that senior’s house when they knock at the door. “Ma’am/sir, we’re in the neighborhood. We have some left over black top. We see your gutters are full. We can clean them. Or, the Lord sent us here.”

What senior citizen with a 7 or 8-year-old little boy standing there tugging on his blue jeans, making the gesture he has to go to the restroom, or on a 90 degree day saying to his dad in front of the senior, “Dad, I’m really thirsty. Dad, I need something to drink,” What senior do you know who would not volunteer to allow that young man to come in the house, get a drink of water or to use the restroom? Because the generation they were raised in, that’s the right thing to do.

But, unfortunately, that young child at 7, 8, 9 years old is already trained and conditioned that once they get in the house, they’re burglars. Two areas they look for: A) Straight to the master bedroom where the senior hides their money because of the era they grew up in, the Depression, never trusting financial institutions. Then B) Head for the rest room medicine cabinets for pain medication, because a lot of these predators have substance abuse issues. These are organized criminals. Often in our investigations, we target them under the RICO statutes here in the state of Ohio is of the highest felony level equivalent to the felony level of homicides and more violent offenses.

The elderly have worked all their lives, getting up at 4:00, 5:00, 6:00 a.m. in the morning. Now they go in the morning to meet friends or meet co-workers or other retirees. They like to go to malls or different restaurants. The No. 1 restaurant I see where the predators go try to target their victims is McDonald's. Or think about how many women are going to the grocery store, Wal-Mart or Target, park their cars, get out and walk in the parking lot, where you have a lot of your pigeon drop frauds. Predators watch the handicap spots, see the senior pull in, walk up, and offer to help them with their cart, or the entrance to the store, anything to befriend or be nice to the elderly victim, anything to start to build trust.

What is the word "CON" is short for when you deal with these crimes? Confidence. These are confidence crimes. The elderly victim will never allow you to clean their gutters, do their driveway, trim their bushes, cut their trees, unless they feel like you're a good person. So obviously, it's always "Yes, ma'am; no, sir; the Lord sent me here today; I'm just working hard because I got four children at home, and this is how I provide for my family."

The No. 1 deterrent I try to get across to the seniors is think about the contractor or the person that comes to your door and solicits you for work. If they have to knock at your door and solicit you, they're either a bad contractor who has to solicit work the hard way, which you don't want to deal with, or a criminal.

The final type of predator we frequently see with elder fraud is family members. The most prevalent issues I deal with family members stealing from their own are substance abuse, gambling, or their own business failures, such that they have to go to the seniors in their life to steal from them to keep their businesses afloat. The family member is trying to steal their inheritance or get the inheritance they think they may not get early, pure greed. Undue influence and deception are always present, a two pronged approach; isolate the victim from their family and friends so no one will see or get red flags of the victimization.

The predator may impress the victim that they're a knight in shining armor so the victim trusts them. A deception often used with the elderly is the scare tactic of "Your family wants to put you in a nursing home. I'm the only one that wants you to stay in your house. Everybody else wants to tuck you away and never come visit you. I will never allow that to happen." The other scare tactic is "The government is going to take your money or your home." Anything that's going to upset the senior to make them believe that the predator has their best interests in mind.

A common tactic used by the perpetrator is killing with kindness. It's very sad how many times seniors across the country have told me when they've been victimized, "Mr. Kessler, the person or the predator or the person who stole from me was nicer to me than my own children." The predator has to be nicer than the kids, friendlier, everything that that senior needs them to be for that senior to gain the confidence to give them what they want. Another tactic is being the knight in shining armor. In other words, the only thing that matters is, "I'm going to look after you, Grandma Agnes. I'll never let you die in a nursing home."

Remember, we can't blame the victim for the victimization, whether an elderly victim is robbed when their purse is stolen as they're walking out of the local grocery store, or if they're taken advantage of in a con or a scam. Often times, the victim will not come forward because they're going to think that their family or their friends think they're dumb, they're stupid, and that they should know better. Think about how the trauma will affect you if you find out after the death of your elderly loved one that they never felt comfortable coming to tell you about their victimization because they were afraid that you were going to yell at them or criticize them or take their check book away. Those thoughts would never occur if mom or dad came out of the local grocery store and had a purse snatched or was knocked down and with a wallet stolen. Why would we yell at them for being a victim of a fraud or a con?

If we use compassion and understanding, more of our elderly victims will come forward. We need to figure out how the victimization of the person was planned. The predators of the elderly put a lot of time and effort into their plans. They get a mindset that they're entitled to what they steal because they put so much work into it. We must never blame the victim for their victimization. We're not ones to judge which crime is more important than another.

How should you respond when you suspect the client is a victim of financial exploitation? When you get that gut feeling, if you feel like there could be something wrong, that's when you have to take the time and speak with your elderly client privately. Let them talk to you and listen. Being a patient listener is so important because, often times, they will repeat and tell you, as the professional, what they want to do because they've been told and conditioned what to say. When in doubt, question because you will learn a lot more.

Say, "Ma'am, how did you know about this?" "Well, my grandson told me about it. He said this is what I need to ask for." Those are the red flags, and by listening will tell you, there may be a problem. Understand when the victim is overwhelmed. Often times, they're so prepped that they they'll stutter, forget things, or tell you, the professional, the way they were conditioned to say it. They get out of sorts or frustrated. Let the victim have all the time in the world they need.

Each situation is unique. There are no set rules for all victims. Frequently clients don't even realize they're victims. If their house was broken into or their car stolen, they would understand and know that they're victims. But they don't realize when they've been conditioned to participate in their own victimization, especially if the perpetrator is their own family member, and the last thing they want to do is get their family member in trouble.

Takeaways for the Advisors

Trust your gut instincts. You've had a lot of interaction with people over the years. When something just doesn't seem to be correct, take time to investigate, explore, and be nosey in a professional manner. Ask a lot of questions to see if the victim understands what they're telling you, or if there is something they've been told to tell you. Make sure the transaction is understood by the elderly client. Often times, we just perceive or think the victim understands.

Make sure they clearly know the explanation from you, the professional, not from the potential predator. Do not allow someone else to influence the elderly client's decision. For example, you're sitting there with a grandma and grandson. You ask grandma questions, grandson answers all of the questions. That's a huge red flag. Or you ask grandpa a question, and he looks at his son for acknowledgment that it's okay to answer you. That type of behavior is a control factor from the predator to the victim. Try to separate the two and ask your questions to the victim.

Tom Brokaw said, "We owe it to America's greatest generation of senior citizens to protect them from those who are determined to steal their assets and dignity." Think about the seniors in your lives and what they've done for us and for their country. We need to go the extra mile to protect the things they've worked so hard for.

Now you've heard how perpetrators victimize elderly, and what it is like to be a victim including the emotions that the elderly go through when victimized. In my opinion, after 34 years of working these crimes, elder fraud is misdiagnosed such that the system victimizes the elderly a second time, first, by the predator; second, often times, by the criminal justice system. Thank you for being proactive and learning more about a topic that is so misunderstood.

About the author:

***David Kessler, Elder Fraud Expert**, speaks throughout the country about the escalating problem of exploitation of the elderly. As a keynote speaker and trainer on the topic of exploitation of the elderly, David addresses all facets of these crimes, including Undue influence, Sweetheart Swindles, Power of Attorney Thefts, and Home Improvement Scams.*

Crimes against the elderly are highly under reported throughout the United States. Too often, incidents of stealing from an elderly victim are misdiagnosed as a "family matter," or a civil court issue. Protecting the elderly from crimes of fraud committed against the elderly is the focus of David Kessler's training and consulting efforts. He has dedicated his professional life to providing education and guidance for public and private sector professionals on the topic of exploitation of the elderly, and making certain those who prey on elderly victims are punished.

David M. Kessler is a retired Police Officer (former Commander of the Financial Crimes Unit) with the Dekalb County Police Department in Decatur, Georgia. David was recruited by the Ohio Attorney General in 1999 to serve as Chief Investigator of the Attorney General's Consumer Protection Unit. Within this role, David's primary focus became the protection of senior citizens against those who would prey upon them. With extensive knowledge and vast experience in the area of elder exploitation, David chose to leave the government sector in 2008 to form his own consulting business, ***Protecting The Elderly****.*

David holds the distinction of being a member of the [Association of Certified Fraud Examiners – A.C.F.E.] and has a Bachelor of Science degree in Criminal Justice.

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What Advisors Need to Know About Qualified Longevity Annuity Contracts

retirement-insight.com/advisors-need-know-qualified-longevity-annuity-contracts/

by ***Gary Baker, President, U.S. Division at CANNEX Financial Exchanges*** *and Curtis Cloke, CLTC, LUTCF, RICP*

Editor's note:
This presentation was delivered in live webinar format in 2015. Gary's and Curtis' comments below have been edited for clarity and length.

You can view a **YouTube** brief of the original presentation here.

You may also choose to take the **full length course** to earn 1 CRC®, CFP®, and/or PACE CE credit.

Gary Baker, President, US Operation of CANNEX Financial Exchanges

Our objective today is to explore the story and the background behind why the U.S. Treasury came out with these announcements last year about Qualified Longevity Annuity Contracts (QLACs), the advantages and disadvantages of deploying or using these types of contracts in a financial plan, and even more importantly, what type of basic strategies you can deploy with these types of contracts.

Why Did the US Treasury Issue a Ruling About QLACs?

Last year there were actually two rulings that the U.S. Treasury published regarding deferred income annuities. If there's at least one takeaway from this session, it's that a QLAC is really a deferred income annuity contract, or otherwise known as DIAs in the industry. Another word for a DIA is longevity insurance.

The first ruling from the US Treasury was back in July 2014, and essentially allowed for the deferral of income from these types of contracts to extend beyond age 70½. The essence of this ruling really addressed some tax issues that were fundamental in the IRC or (the Internal Revenue Code) relative to income annuities in general.

Twenty or 30 years ago, there was some concerns around partial annuitization and other elements regarding the use of qualified money in annuities. If you were to take a literal interpretation of the Code, until recently you would only be able to put a single premium into some of these contracts. The income start date from income annuity contracts really couldn't start any later than 12 months after the purchase or deposit and the contract or annuity itself would have to at least provide for substantially equal payments during the life of the obligation.

For single premium immediate annuities and how they've traditionally sold for over 100-plus years, that doesn't seem to be a problem. But with the innovations that have occurred over the last ten or 20 years around applying these types of concepts or contracts where you cover the tail end risk of the longevity issue for a client, the IRC had become quite outdated.

The second and probably equally important ruling, but one that's probably gotten less press, is what followed up in October 2014, which essentially allows for the allocation of a deferred income annuity inside a target date fund, especially when it's made available to 401(k) participants in a plan.

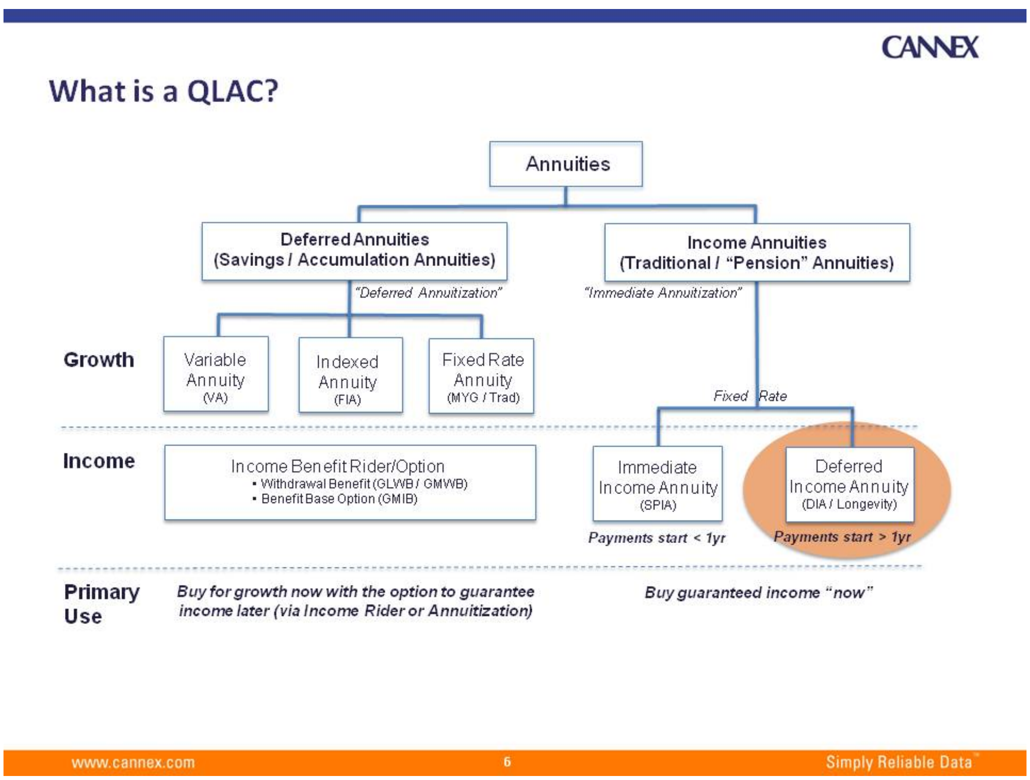
The reason why this is important is that the government has also identified that there are allocation concepts that are appropriate for these types of contracts and that they wanted to make an income annuity, or specifically, a deferred income annuity, more available to the middle market and allow them to participate in the potential benefits that they would receive. When you place a deferred income annuity inside of a target date fund, it really operates as a special type of bond, if you will, which then asset managers could potentially manage a glide path over time to help manage these type of guarantees.

Why did the US Treasury Focus on Deferred Income Annuities Compared to Other Forms of Annuities?

Over the last ten years or so, there have been quite a number of innovations and improvements around financial planning concepts that address the product allocation or ways to allocate between investments and insurance when you shift over to drawing down on assets in retirement. The longer term guarantees from annuity contracts can act as a shock absorber to help lengthen the time that you can work with the portfolio and essentially free up more assets to address other investment needs.

But the reason why the government focused on deferred income annuities is that the deferred income annuity actually, and actuarially, is considered to be the most efficient use of capital to address the tail risk of longevity. All annuities can address some form of that risk through annuitization or income riders, even single premium immediate annuities. However, by making a purchase up front and deferring that benefit for a long period of time, it essentially provides the consumer or the client the best use of that capital.

In this overall map of annuities, most advisors are used to annuities that are available on the left side of the page here; we refer to deferred annuities as savings annuities.



The most traditional is fixed rate annuities, whether they're traditional in nature or multi-year guarantee. Out of the $225 billion dollars of annuities that are purchased each year, over half of that is still in the form of variable annuities, or deferred variable annuities.

About 20 percent of the purchase of variable annuities is used for pure tax deferral. Over 80 percent of those contracts are sold with an income benefit rider, which essentially allows the investor to have the flexibility to have access to those assets and the capital within that contract, while still potentially taking out a guaranteed stream of income in the form of a systematic withdrawal at a particular defined rate, to the point that if those assets are exhausted in the contract over the course of time then the insurance aspect of that rider kicks in.

At that point, a sustainable withdrawal rate is maintained for the rest of the lifetime. These are called guaranteed minimum withdrawal benefits or lifetime withdrawal benefits. There are a few contracts that still offer a guaranteed income benefit, which essentially doesn't necessarily provide the guarantee on that withdrawal rate, but instead maintains a benefit-based guarantee, of which then the client can flip and choose to annuitize that overall contract at a particular level down the road.

These types of income benefit riders are also available on fixed income annuities, which actually have been growing as of late. We're also finding that these income benefit rider options are finding their way onto traditional fixed rate annuity contracts as well, as yet another alternative.

As we shift to the right side of the picture above, now we're talking about the traditional pension-like annuities that have essentially existed for thousands of years. The difference between an immediate income annuity and the deferred income annuity, which both provide for a fixed rate of the contract, is essentially when you're purchasing a single premium immediate annuity, your payments have to start within the next 12 months

Today, the average age of investors or clients that are purchasing single premium annuities is around 69 or 70 years old. This coincidentally bumps up against the decisions they have to make when they approach age 70½ and begin either consolidating assets or start to adjust their required minimum distribution (RMD) obligations.

The inverse of this is the deferred income annuity or longevity insurance, which allows you to defer the first income payment for a number of years. It could be deferred for as long as 20 or 30 years to primarily adjust the tail risk on the end of the systematic withdrawal plan

Today, deferred income annuities – and we'll get to this a little bit also – are primarily being purchased by clients who are mid to late 50's. The average deferral of that income typically is between five to ten years. However, there are opportunities to defer that income payment start date for a much longer period of time.

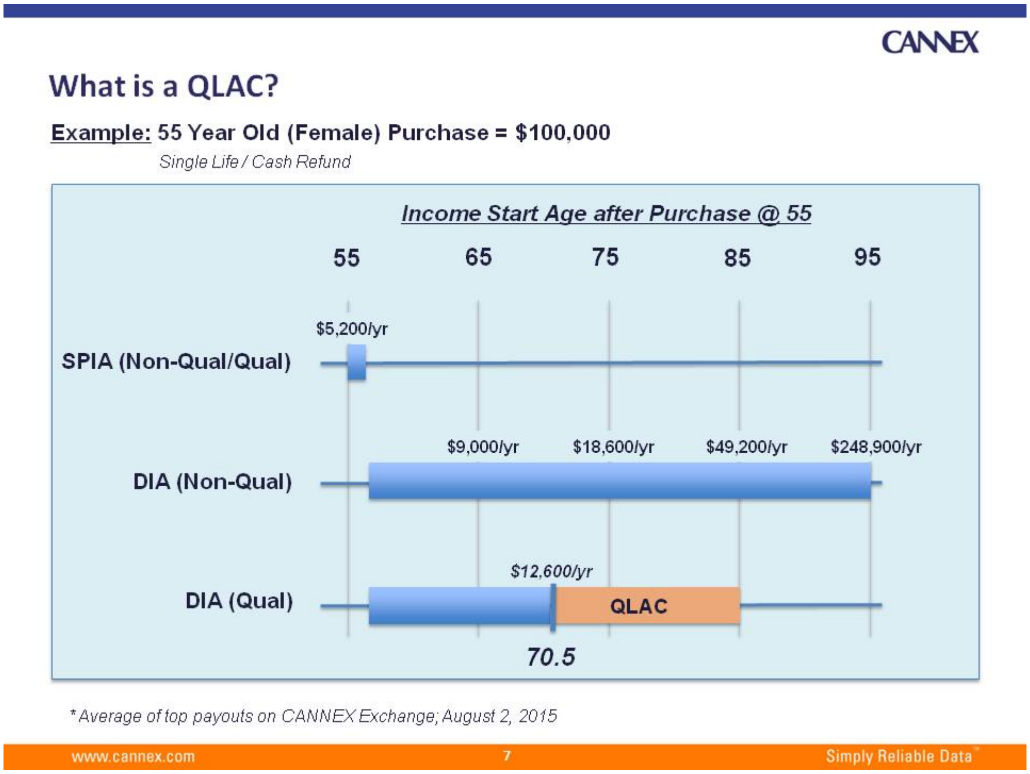
Deferred income annuities together probably represent only about 5 percent of the income annuity market today. But it is increasing at a rapid rate relative to the market. Again, the QLAC contract is a form of deferred income annuity which provides more flexibility for qualified assets.

How are Deferred Income Annuities Relevant to Qualified Longevity Annuity Contracts?

Assume a 55 year old female with $100,000 purchases an income annuity. In this case, we're assuming it would be for a single life annuity, as opposed to joint life, and has a cash refund, as opposed to a life-only annuity where there's no obligation back to the estate in the event that the annuitant would pass away.

The majority of income annuities purchased today, 80 percent or more, has some form of a beneficiary guarantee or estate guarantee that if the annuitant were to pass away, the obligations of the contract are passed on to their heirs. The most common or popular form of that guarantee today is in the form of a cash refund, where at least your estate will get the remainder of the original deposit that was provided to these contracts.

A single premium immediate annuity requires that you have to start taking your income within 12 months. If the 55-year-old female were to put $100,000 into a single premium annuity, she would generally receive $5,200 per year for the rest of her life, again, with that cash refund option.



With the non-qualified deferred income annuity, you see there's great flexibility today with the carriers that do offer these contracts where the longer you defer, the amount of benefit that you would receive increases exponentially the longer you wait. For example, paying $9,000 a year at age 65 for a $100,000 investment, more than doubling at 75, and certainly really paying off if you can actually defer it until age 85.

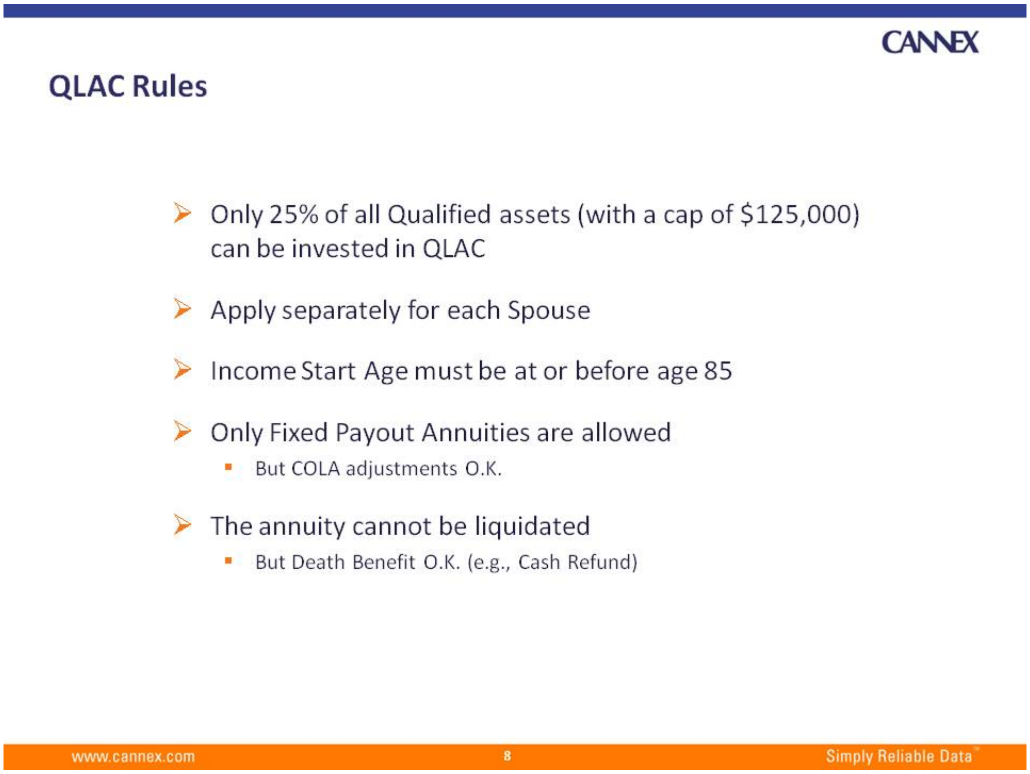
There are actually a few carriers that will allow you to make that deferral on a non-qualified basis up to age 94. For the purposes of this slide I charted it to age 95, but you can see that the longer you wait the exponentially bigger the benefit can be, not too dissimilar to the strategy that the longer you can hold off on Social Security your benefit will increase.

The problem that existed up to recently is that by trying to use these types of products on a qualified basis, it was very limited that the client would only have the benefit of deferring up to 70½ when RMDs have to be taken. The government has recognized the benefit of these types of contracts, and now allow us to defer the start date of income up to age 85. If you can apply a portion of the client's assets into a QLAC you can essentially achieve a similar benefit at 85 of $49,000 per year for that original $100,000 investment.

That's the essence of the new ruling on QLACs. Again, we're not really just talking about QLAC. We're really talking about the overall use of deferred income annuities and the ability to provide greater access and flexibility on a qualified basis.

What are the rules around QLACs?

The government and the IRS are still going to want their share. They have provided some caps around the amount of money that you can put into these contracts at either 25 percent of all the qualified assets that the investor holds, or a cap of $125,000 total invested in either a single contract or a number of contracts.



This cap applies separately for each of the spouses, so you could apply this $125,000 cap to both individuals. The income has to start at any time before 85 or at age 85. There are income annuities that are variable income annuities. Indexed income annuities have not been introduced as of this point, but technically, you could buy an immediate variable income annuity. From a financial planning perspective, however, when you're looking to lock in a floor or some form of guarantee, especially for a long-term retirement income plan, it's difficult to count on a variable payment to cover your rent, taxes and utilities, especially if you're applying some type of flooring concept.

The government had actually specified that QLACs would only apply for fixed payout annuities. But even for income annuities that are fixed in nature today, there are options of which you can have cost of living adjustments, typically around 2 or 3 percent increase per year off the payment, and there are a few that are offered on a CPI basis. But those represent probably only about 5 percent in overall income annuities contracts purchased today. Generally, most advisors are applying fixed payouts, but there are some great opportunities to apply COLA adjustments.

Finally, the annuity cannot be liquidated. For the most part, the majority of income annuities available today and even deferred annuities do provide some way you can change your mind. They can "commute" that contract and give some money back to you. In the case of extending this longevity, for now the government has put a restriction on that for the purpose of these types of contracts. But as I mentioned, they're okay with the death benefits of the estate in the event that the obligation is still paid out to the heirs.

Why are DIAs Such a Hot Topic These Days?

You could argue that longevity contracts existed well beyond before 2000; there are one or two instances that it has. But generally speaking, the industry started to really focus on these types of contracts at the turn of the century.

What was built and provided at that time was the pure essence of the contract to manage the longevity tail risk. They were built with some flexibility, but fundamentally were marketed as a position to be deferred for a long period of time to not really turn on income until around age 80 or 85, so that the investor didn't have to keep as tight grasp onto their investments and withdrawal strategies and to be able to essentially mitigate that income risk on the tail end of retirement.

Unfortunately, having that conversation with a client across the kitchen table was a very horrible conversation. It didn’t really appeal to them and the fundamental behavioral finance issue of buying something now and not seeing the benefit for 20 and 30 years when you’re talking about a specific product just really didn’t translate, and turned into low adoption rates overall for these types of concepts and products.

To make the story translate better across the kitchen table, insurance companies started to tighten up some of the specs around these contracts and really position the deferred income annuity with shorter deferral periods to align it with somebody in their mid ‘50s who is looking to catch up on their 401(k) as a last ten-year ramp up before retirement. In a similar manner, in most cases, if a defined benefit or pension plan is not available to someone, they can try to catch up by essentially creating their own pension plan.

How QLACs Can Be Deployed in Client Accounts

Some of the opportunities that exist now will allow certain clients to further delay withdrawing some of their assets based upon how much qualified assets they have in their portfolio, and can have a positive effect on their tax position.

The most basic way that we at first found QLACs to be impactful is with successful 40-year-olds and 50-year-olds, realizing that the $125,000 asset cap will be indexed to increase in $10,000 increments in the future. Let’s say I’ve got a 45-year-old or a 50-year-old that’s got a half a million dollars of qualified plan assets already, maybe for themselves and for their spouse. When you put a total of $250,000 into a QLAC and you delay that to age 85 for both spouses, the discount benefit to them with a joint lifetime cash refund provision provides incredible tail swings for that client, depending on the composition of their other assets. By the time they hit 70½ it provides some significant tax relief when the valuation of that is bought much younger than just 65 to 70.

So the younger the client is when you can deploy assets up to the value of the asset cap, the more beneficial it would be from a taxing point of view or from age 70½ when RMDs would normally be triggered up until the date you can defer. There is a minimum age you can turn it on. So if you buy a QLAC, whether you’re buying at 70 or 65 or whatever age, you cannot begin the “turn on” date, or the commencement date of that QLAC prior to age 72. You can turn it on from age 72 all the way up to age 85 and not to exceed, of course, age 85.

There are two things that we’ve found that we’re incorporating these discussions with our clients. One is that we’re getting tax relief on the non-QLAC portion when we’re not required to take RMDs between age 70½ and the date that we commence the income payments of that contract. The other thing QLACs do is pull down the distribution requirements of the portfolio, bringing it down to a safer range when incorporated with traditional assets, and creating a systematic withdrawal strategy that actually improves the distribution rate on the tail end of retirement. But where the real benefit is, we think, is with the younger the client who maximizes their use of a QLAC; it can have more impact on both controlling some taxes as well as helping out with distribution rates later on.

The Disadvantages of QLACs

Other than the $125,000 cap, annuities in general are a behavioral finance challenge.

Any advisor would agree that financial planning is about 90 percent psychology and 10 percent actual practice. It’s certainly evident when you sit across from your client. When you’re trying to position an annuity as part of a portfolio with such a long term guarantee and your need to hold those assets to receive that guarantee, there is a real tug of war between the control that both the client and the advisor wants to have over those assets ultimately, versus the guarantee they receive and the benefits that can really impact and provide a lot more flexibility to the rest of the portfolio.

Whether you’re buying a CD over a course of five years or if you look at an income annuity, you’re really asking the client to lock in a portion of assets to receive that efficient guarantee. But when you’re deferring that income start date, that psychological tug of war in their head is really amplified, especially if you’re talking about 20-year deferral period.

The one disadvantage about any of these products is the fact that when you buy a QLAC you've done something that's irrevocable. Once you've bought and put money into the QLAC, QLACs do not provide a commutation opportunity. So once you've purchased it, you've purchased it.

Flexibility is always paramount in terms of building a plan. There are QLAC contracts that exist out there and will exist, some of which will allow a change to the commencement date, flexibility features, and yet others that will not. It's important where the option is available to test the pricing of changing the start date or the commencement date, compared to those that don't. What I'm finding is when the flexibility exists, you can turn on the income five years sooner than the commencement date that you targeted in the original application and contract, or push it up to five years in the future. Ideally, we target age 80 as the commencement date because basically by putting it at 80 we can possibly start it at age 75.

QLACs and Estate Planning

The last thing we want to do is hold up settlement of the estates of clients that might pass away prior to some of these commencement dates or these payouts with a cash refund, whereby the estate would have to be held open waiting on future payments in an installment refund situation.

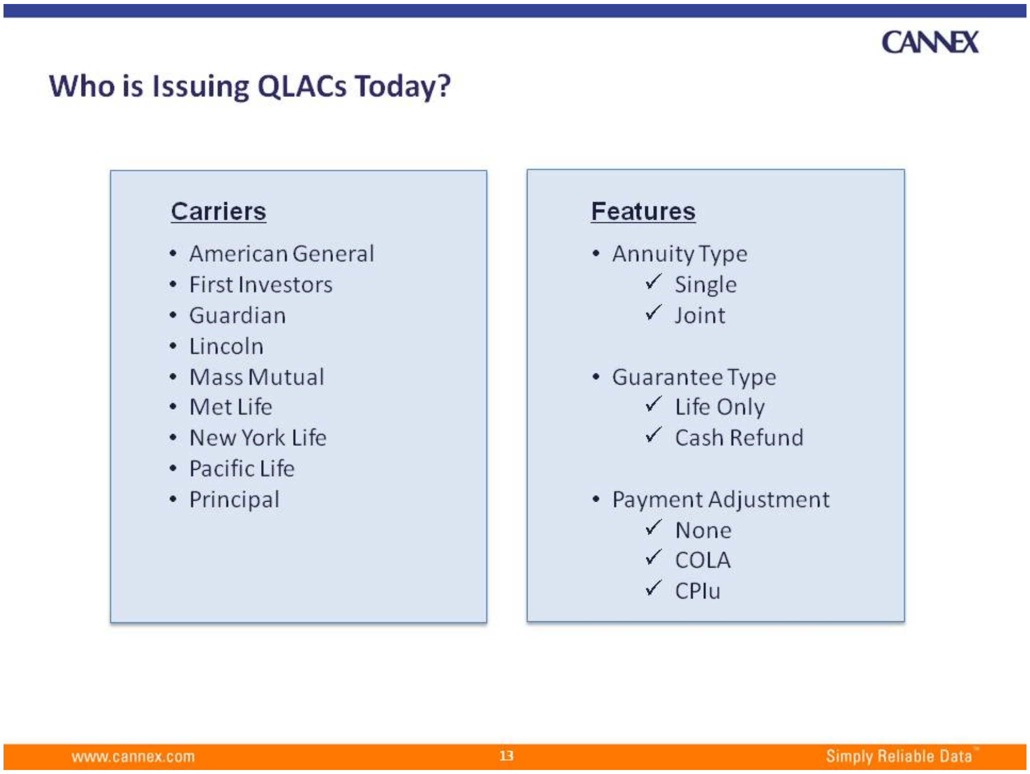
We also see retirees who have so much qualified money that the RMDs that are forced on them is so high that with social security and pension and other resources they have more cash flow than their desired income needs. There's a perfect opportunity even at or beyond age 70½ to consider allocating some of the qualified money to a QLAC. You literally could move $250,000 of the present value of qualified dollars ($125,000 lifetime cap per spouse) to QLACs and push some of those RMDs down the road. We're really looking to actually provide this specifically to those couples where one spouse has an extremely long family history projection.

Also, rather than doing one DIA, we might split it into five different $25,000 chunks between ages 65 and 70 so that we could constrain the actual present value that would be reported to the IRS on how much each of those conversions over the years would be taxable.

Top Takeaways for Clients

What QLACs do is provide broader access to income annuities in general. The government is opening up the ability for asset managers to place these types of contracts inside of a target date fund itself, which provides a clue as to the direction this is going, and ultimately provides some of these complicated strategies on a more available basis to the middle market.

Putting a little piece of your nest egg into these types of contracts is helpful. Deferred income annuities are being positioned now for folks in their mid-50s to correspond with the catch-ups that they may need to do for their 401(k). The longer you wait, the bigger the benefit, and certainly, it can have a huge tax benefit depending upon the client situation.



About the author:

[**Gary Baker**, President, U.S. Division at CANNEX Financial Exchanges] leads the U.S. operation of CANNEX Financial Exchanges. CANNEX provides a central exchange for guaranteed product data and calculations in the U.S. and Canada. The business also provides educational tools, product illustrations, transaction support and custom applications.

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Gary Baker's experience in the retirement market has broadly covered retail and institutional business as well as insurance and money management. Before joining CANNEX, Gary led product development and marketing for MassMutual's Retirement Incomer business. Prior to that, he was with GE Capital where he held a variety of senior positions in business development, product development and marketing both domestically and internationally.

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Curtis Cloke, Founder and Developer of Thrive Income Distribution System. Curtis is an award-winning retirement income expert who has established an agnostic retirement planning approach utilizing the math and science of income annuities to help create more income while utilizing less of the client's portfolio. In 1999 he discovered the modern DIA and began development and framing DIAs into the retirement planning model along with other traditional investments options.   His work is utilized by The American College where he also serves as Adjunct Instructor for classroom studies.

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IRS Notice Paves Way for Easier Tax-Free Roth Conversions of After-Tax Dollars

*By **Denise Appleby**, CISP, CRC®, CRPS, CRSP, APA, President of Appleby Retirement Consulting, Inc.*

Denise Appleby, APA, CISP, CRPS, CRC, CRSP – IRA Strategies for Mistakes Prevention Expert

If you are one of the many financial/tax professionals who have been seeking clarity about converting after-tax amounts to Roth IRAs tax-free, IRS Notice 2014-54, issued September 18, 2014, provides welcome answers.

While there was never any question that after-tax amounts can be converted to Roth IRAs tax-free, there was uncertainty about whether such an objective could be accomplished without either including pre-tax amounts, or by using a three-step process which required the payor to withhold 20% of the pre-tax amount for federal income tax. IRS Notice 2014-54 makes it clear that the objective can be accomplished with a one-step process without any tax withholding.

Note: After-tax amounts accrued before 1987 are not subject to the pro-rata rule. As such, this article focuses on after-tax amounts contributed after 1986.

Effective Date

The rules provided in Notice 2014-54 become effective for distributions processed January 1, 2015 and after. However, transitional rules have been included for distributions processed before then.

Previous Guidance- IRS Notice 2009-68

The IRS issued IRS Notice 2009-68 in 2009, which included language that plan administrators could include in distribution notices to recipients of eligible rollover distributions. In part, Notice 2009-68 provided that if a distribution from a qualified plan or 403(b) is split between a direct rollover and a distribution to the participant, each payment would include a pro-rata amount of any after-tax and pre-tax funds. It also provided that if a participant receives a distribution to him or herself, and rolls over a portion of the distribution, the amount rolled over would come from the pre-tax amount first.

The following example was provided in Notice 2009-68:

“Assume you are receiving a complete distribution of your benefit which totals $12,000, of which $2,000 is after-tax contributions. In this case, if you roll over $10,000 to an IRA in a 60-day rollover, no amount is taxable because the $2,000 amount not rolled over is treated as being aftertax contributions”.

While the IRS did not address the issue of splitting a direct rollover between a Roth IRA and a traditional IRA, many felt that without guidance that said otherwise, so the only way to complete a tax-free Roth conversion of after-tax amounts (from a qualified plan or 403(b)), was to use the following three step process:

1. The amount distributed is paid to the participant.
2. The participant rolls over the pre-tax amounts to a traditional IRA. The remaining amount would be after-tax funds
3. The participant rolls over the after-tax amount to a Roth IRA as a conversion

The challenge with this method is that the payor would be required to withhold 20% of the pre-tax amount for federal income tax. And, for those who also perform state tax withholding, the required tax-withholding amount could be more than 20%. In such cases, participants who wanted to rollover the entire withdrawal would need to make up the taxes withheld out of pocket. For those who could not afford to do so, the rollover would be short the withholding tax amount.

Example:

Assume that Jim has a 401(k) balance of $500,000, of which $100,000 is after-tax.

If Jim requests to have the $500,000 paid to him, the plan administrator would be required to withhold $80,000 for federal income tax ($400,000 x 20%).

Jim would receive only $420,000.

In order to rollover the entire $500,000, Jim would need to make-up the $80,000 out of pocket.

IRS Notice 2014-54 Provides More Favorable Solutions

According to Notice 2014-54, distributions from a qualified plan or 403(b) that are scheduled to be paid at the same time are treated as a single distribution, even if the amount is paid to multiple locations. This allows pre-tax and after tax amounts to be segregated when paid to multiple locations, instead of each amount including a pro-rata allocation (of the pretax and after tax amounts).

Notice 2014-54 also provides that if a portion of a distribution is processed as a direct rollover to an eligible retirement account, and a portion paid to the participant, the pre-tax portion of the account balance would be allocated to the direct rollover first. The same treatment would be applied to an amount paid to the participant, when a portion of that distribution is rolled over within 60-days of receipt (60-day rollover).

Finally, participants can choose how pre-tax and after-tax amounts are allocated among direct rollovers to multiple retirement plans. In such cases, the participant must inform the plan administrator of the allocation prior to the direct rollovers being processed.

The following are examples of options available to participants with after-tax and pretax amounts in a qualified plan or 403(b) account.

Example:

Assume that Jim has a 401(k) balance of $500,000, of which $100,000 is after-tax. The following are some of the options available to Jack, and the instructions he would provide to the plan administrator.

Objective 1: No income tax owed and tax-free conversion of $100,000

- Submit instructions for withdrawal of $500,000
- Instruct plan administrator to split amount as follows:
    - Direct rollover of $400,000 in pre-tax amount to traditional IRA. No tax withholding would apply. Amount would continue to be tax-deferred. Earnings would grow tax-deferred
    - Direct rollover of $100,000 of after-tax amount to Roth IRA. No tax withholding would apply. Transaction would be tax-free. Qualified distributions would be tax-free

Objective 2: No income tax owed and tax-free distribution or conversion of $100,000

- Submit instructions for withdrawal of $500,000

- Instruct plan administrator to split check as follows:
  - Direct rollover of $400,000 in pre-tax amount to traditional IRA. No tax withholding would apply. Amount would continue to be tax-deferred. Earnings would grow tax-deferred
  - Distribution to Jack of $100,000 in after-tax amount. No tax withholding would apply. Transaction would be tax-free. Jack can keep amount or rollover amount within 60-days. If the amount is rolled over to a Roth IRA, it would result in a tax-free conversion. Qualified distributions would be tax-free

Objective 3: Mandatory 20% tax withholding, tax-deferment of pre-tax amount and tax-free conversion

- Submit instructions for withdrawal of $500,000
- Instruct plan administrator to distribute entire $500,000 to Jack. Plan administrator must withhold 20% ($80,000) of the pretax amount of $400,000.
- Jack receives only $420,000.
- Jack rolls over $400,000 to his traditional IRA. This would come from the pre-tax amount. Amount would continue to be tax-deferred. Earnings would grow tax-deferred
- Jack has $20,000 remaining, all of which is after-tax. Jack can:
  - Make up the $80,000 out of pocket and rollover $100,000 to a Roth IRA. All of this would be after-tax. Conversion would be tax-free. Qualified distribution would be tax-free
  - Make up less than $80,000 and rollover the amount to a Roth IRA. All of this would be after-tax. Conversion would be tax-free. Qualified distribution would be tax-free
  - Rollover the $20,000 to a Roth IRA. All of this would be after-tax. Conversion would be tax-free. Qualified distribution would be tax-free

Any amount not rolled over would still be nontaxable, as it would come from the after-tax amount of $100,000.

Any amount withheld is paid to the IRS as an advance tax withholding amount for Jack.

Objective 4: Split after-tax and pre-tax between traditional IRA and Roth IRA

- Submit instructions for withdrawal of $500,000
- Instruct plan administrator to split amount as follows:
  - Direct rollover of $400,000 to traditional IRA – $350,000 pre-tax and $50,000 after-tax. No tax withholding would apply. Amount would continue to be tax-deferred. Earnings would grow tax-deferred.
    - Any subsequent distribution or Roth conversion from any of the individual’s Traditional, SEP or SIMPLE IRA will include a pro-rata amount of pretax and after tax amounts. IRS Form 8606 must be filed for any such distributions or conversions, so as to ensure that the after-tax portion is nontaxable.
  - Direct rollover of $100,000 to Roth IRA. $50,000 pre-tax and $50,000 after-tax No tax withholding would apply. $50,000 would be taxable. Qualified distributions would be tax-free

While these examples show rollovers to traditional IRAs and Roth IRAs, eligible amounts can be rolled over to qualified plans such as 401(k) plans, 403(b) plans and governmental 457(b) plans as well. After-tax amounts can be rolled over to a qualified plan or 403(b), only if done as a direct rollover, and only if allowed under the plan. After-tax amounts cannot be rolled over to a 457(b) plan.

Distributions before January 1, 2015

For distributions from qualified plans or 403(b)s that occur before January 1 2015, the rules as explained above can be applied to the transaction. Clients should obtain confirmation from plan administrators regarding the approach they – the plan administrators – will take, and ensure that the tax reporting done of their tax return corresponds to the plan administrator's.

Final Note: IRA Distributions Not Affected

The rules explained above apply to distributions from qualified plans and 403(b) plans. They do not apply to distributions from IRAs. As such, the pro-rata rule that applies to distributions from traditional, SEP and SIMPLE IRAs, when the owner's traditional IRA balance includes basis still applies.

__Denise Appleby__, CISP, CRC®, CRPS, CRSP, APA, President of Appleby Retirement Consulting, Inc., provides technical consulting, coaching and marketing-content to financial, tax and legal professionals. She has more than 15 years' experience in the IRA and defined contribution plans fields. She has held several senior retirement plans related positions with Pershing LLC and has written over 400 articles for many newsletters, newspapers and website.

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Denise has co-authored the following three books on retirement accounts:

– ***Roth IRA Answer Book***
– ***Quick Reference to IRAs***
– ***Adviser's Guide to Retirement Plans for Small Businesses***

She has also provided technical editing to several other retirement plan-related books.

Her expertise and knack of explaining complex retirement plans rules and regulations so that they are easily understood, led her to create several professional and client Quick Reference and other aides which we'll share more about with you at the end of this session.

Denise is a Rutgers State University graduate, holds the following professional certifications:

- *Certified IRA Services Professional (CISP), Institute Of Certified Bankers, Washington DC*
- *Certified Retirement Counselor® (CRC®), International Foundation for Retirement Education (InFRE)*
- *Accredited Pension Administrator (APA), National Institute of Pension Administrators, Chicago IL, among others*

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