Cautionary Tales

The Importance of Beneficiary Reviews

Robert Vashko
Advanced Sales Consultant
Lincoln Financial Distributors

November 19th, 2021

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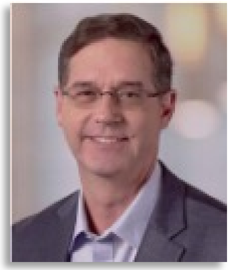
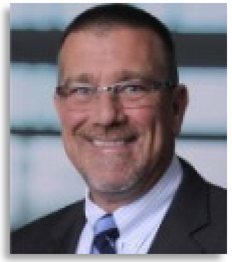
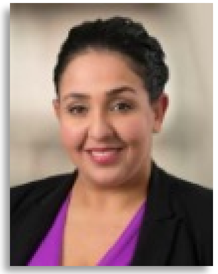
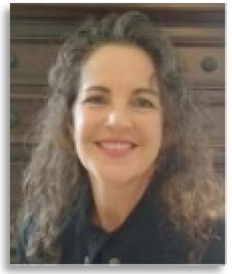
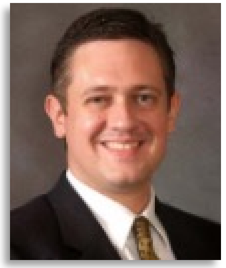
Lincoln Annuity Advanced Sales Team











From conversations to contract structuring – we're a tenured team of industry professionals here to help. We consult, educate and collaborate on a wide array of client situations.

Our goal is to share our expertise and resources to help you uncover new opportunities, attract new clients, expand your centers of influence, and create a richer experience for you and your clients

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Sales strategies: Annuities

1035 exchange by a beneficiary
Gives beneficiaries tax-efficient options for unwinding inherited assets

Trusts and annuities
Leverages industry-leading expertise to best position trust assets for tax deferral and income

Lifetime gifting
Repurposes unwanted, unneeded or unused annuities into the gift of income for a loved one

Special needs planning
Provides long-term security and income for those caring for a loved one with special needs

Multigenerational income
Creates an income stream that spans multiple lifetimes

Income before age 59½
Helps clients retire earlier with protected lifetime income

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How Many Annuity Beneficiaries Are Out There?

Since 2005:

Immediate Annuities (SPIAs/DIAs)	Traditional Fixed Annuities	Fixed Index Annuities	Traditional Variable Annuities (including IOVA)	Registered Index-Linked Annuities (2018-2020)
$153B	$639B	$683B	$2.3T	$47B

Source: The Cerulli Report, "U.S. Annuity Markets 2020: A Decade of Adaptation," Exhibit 2.01, p. 37 (2020).

Agenda

1 Why are regular beneficiary reviews so important?

2 The pitfalls of not performing regular beneficiary reviews

3 Good questions to ask during a beneficiary review

4 How an annuity beneficiary review can streamline a client's entire legacy plan

The Importance of Beneficiary Reviews

How Do Beneficiary Errors Arise?

Financial planning is dynamic

- Changing lives
- Changing priorities
- Changing goals

Death

Career Change

Divorce

Remarriage

New Baby

Health Issues

Disinheritance

How do beneficiary errors arise?

- Distractions
- Procrastination
- Forgetting (or "forgetting")
- Not knowing

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The Timing of Problem-Spotting

Potential problem

Spotted <u>before</u> the client passes away

Permanent problem

Spotted <u>after</u> the client passes away

Real-life Cautionary Tales

Second Marriages

From:, [redacted]
Sent: Tuesday, April 09, 2019 1:46 PM
To: [redacted]
Subject: RE: Unintended outcome

40-year-old couple. The husband was married previously; the wife was never married. They were married six weeks when he suddenly and unexpectedly passed away. The wife hadn't even sent out the thank you notes from the wedding before she was sending out obituary notes. He had a qualified plan, and never changed the beneficiary on it after they married, although he did update his will. However, as you now know, beneficiary designations supersede anything in a will. We had no choice but to pay the qualified pan asset to the first wife.

It was a sad story and with an unhappy ending.

[redacted]

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Former Spouses

Bill (plan participant)

Liz (spouse)

Bill names Liz as sole primary beneficiary on his retirement plan)

Bill (plan participant)

Liz (spouse)

Divorce decree, which Liz signed, terminated her right to Bill's retirement benefits; Bill never removed Liz as beneficiary.

Bill later died, naming his daughter Kari as sole beneficiary of his estate.

What was the result?

1. Kennedy v. Dupont, 129 S.Ct. 865 (2009)

State Law vs. Federal Law

Liz, the ex-spouse, received all the money

Why?

- **Bill's retirement plan was governed under ERISA**
- **A state divorce decree cannot override or supersede federal law**
- **ERISA rules, as well as the plan document itself, required payout to the designated beneficiary, whoever it may be**

1. Kennedy v. Dupont, 129 S.Ct. 865 (2009)

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Auto-revoke Statutes

Warren (federal employee)

Judy

Warren names Judy as sole primary beneficiary on his employer-sponsored life policy)

Warren (plan participant)

Jackie

- Warren died, and was survived by Jackie.
- Warren never removed Judy as beneficiary on policy.
- Virginia is an auto-revoke state

What was the result?

State Law vs. Federal Law

Judy, the ex-spouse, received the death benefit.

Why?

- **Warren's life policy was governed by the Federal Employees' Group Life Insurance Act**
- **State auto-revoke statutes cannot supersede federal law any more than state divorce decrees can**

1. Hillman v. Maretta, 569 U.S. 483(2013)

Failure to Include Contingent Beneficiaries

John (Plan participant) ❤ **Joyce**

Joyce = sole beneficiary of John's pension plan

John's step-sons (though Joyce) = Stephen & Michael

Joyce dies, but John does not update his beneficiary designations on the plan

John later dies, with Joyce still listed as sole beneficiary
NO CONTINGENT BENEFICIARIES LISTED

Plan terms: with no designated beneficiaries, benefits were payable in following order:

1.) Surviving spouse
2.) Surviving children
3.) Surviving parents
4.) Surviving siblings
5.) Decedent's estate

What was the result?

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Failure to Include Contingent Beneficiaries

John's $300,000 pension benefit was left to his six siblings, none of whom were named in his will.

Why?

- "Children" defined by plan admin are either biological or legally adopted
- Unadopted step-children did not count as "children"

~~Surviving spouse~~
~~Surviving children~~
~~Surviving parents~~
Surviving siblings
Decedent's estate

1. Herring v. Campbell, 690 F.3d 413 (5th Cir., 2012)

Naming (or Defaulting to) the Estate as Beneficiary

Naming your estate as beneficiary subjects the assets to probate, which is:

- Time-consuming
- Expensive
- Public
- Loss of IRA and NQ annuity distribution options

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Naming Your Estate as a Beneficiary

"I'll just leave everything to my estate and let my will sort it out."

Larry | Jane (spouse)

Larry's IRA ($400,000) → Larry's estate

Larry's will → Jane (spouse)

What was Jane able to do with the IRA when Larry died?

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Naming Your Estate as a Beneficiary

Roll it into her own name?	NO
Take it as a beneficiary IRA and stretch it?	NO
Cash it out and have a check made out directly to her?	NO

Lump-sum or out-in-five to the estate.
$400,000 at 37% marginal rate = $148,000 tax bill.

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Non-spousal Joint Ownership

Grandma (Virginia, 83)

Granddaughter (Sandy, 37)

Non-qualified annuity
Basis = $130k
Deferred gains = $200k
Total cash value = $330k

Grandma adds Granddaughter as a joint owner

BEFORE
Owner: Grandma
Annuitant: Grandma
Beneficiary: Granddaughter

AFTER
Owner: Grandma & Granddaughter
Annuitant: Grandma
Beneficiary: Granddaughter

What was the result?

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Non-spousal joint ownership

Non-qualified annuity
Basis = $130K
Deferred gains = $200K
Total cash value = $330K

Adding Granddaughter as joint owner

- Gift by Grandma
- Full ownership rights to Granddaughter
- Lump-sum taxable event - **$200K of taxable income to Grandma!**

What if Granddaughter pre-deceases Grandma?

- No joint tenancy with rights of survivorship
- Death of either owner triggers a death benefit
- **Another taxable event for Grandma!**

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Owner- vs. annuitant-driven contracts

Owner-driven contract

Owner: Mom & Dad
Annuitant: Son
Bene: Daughter-in-Law

→ Son dies → Nothing. Contract remains in-force

Annuitant-driven contract

Owner: Mom & Dad
Annuitant: Son
Bene: Daughter-in-Law

→ Son died → DB triggered, paid to Daughter-in Law

Mom & Dad effected a gift to Daughter-in-Law

1099 on DB issued to Mom & Dad

Mom & Dad paid a 10% penalty

Trust-owned Contracts = Annuitant-driven

From: [redacted]
Sent: Tuesday, April 09, 2019 5:51 PM
To: [redacted]
Subject: RE: Unintended outcome

[redacted],

One we just avoided was a joint trust as owner and dad as annuitant and daughters as beneficiaries. They wanted the annuity to pay to both parents and then to daughters upon the last death. With dad older and more sickly than mom, this wouldn't have worked out quite like they thought.

[redacted]

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Missing the Non-qualified Stretch Option

“Similar stories (different $ amounts), but the advisor/beneficiary never had a conversation about choices at death. Sixteen months after death and they would like to do something. Too late, stuck in a five-year payout.”

“One major area that I see that is an issue — when a client doesn’t realize that they can do a 1035 exchange I’ve had a client that lump-summed a 600K DB with a 200K cost basis because they didn’t know a 1035 was avail. They just lump-summed it and paid all the gains. No good for anyone.”

“Parent left NQ annuity to adult child. The beneficiary wasn’t informed on the ability to execute a deceased 1035 and took a lump sum of $3.1M with a cost basis of $1M. I have many of these stories; they just vary a little.”

Naming a Trust as Beneficiary

Dad (Robert)

Credit Shelter Trust
$400K

Trust purchases a non-qualified deferred annuity

Owner: Trust
Annuitant: Mom (Julia)
Bene: Trust

Son (William) is beneficiary of the trust *but not beneficiary of the annuity.*

Trust language: *"Upon Julia's death, begin a non-qualified stretch on William's behalf."*

Mom dies
DB = $1.2MM

What was the result?

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Naming a Trust as Beneficiary

Lump-sum distribution to the trust of $1.2MM

$800K of gains taxed at 36% vs. 26%

$80,000 tax inefficiency

- **Nonqualified stretch is for *natural* beneficiaries (living, breathing people)**
- **Trusts can't cannot "bootstrap" a NQ stretch off the natural trust beneficiaries**
- **Trust language cannot supersede IRS statues, rules, regulations or the terms of the annuity contract**

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Naming a Special Needs Individual as a Beneficiary

Owner: Mom
Annuitant: Mom
Beneficiary: Brian & Trey (50/50)

Trey is collecting SSI and Medicaid

Mom passes

$300,000 → **Brian**

$300,000 → **Trey**

Trey disclaims his share of death benefit to preserve his government benefits

What was the result?

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Naming a Special Needs Individual as a Beneficiary

Trey received none of the money, yet was still disqualified from receiving benefits

Why?

- Disclaimers can help avoid income tax, but generally do not work with regard to "countable assets" for SSI/Medicaid
- "You can't disclaim something you never had rights to"
- Medicaid treated the $300,000 of death benefit as a "countable asset" for Trey, even though he had disclaimed to Brian

Medicaid/Nursing Home "Spend-down"

To be "Medicaid-friendly," an annuity must generally be:

Annuitized
Income is turned on at or prior to application for benefits

Noncancelable
Cannot surrender for cash value

Non-assignable
Can't be sold, and the Dept. of Medicaid must be irrevocable beneficiary

Actuarially sound
Payments must be structured no longer than applicant's life expectancy

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Medicaid/Nursing Home “Spend-down”

Anticipates need for nursing home care. Wants to apply for Medicaid.

Madeleine (74)

Has $250K of liquid assets in her name

Places $250K into single-premium immediate annuity

Owner: Madeleine
Annuitant: Madeleine
Bene: Daughter (Kelly)

Madeleine no longer has $250k of countable assets?

Annuity was *not* “Medicaid-friendly” in Madeleine’s state

She couldn’t qualify for Medicaid

She couldn’t cash out the SPIA

The SPIA didn’t provide enough income to cover the nursing home

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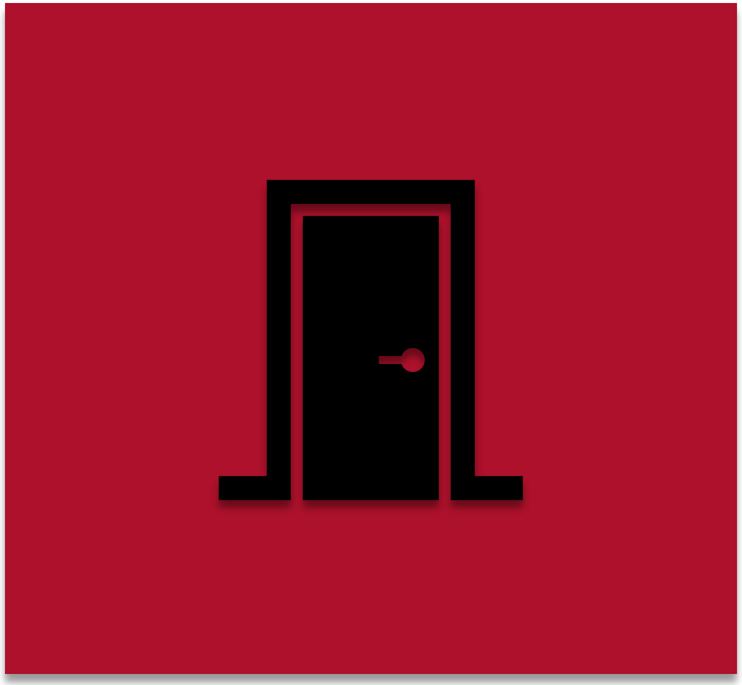
What Makes a Good Beneficiary Review?

Types of Questions During a Beneficiary Review

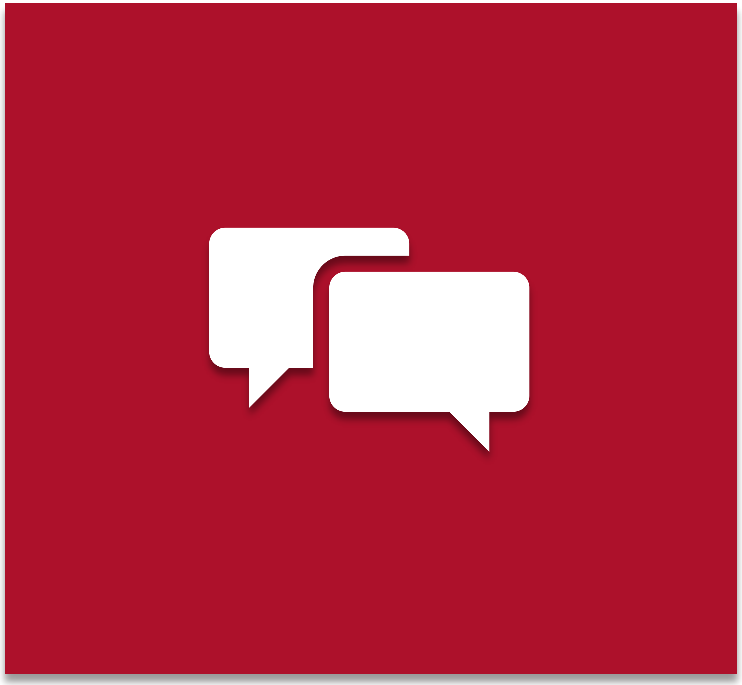


Close-ended Questions

"Did you watch the Saints game yesterday?"

Open-ended Questions

"What did you do for the holidays?"



Impact Questions

"What are the top three priorities in your life right now?"

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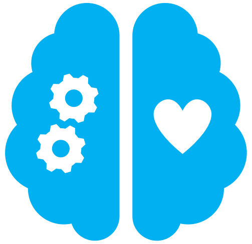
Why Are Impact Questions So Important?

Give you insight into the client’s thought process



Help the client think critically and analyze their current situation

Demonstrates that you truly want to understand

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Suggested Impact Questions - Existing Client

- **Can you tell me about any new additions to your family since we last met?**
- **What changes in family dynamics have you experienced since we last met?**
- **Have you made any gifts in the last year that may require a shift in how the annuity death benefits are divided up?**
- **Will any of your beneficiaries want or need their share of the death benefit up-front in a lump-sum?**

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Suggested Impact Questions – New Client/Prospect

- When was the last time you and your advisor reviewed the beneficiary designations on all of your accounts?

- Can you share the names and ages of the people (or organizations) who matter most to you in the world? How would you like to be remembered by these people?

- Do you have any heirs who are currently unable to responsibly manage their financial affairs?

- Have you created any trusts as part of your legacy planning? If so, can you tell me about the trust's purpose and goals?

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Trust Your Process

Design a Process

Stick to It

Schedule Regularly

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Streamlining a Client's Entire Legacy Plan

Coordination of Accounts

“Financial quarterback” – reads the entire field and calls the plays

“Comprehensive financial advice” – one-stop shopping

“Top-down” – start with the goals first, and then work into strategies and products

“Efficient organization of assets” – avoids redundancies in fees and mismatched asset allocation

All of the above?

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Why Don’t Clients Consolidate?

- They designate “specialists”
- They don’t fully trust the advisor
- They have the advisors compete
- They can’t consolidate
- They don’t see the benefits

Consolidation is ideal

but

Coordination is *critical*

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Coordination for Legacy Planning

Different goals for different heirs	*"I want to fund 529 accounts for my grandkids…"*
Different tax situations	*"Bobby is doing well, so he doesn't need the money up-front…."*
Different assets	*"Megan is the one who always loved the house…."*
Different amounts	*"I helped Kevin buy a car, so he should get less than Beth…."*
Different personalities	*"Jimmy shouldn't be trusted with a bunch of cash…."*

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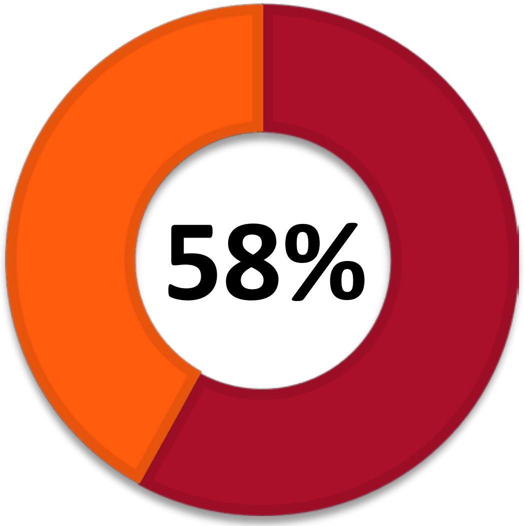
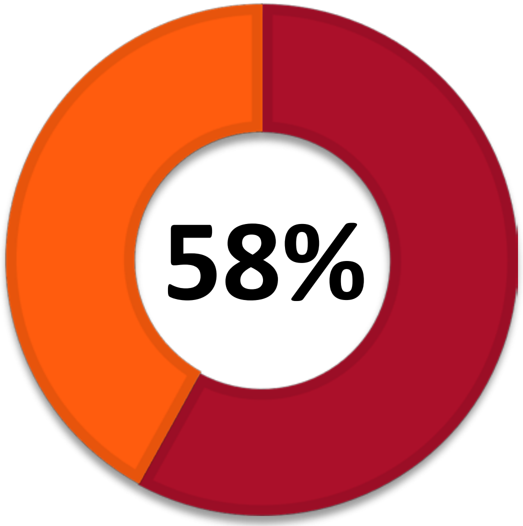
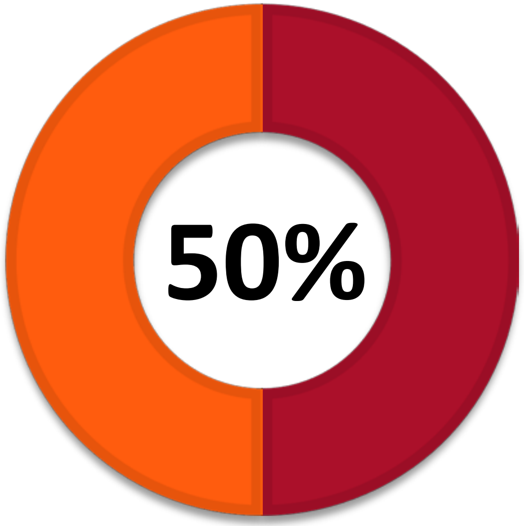
Clients Aren’t Talking to Their Kids….



Uncomfortable sharing financial data with children



Fear that children are unprepared to inherit wealth



Unwilling to give up control to the next generation

The Cerulli Report, “U.S. High-Net-Worth and Ultra-High-Net-Worth Markets,” Exhibit 8.11, p. 149 (2020).

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…And Neither Are Most Financial Professionals

Meet with children more than once a year

28%

Meet with the children once a year or less

54%

Do not meet with any of the children

18%

Source: Liz Skinner, "The Great Wealth Transfer is Coming, Putting Advisers at Risk." *InvestmentNews.* July 13, 2015.
http://www.investmentnews.com/article/20150713/FEATURE/150719999/the-great-wealth-transfer-is-coming-putting-advisers-at-risk.

The Family Mission Statement

A sense of purpose

Align ideals

A baseline for decision-making

Avoid confusion, disagreement and contention

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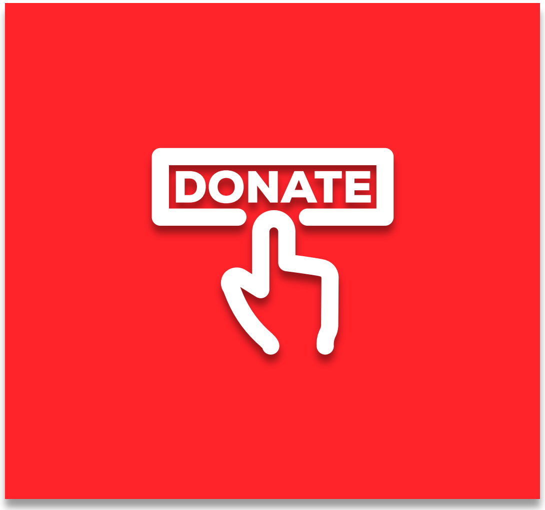
The Family Mission Statement

Events that helped build family wealth, such as achievements, failures and adversity



Ties to the community, charities or philanthropic pursuits

Family values, including religious, educational, moral and political

Family traditions, such as celebrations, memorials and vacations

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Summary

Recap

- **Beneficiary reviews are critical to the financial planning process**
- **Regular review help ensure that a client's legacy wishes are fulfilled**
- **Impact questions during a review can proactively address "hidden problems"**
- **Coordination across all of a client's accounts and assets can streamline the wealth-transfer process for everyone**

What You Can Do Today

- **Start by scheduling regular beneficiary reviews with your clients**
  - *Explain how being proactive will help them ensure that their legacy wishes are fulfilled*
- **Ask to include their children in the discussions**
  - *Family members who are included are more likely to “stay the course”*
- **Explain how important it is for them to keep you updated on any changes**
  - *Maintaining a regular review schedule will help this process*
- **Confer with your clients’ tax and legal advisors**
  - *Make sure you’re all on the same page*

Your Lincoln Wholesaler Is Here to Help

Reach out to your Lincoln wholesaler to discuss a beneficiary review of your existing annuity book of business

Improvements in annuity titling usually suggest improvements can be made in other accounts (e.g., employer plans, life policies, etc.)

Lincoln's Advanced Sales team is ready, willing and able to assist in tackling unique and complex situations

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Thank you

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