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The workshop license includes:

- Full-color, 40-slide PowerPoint presentation with script
- content for a one-hour seminar
- Annual updates

What attendees say about the workshop:

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"Great information and explained some questions that I was unsure about. The session was very helpful and pertained to my situation."

"Some of the best information I have ever received about financial planning for retirement."

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New Horizons in Estate Planning

Steve Parrish, JD®, RICP®, CLU, ChFC®, AEP®, Co-Director Retirement Income Center and Adjunct Professor of Advanced Planning at The American College

Editor's note: This article is an adaptation of the live webinar delivered by Steve Parrish in 2021. His comments have been edited for clarity and length.

You can read the summary article here as part of the 2nd Qtr 2021 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)
You may also choose to take the full length course New Horizons in Estate Planning for 1.0 hour continuing education (CE) credit.

By Steve Parrish, JD®, RICP®, CLU, ChFC®, AEP®, Co-Director Retirement Income Center and Adjunct Professor of Advanced Planning at The American College

Estate planning is typically not a top of mind for consumers. However, lately, it has been a hot topic. I was surprised earlier this month when I was watching TV, and the local news headline from the 11:00 pm anchor was, "Estate planning is more important after COVID; why you don't want to do this alone on tonight's 11:00 news."

However, estate planning is very much back in vogue. Aretha Franklin and Prince died without a will, and we heard about all the problems and consequences. More recently, Tony Shay died at a very young age, again without a will. It's no longer a matter of just estate tax planning. It's talking about estate planning in general.

Now, there's more flexibility in the law. When I was in law school, there were no such things as living wills or the idea of physician-assisted suicide; none of that existed. We've had the effects of the pandemic when people saw these tragic things happening and nothing they could do about it. This was the wake-up call. Then, we had the SECURE Act, the CARES act, and whatever we have on upcoming changes on the financial side. Anytime you have a change in tax law, it also affects estate planning.

I teach both law students and financial advisors about estate planning. A lot has changed. Significant changes were already occurring before the pandemic hit. But then, when people saw loved ones going into hospitals without the ability to have another speak on their behalf, it was a wake-up call. My friends who are estate planning attorneys are besieged with appointments and requests for estate planning documents.

As financial advisors, if we do this right, we can move our trustworthy status with the public further away from mechanics and politicians and closer to doctors and accountants. In other words, building estate planning into your financial planning advisory practice really can help build that trust factor.

Eight Major Shifts or Horizons in Estate Planning

My comments here are focused on financial advisors. What do you need to know about the new things happening in estate planning?

1. Estate planning has become more and more a part of financial and retirement planning. It used to be a separate discipline that essentially estate planning attorneys did.
2. There's much more of a focus on longevity versus mortality. In other words, living too long, as well as dying too soon.
3. In the tax arena, it's changed quite a bit. Now, we're talking about required minimum distributions and inherited IRAs and income taxation when you die versus estate and Gift and generation-skipping taxes. It's much more emphasis on the income side.
4. Life insurance for estate planning purposes was typically put in an irrevocable life insurance trust, and you were done. Now, it's become much more of a wealth management tool.
5. End-of-life planning has become the new planning motivator. What gets clients into offices is more the issue of what happens at the end of life. A lot of that's was sparked because of COVID-19.
6. Housing is a critical challenge and opportunity. So much of our net worth is tied up in our housing. There are new ways to release some of that equity and use it in retirement and estate planning.
7. Elder law and family law have increased importance because of what's going on and have key aspects of integration with estate planning.
8. There are new estate planning topics and issues such as pet estate planning and digital estate planning because we need to incorporate those in our thinking.

Estate Planning is Part of the Financial Planning

It used to be when you heard the term "estate planning," you thought of rich people and estate tax planning. That has changed quite a bit because the estate tax only currently applies to a very small elite group of typically wealthy people. When you say "estate planning" now, it's part of that whole planning process that you do when you're doing financial planning.

There's now an emphasis on living versus death and estate planning. Because estate planning is not just an after-death thing anymore, it also involves living receive much more attention, such as, "What happens if I have a disability or become capacitated?" Or "Is there somebody that can speak for me with a pow

attorney?" Also, what about end-of-life? COVID got a lot of this going. Do I have a say in managing my death? And now there's a lot more opportunity to do that. And finally, the whole idea of longevity versus mortality. People are thinking about that more than just dying too soon.

I write a column on retirement planning in *Forbes*. If anything in this article sounds like something you want to hear more about, you'll see that I have an article on it.

Longevity versus Mortality

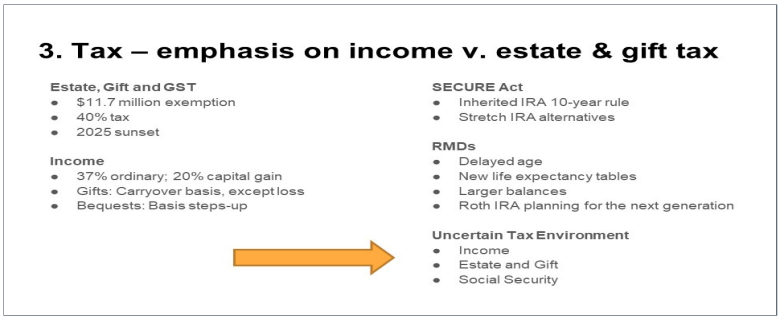
When I was young, an uncle in his early 40s was walking down the street. He suddenly clutched his chest, fell over, and died of a massive heart attack. I also have an aunt who lived well into her 90s. The challenge she had is that for over 25 years, she had dementia, which turned into full-blown Alzheimer's. For 20 years, she didn't even know her own kids' names.

People now associate more with the issue of my aunt living into her nineties with Alzheimer's than the idea of someone in their young 40s dying early. Living too long has become more pressing than dying too soon. This has been mainly seen with affluent trends in life expectancy, even with COVID last year, where mortality went worse rather than better. As far as the affluent, their life expectancy still improved. What happens when you have that conflict between dying too soon and living too long is at the client level, they worry about, "I need to have enough retirement income stream so that I can live my whole life comfortably, and I don't know how long that is." But, most of these individuals also would like to leave a legacy for their children or grandchildren. Now the two are running into each other, and that's part of the planning process.

Then, we have a challenge that has evolved over the last 10 – 15 years: life expectancy and life quality can disconnect. Longevity no longer necessarily equals the quality of life because you could be hooked up to a feeding tube or a respirator. Suddenly people realize, "Oh, okay, living a long life does not necessarily mean leading a good life." Then, you add in COVID-19, which caused people to realize they didn't want to suddenly be rushed into a hospital, not have anyone speaking for them, suddenly be intubated, have a respirator, and have no say over what's going on. This is the emphasis on longevity versus mortality.

Emphasis on Income versus Estate & Gift Tax

Where are we with the state gift and generation-skipping trust? We have an $11.7 million exemption level this year. When the tax hits, it hits big, at 40%. It's a cliff tax.



Remember that when 2025 is over, the current law sunsets and goes back to an exemption of about half of that. That's where we are right now. What about income tax? We're sitting at a 37% top marginal income tax bracket, but that's only when a couple hits about $600,000 in income. We also have a 20% maximum capital gain tax.

As far as gifts, if you make a gift for estate planning purposes, the lower of the basis or the fair market value will carry over. Any gain is going to be taxed when the donor sells it. However, if you receive it in a will, then the basis steps up.

The SECURE Act came in and significantly changed Inherited IRAs. If you inherit an IRA from someone and if you're an adult, you're going to have to liquidate that within ten years. It used to be that that could be stretched over your lifetime.

Because of that, people are not just assuming that when you inherit an IRA, it's going to be stretched. Now people are asking, "What are the alternatives? Maybe life insurance? Maybe charitable remainder trusts?" So, a lot has changed.

This leads to another issue that certainly has been sparked in part because of the SECURE Act, and that's required minimum distributions. The SECURE Act delayed the age at which you have to begin drawing down your IRAs from age 70½ to 72. They're talking about moving it up to age 75; we'll see. Another thing people aren't always aware of is that they also increased the life expectancy tables. They did this late November last year, but they're not effective until January 2022, where they're assuming people at retirement age will live about two years longer than the tables used to assume.

Because of this, you're now can draw down less than you had to before from your retirement savings. This means that many people will have larger balances, leading to more planning for the next generation, not just the donor or the decedent. We're looking more and more at Roth IRA planning and trying to get the taxes down for the beneficiary.

In addition, we have this uncertain tax environment. We know that there's talk about increasing the top income tax bracket from 37% to 39.5%. The scary one to me is bringing capital gains rates to that amount. When you add into that the 3.8% net investment income tax (NIIT) for higher-income earners, you're talking about over a 40% tax on potential capital gains.

In the estate and gift arena, a lot is going on there. They're talking about maybe moving the gift tax exemption as low as $1,000,000 and the estate tax exem
three and a half million dollars. There's also a discussion about what to do to shore up Social Security. There's been the idea that you would still have a cap

wages at about $140,000 or so on Social Security, but then when you make more than $400,000, they kick in the 12.5% FICA tax again. I'm not saying all these tax changes are going to happen. I am saying there's the potential that some of those can happen, and we must factor that in.

How do you plan your estate when the tax law may be changing? A way to look at it from an estate planning standpoint is first to say, "What's my target at the tax level? Is it estate tax and gift tax? Or is it more on the income tax side?" If your target tax level is on the estate side, we need to do 'now strategies' to freeze assets and leverage the higher exemption while still here. And so, there is much talk now with high net worth and ultra-high net worth clients about doing gifting to get those appreciated assets out using the $11.7 million exemption.

Planning Your Estate When Tax Laws May Change

They're also talking about taking away some of our toys in the estate tax planning like GRATS, so people are talking about, "Let's beat the buzzer and set up GRATS now so that we can get all that appreciation out of the estate." Many of the strategies we're talking about are also trying to lower valuations so that to the extent they're going to be taxed, they get taxed at a lower valuation.

Businesses that are in the process of being sold are trying to advance the dates on it so that they can do an installment sale and maybe pay the lower capital gains. They also do things like locking in the value instead of appreciating assets by putting them in the family limited partnership.

And finally, try to move some of the money out by putting it into an irrevocable life insurance trust (ILIT) while you still can. Use the exemption to move some of the premiums out and put them in an ILIT that's outside of the estate. For the high net worth and the ultra-high net worth clients who are worried about the estate tax, we're completely changing the retirement draw-down technique because they'll need to take their taxable income first. They will draw down their IRAs because every dollar that the grantor or the decedent pays in taxes is a dollar that is not subject to the gift tax.

All of this is different than what most people have been doing. Compare and contrast. What if, as is the case with most of us, we're looking at income tax as the primary issue? When you're focused on income tax, you're starting to look at things like tax characterization, and timing how you're going to all do it. Because people are gifting out now, if income tax is the issue, maybe you want to do it by bequests rather than by gifts, because that way you get the step-up in cost basis.

There are other options like Roth conversions so that you're spreading out the income and coming up with less of a tax burden for beneficiaries. You are figuring out how to keep your tax brackets lower so that you don't have to pay the higher Medicare Part B premiums (IRMAA premiums) that are a penalty for making too much money or losing some of the deductibility you have for a closely held business under the qualified business interest.

What you're trying to do is work your tax brackets. Another thing you're trying to do is retain value rather than lower valuation. A lot of it has to do with tax bracket timing with IRAs.

A SECURE Act IRA Example

Let's say that you had a client who turned age 70½ last year (2020). I'm using last year for a particular reason. This individual has about $2 million that they've built up an IRA. None of it is in a Roth. If we hadn't had the SECURE Act and if we hadn't had the new life expectancy tables, they would have this $2 million balance, and required minimum distributions would have to start.

If they took it out over ten years (I use a zero-interest rate to make it easy), that $2 million burns down to about 1.2 – $1.3 million ten years later because they had to take required minimum distributions (RMDs). However, along comes the SECURE Act and the CARES Act, plus these newly-revised life expectancy tables starting next year.

This 70-year-old now doesn't have to take required minimum distributions until they turn 72, which will be this next year. In addition, the new life expectancy factors assume people will live two years longer than we thought before. Because of this, the RMD factor is smaller, so they don't have to take out as much.

After ten years, they will have $1.4 million because of these changes. That means they have an 11% higher balance ten years down the road. Let's say they then die. What's the consequence to the beneficiary?

With the beneficiary, you've got the 10-year rule instead of the stretch IRA rule where they have to liquidate the IRA within ten years the year after the date of death. So, what does this really mean for the beneficiary? First of all, that means you're going to be taking in money earlier, which means higher marginal tax rates. Remember that when I say beneficiary, if somebody dies in their 80s, that typically means it might be an adult kid who's in their 50s.

So now they're in a higher marginal tax bracket. That also means that they're going to have more taxable income that might decrease their business deduction, increase their Medicare Part B premiums, increase or make them subject to the 3.8% net investment income tax. All these threshold taxes suddenly kick in because mom and dad gave them an IRA.

This also means they'll have less tax-deferred growth because they will be taking it out over ten years, depending on who they are. What do you do about it from a planning standpoint?

Just because they can put off taking required minimum distributions to 72, and it won't be as much, does that mean they want to? So, is it wait or not wait to take your RMDs? Maybe they want to spread some of that out.

Also, review trust language. Because the deal was that we as estate planners did all kinds of interesting things with trusts for people that were going to have inherited IRAs. The trouble is that some of these clients are sitting out there saying, "If there's any IRA left when I die, is the remainder paid to my beneficiaries from a is to pay out the required minimum distribution?" However, the required minimum distribution for the IRA is no longer over a lifetime. Now, the required min distribution is the last month of 10 years after the person dies.

You don't have to amortize or pay the money out over ten years. You could pay it on the very last day of ten years. So, suddenly this trust that was supposed to be helping beneficiaries, they might not get a dime until ten years after mom and dad die. That sounds to me like an opportunity to find out if your errors and omission insurance really works. Those trusts have to be looked at and probably redone.

That's also an opportunity to look at beneficiary language because what many people are doing is now making sure their spouse is the beneficiary of the IRA because they can stretch it and then make the contingent beneficiary the kids. You want to factor in the tax impact on the beneficiaries because they'll probably be adults. So, you don't just plan for the owner; you plan for the beneficiaries and their tax situation.

So, what do you do? First, instead of putting as much of that money as you can into a traditional IRA, make it a Roth IRA. Do some Roth conversions so that the beneficiaries don't have to pay tax on it. Look at alternatives like life insurance. I am getting many inquiries and interest in life insurance instead of using the stretch IRA since they were taken away. It's a tax-free, known bequest. Also, using annuities, using charitable remainder trusts. This gives you an idea of why estate planning has changed so much in the tax area.

What About End-of-Life Planning as the New Motivator?

People are starting to think about the events before they die, not necessarily after they die. What's going on? You have all these medical advancements to maintain people's lives even if the quality of life is gone. Recall the high-profile cases of Karen Ann Quinlan and Terri Schiavo. Then add in Alzheimer's, which is statistically the largest cause of people going into long-term care facilities. We also had a long-term care crisis.

When I say crisis, I mean in terms of people not being prepared for it. The insurance industry had struggled with basically undershooting on premiums. This has caused some skepticism as to whether they've got that together.

You also have liberalized state laws, meaning that you didn't have a call on your end-of-life planning before. That was the doctor's decision. Now, you can have much more liberal powers of attorneys for who's making decisions for you. You can have a living will or advanced directive. You can have a living will, or a Physician Ordered Life-Sustaining Treatment (POLST). It's a fluorescent sheet of paper that is on the orders in the hospital that states you said, "Do not resuscitate." Even in eight states, you can have physician-assisted suicide.

And so, all these other pre-planning things like organ donation and disposition of remains are available. Well, COVID just made it more of an issue where people said, "Whoa, I didn't realize that these things can happen; I want to have some control over it." In my opinion, this is what is bringing people into attorney's offices.

Housing Considerations and Planning

For so many people, the net worth in their house is their primary asset.

For the average American, then their net worth is $170,000. If you subtract the house, then it's at $27,000. Let's be honest; a house is not a good investment. It's a place you sleep and enjoy and raise your kids and all that. But it is very subject to local markets. We know it can go up and down. Tight now, it's hot. What's going to happen a year from now?

What do you do to free some of that up when it comes time from an estate planning standpoint? Well, one of the things I just did less than a month ago was an article in my *Forbes* column that says, "Your residence in many ways is your retirement." As you think about retirement, you're also thinking about, "I'm not going to be here forever; what happens when I'm gone?" So, here are some of the considerations that are new, that are driving both these retirement and estate planning issues.

First of all, we have the estate and local tax deduction issue that is now limited to $10,000. That has caused many people in high-tax states to be angry. Then along comes a pandemic, and they realize they can work remotely. And they're starting to say, "Should I be a snowbird?" or "Should I move?" to other states to avoid the limitations on state and local taxes.

In general, consumers are carrying more debt, including mortgages, credit cards, and student loans. Mortgage debt is the key driver of this trend. And compared to the decade ago, fewer homeowners own their homes outright. So, you've got this line between economically challenged people from an estate planning and retirement planning standpoint to those who have opportunities.

What do you do from a planning standpoint? First, we have some tools available to us that we didn't always have – reverse mortgages. Despite the things you hear about them in the silly commercials on them in the middle of the night, reverse mortgages are a very powerful planning tool in retirement. They can help you augment the money you're taking from your savings on a tax-favored basis. When used correctly, you can leave a more significant legacy to your family.

Home equity conversion mortgages (HECMs) have become a way of freeing up some of the illiquidity in your home equity. You can access that home equity as a line of credit. You could take it as tenure payments, where it's paid out in a monthly amount, as long as you stay in the house. It can be used to replace your conventional mortgage. If you buy a new home, you can use a HECM for Purchase to have no mortgage payments in retirement.

You could essentially gift a fast-appreciating residence to your kids and still be able to live there, or maybe do it through a sale-leaseback. It used to be that Medicaid planning was considered somehow unethical, but that has changed because the government, the states all recognize that we need some flexibility in Medicaid planning.

There are things like long-term care and annuity products that are qualified through state partnerships which can provide dollars beyond the $2,000 that you can keep in assets and the $2,000 a month in income and still qualify for Medicaid. These are tools that can help improve the quality of life for somebody on Medicaid.

Can you use techniques like the Miller Trust? This is where essentially you take 401k assets, put them in a Miller Trust, and that'll help pay for a cell phone o clothes, etc., and still qualify for Medicaid. From an estate planning standpoint, the Medicaid planning question for so many of your clients may be this situa

Should we use the family inheritance now or later if you have a loved one who is elderly and will need your financial help in securing a decent residence for their golden years? One way you could do it is by taking some of the money out of your pocket and helping them. Another way is helping them qualify for Medicaid; however, then the state has a call on any inheritance before you do. The question is, should I let the government go ahead and fund a lot of this a while my mom or grandfather or whoever is alive and then have that come out of the inheritance? Or should I go ahead and pay for it? This gives you some new flexibility from a housing consideration standpoint.

Key Takeaways

1. Build estate planning into your retirement or financial planning practice because it is an integral part of today's financial planning process.
2. This includes asking end-of-life questions in your fact-finding such as, "How do you feel about if you were unable to represent yourself financially, or as far as health decisions, who would you want to do that?"
3. Consider, if you're not already there, broadening the scope of planning to include long-term care, Medicaid, digital assets, pets, etc., and not just, "Let me show you how to improve your portfolio."
4. There are many ways to embrace technology. Be aware that some of the broker-dealers have things like vaults for electronically holding onto some of these documents. Consider some of the things being done with genealogy and search engines today where people are using some of these tools to make sure that no surprise beneficiary will contest something. A lot of that is now being caught with technology. Be a part of the solution.
5. Be a trusted advisor regarding proposed legislation. I've seen advisors who just get in camp with a client and say, "Yeah, that president's doing the wrong thing, so we should ignore that." No, be a trusted advisor, whether they think there's going to be a tax change or not. They need to plan for the possibility of it. Leverage your professional relationships because I realize I've talked about a lot of legal stuff. The more you can work with centers of influence, the better you're going to do.

New Horizons in Estate Planning – Steve Parrish

About Steve Parrish, JD®, RICP®, CLU, ChFC®, AEP®, Co-Director Retirement Income Center and Adjunct Professor of Advanced Planning at The American College

Steve Parrish is the Co-Director of the *Center for Retirement Income* at The American College of Financial Services, where he also serves as an Adjunct Professor of Advanced Planning. He is also an Adjunct Professor of Estate Planning at Drake University Law School. With over 40 years' experience as an attorney and financial planner, Parrish frequently addresses the financial challenges of individuals, business owners and executives nationwide.

Steve Parrish is an expert on retirement, estate, and business owner succession planning. He is a recognized industry authority, spokesperson and author serving as an ongoing columnist for Forbes.com.

Parrish has served as an expert source for such prominent media outlets as InvestmentNews, Money.com, Kiplinger, MarketWatch, Wall Street Journal Radio, USN&WR, HR Magazine, and the Retirement Income Journal. He is also an Associate Editor of the Journal of Financial Services Professionals. In addition, he is a sought-after speaker with bar associations, estate planning councils and state AICPA meetings. He has addressed such financial service organizations as MDRT, AICPA, Finseca, NAIFA, INC 5000, and Society of Financial Service Professionals. Parrish also addresses numerous business organizations nationwide and has served as an expert witness.

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Analyzing the Fixed Indexed Annuity (FIA)

Tamiko Toland, Director, Retirement Markets, CANNEX

Editor's note: This article is an adaptation of the live webinar delivered by Tamiko Toland in 2021. Her comments have been edited for clarity and length.

You can read the summary article here as part of the 2nd Qtr 2021 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

You may also choose to take the full length course Analyzing the Fixed Indexed Annuity (FIA) for 1.0 hour continuing education (CE) credit.

By Tamiko Toland, Director, Retirement Markets, CANNEX

There has been much change in this part of the industry since the original fixed index annuity product (FIA) was introduced in the late 1990s, and quite a lot of change just in the past couple of years. This is a very dynamic part of the industry.

FIAs are potentially very useful for specific portfolios. My objective is to help demystify how an FIA works and explain the fundamental pricing dynamics (which are the inner workings) to help you better understand how the index interacts with that crediting strategy to generate that yield.

There is a profusion of low volatility indices right now in the marketplace. There's much confusion about the individual indices and what value they might be providing or not to clients.

What is a Fixed Index Annuity (FIA)?

First and foremost, it is a fixed annuity. This means that it is regulated and sold as an insurance product. It is not a security. It cannot have a negative return. And this is what distinguishes it from the registered index-linked annuity. Expected performance, ultimately, is closer to a fixed annuity.

Secondly, the index component is a fixed indexed annuity. This means that the return is linked to an index, whether that's an ETF, blend of indices, etc., but there is no direct investment in an index. These are promise products from an insurance company. They have a reference index without actually providing the direct index performance and protection from loss.

The third component is guaranteed income, particularly in the form of an income guarantee, whether somebody is looking for income today or in the future, such as guaranteed lifetime withdrawal benefit (GLWB), guaranteed minimum income benefit (GMIB), or other riders. These are the primary way clients receive guaranteed income from an FIA. FIAs can be annuitized, which is rarely done.

What Role Does a Fixed Index Annuity Serve in a Portfolio?

An FIA is a fixed income replacement because we expect the returns to be fixed-income-like with the possibility for more upside potential. The guaranteed income is either through an income benefit or through some form of annuitization. These products work well for people who want to supplement or delay Social Security and may want some other form of guaranteed income on top of Social Security or help them get to that point.

Another element of these income benefit guarantees is that you may want to have or provide a safety net of future income. It's something that the client might end up not needing or might want to use those assets differently in the future. But you want to put the guarantee in place. This is a pretty common utilization of these products. It's not necessarily the most economically efficient, but it's certainly understandable that people want security. These products are also often used for systematic withdrawals, which is a non-guaranteed form of income.

Lastly – and this has actually nothing to do with the annuity component in itself –sometimes folks invest in an FIA because they want life insurance through the death benefit for somebody who's uninsurable or very difficult to insure. This is not that uncommon, particularly now. Long-term care benefits are another thing people try to access through an FIA. These are other valid use cases for the FIA that are not necessarily core to the product's functioning.

How Does a Fixed Index Annuity Work?

The basics of it are you are limiting downside to a floor of zero, so you cannot lose money, and in exchange for that, you are provided upside that is modified. It's the interaction between these two things that end up giving you the yield.

With an FIA, we take an index, and we push the index through the crediting strategy. It's neither the index itself nor the crediting strategy alone that provides the yield; they function together. The index is the reference asset, and the crediting strategy determines the shape of the yield that comes out the other side and how that credited interest is applied.

One of the components of any fixed annuity is that it's "free" – there are no explicit fees. But there are costs. Everybody gets paid for the work they do, including the insurance company. But it may just be that you're not paying an explicit cost. The costs are implicit; they're not a line item charged as a percentage of the contract. But they manifest in the rates paid for the crediting strategy.

There may be some explicit fees: the index itself may have a fee, the crediting strategy may offer higher upside potential for a fee, and additional benefits su
income or death benefit may have an explicit fee.

If there is an explicit fee, it will be deducted after you calculate the 0% floor, so it is possible that the fee can reduce the account value below the original starting principle when there is no or close to no interest. But it's important to know how that works, that the end credited interest comes first, and then the fees are taken off of that.

How Do Insurers Price a Fixed Index Annuity?

How the carriers price these products is actually fairly straightforward. The first thing they do is very similar to what they would do with a regular fixed annuity. Most of the money from the premium goes into fixed-income investments to establish the principal guarantee that causes interest-rate sensitivity. Some carriers use zero-coupon bonds to return principal at some point in the future. This step is the base for the principal guarantee.

Step two is to establish the options budget. From this money, the insurer pays for everything that it takes to run these products, such as administrative fees, distribution, the insurer's profit, compensating for the use of capital for reserving, and other expenses that must be covered. Whatever is leftover is the options budget which is the pricing component where we see the effect of volatility.

Why is volatility so important? It's crucial to the actual pricing. The volatility of the reference index drives the cost of the options, which is the basic math that determines the rate or upside potential. For example, with the same budget, if you have an option that has a lower cost, you can buy more of it, which is why there are different rates based on a specific index to which the product is tied.

Though it may be counterintuitive, lower volatility can increase yield with all things being equal. Having fewer periods where you have zero to negative returns can equate to a higher net yield. Volatility also affects the stability of renewal rates because lower volatility options have more stable pricing in general. These are things to think about in the pricing dynamics.

Most products have a rate guarantee in the first year. After that, you have a renewal rate, and the renewal rate can change. It may well be that the insurance company wants to keep that renewal rate stable and will do that even when there's some fluctuation in the market. But there's no promise of that, except obviously in the case of products that are designed that way. There's a little bit of a "trust me" relationship between the insurance company and the client over the renewal rate.

With higher volatility options, the insurance company has to consider how they want to handle the price movement of the options for a highly volatile index. However, if you have a lower volatility option, you're just not going to see that kind of price movement, so it naturally makes renewal rates much more stable. Suppose the renewal rate is a high concern. In that case, particularly if it's an insurance company that you don't know what their renewal rate practices are, you can estimate it based on the index's volatility. The chance of the renewal rate being stable over time is much greater when you have a lower volatility index.

What Indices are Used in Fixed Index Annuities?

We're very familiar with the broad market indices, like the S&P 500, which is ubiquitous. Russell 2000 is another example. All kinds of indices have typically been used that have common characteristics of being equity indices that are highly volatile; therefore, they are subject to all those pricing issues.

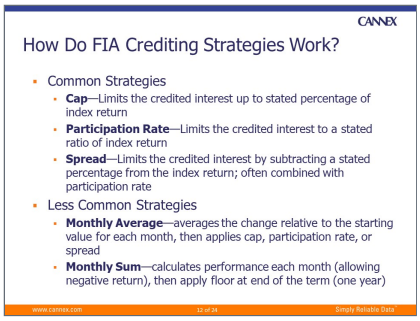
The pricing issues also apply in different types of market environments. If you think about where we are today with low interest rates, the volatility component can push the yield down on something highly volatile when volatility is higher. We certainly have seen this expressed in rates.

The indices can be blends of other indices or exchange-traded funds (ETFs), or some combination thereof. They can simply be a traditional broad market index that is in a lower volatility form. They tend to be unique to the insurance company. So, the carrier develops a relationship where they're the only ones that are allowed to sell a particular index, and they may put it across many different products. Still, you won't find the same index populated in other insurance companies products. Understandably, we see many people getting confused because there are so many different indices out there. There's no consistency because insurance companies want to have their unique index.

There are performance components that can be helpful in terms of the ultimate yield. Some of these indices do some rebalancing or reallocation in response to market changes, though that's not the predominant design.

How Do Fixed Index Annuity Crediting Strategies Work?

This is not an exhaustive list of what's available, and companies are constantly coming up with new crediting strategies. The most common strategies are listed at the top.



The Cap crediting strategy limits the credited interest rate to up to a stated percentage. This is the max that you'll get, and obviously, you're not going to los
The Participation Rate is very simply a ratio of whatever the index happens to return. And the Spread is more of a threshold, and you can get whatever is ab

This is often combined with a Participation Rate where you would calculate the Participation Rate first and then apply the Spread.

The monthly strategies – Monthly Average and Monthly Sum – sound very similar, but they're extremely different from each other. The Monthly Average takes an average of each month and then applies whatever limitation on top of it. The result of that averaging is a lot of smoothing. This tends to be a more consistent type of strategy because you're averaging within the course of the year, not just from that point to point. The Monthly Sum crediting strategy is subject to a lot more volatility. When it does its monthly calculation, the term may be an entire year, but then you're assessing monthly. Within a month, you can allow for a negative return. Because you're adding that up and then applying the 0% floor at the end of that period, you're having the potential for negative return in the middle. It allows for volatility in both directions but in particular exposes you to interim negatives.

The term is just the duration of the crediting strategy at the point on which we do the calculations to determine what the interest is or whether it's 0%. One year is very common, and it's the most prevalent of the terms. But periods can be much longer, like five or seven years. If you have a five-year contract, and you're using a crediting strategy with a five-year term, you only have one completed term within the course of that contract. And so, the chance of a 0% return at the end of that is infinitely higher than it would be if you had one-year terms all added up within that same contract period. It affects the yield that you get at the end.

I think that it's essential to talk about this right now because we're in a low-interest-rate environment. When interest rates are low, and insurance companies are looking to provide more value to the client, they can look at longer terms. This allows for a more significant upside, but it's only at the end of that period. When you're looking at these longer terms, you have to think about how many times that term will be repeated within the contract. With a two-year term in a six-year contract, that's three repetitions instead of six, one-year terms. When the length of the contract and the term are identical, the chance of experiencing a 0% yield at the end is possible.

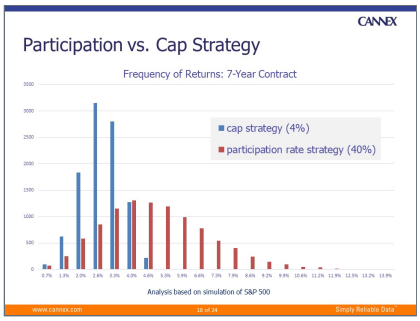
How Do Fixed Index Annuities Perform?

I can't emphasize enough that an FIA is a fixed annuity. It's the interaction of the index return with the crediting strategy that gives you the yield.

An effective market conviction is your or your client's view of the specific index or general market expectations. This should play a role in selecting the index, the crediting method, and the length of the index term.

You can't nominally compare the rates on different indices. If you have Index A and Index B, and one has a higher Cap or a higher Participation rate than another, you don't know how one will work in that situation. It doesn't necessarily mean a larger, higher Participation rate or higher Cap is better. When you see a Participation Rate of 100% or 150%, it doesn't mean that you're going to be shooting the moon. It may well be the opposite. The point here is that the length and repetition of the term – how many of them there are, and the probability of having negatives within that term – matter. So, suppose you have a seven-year contract with an index that's likely to give you fewer negatives in that period. In that case, this can potentially help your index performance, especially depending on the environment.

On Cannex.com, under "Thought Leadership," we have a lot of research that's available. If you want more details about the assumptions or methodology used on the following, that's all in the report. This is a Monte Carlo simulation.



The Cap strategy is 4% with a 0% floor. The average ends up being 2.5%, with the shape of the distribution of returns clustering towards the middle. With a Cap strategy, the way to think about it is that anything above the Cap is ignored. You can't shoot the moon, but you get tighter and more consistent returns over that period.

For the Participation Rate, you earn a ratio of the index performance. In this case, we ran this on a 40% Participation rate and 0% floor. It's a very different distribution that is much wider than you get with Cap. And in this scenario, the return averages about 4.5%. You may think, well, that seems a lot better than the other. But you have to look over the available rates at the time to assess which would be a better choice. You can see the difference in the performance profile of these two approaches.

If you have two different crediting methods – a Cap and a Par –you can actually compare them. Our position is that one method is not better than the other; they're different. It depends on what you're looking for for the client and their planning needs. And it depends a lot on your conviction about what will be happening to the index in the future or where your concerns or fears are about the future.

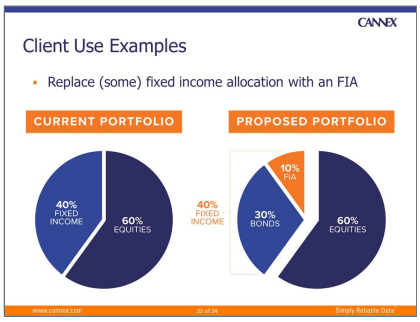
Here is a tool to calculate a breakeven rate between the basic Cap and a basic Participation rate.

In the previous example, we had a Participation rate of 40%, and we had a Cap rate of 4%. So, 100% divided by 40% times 4% equals 10%. What this means is if the index performance is below 10%, then the Cap does better. If the index performance is above 10%, then the Participation rate does better in any given year.

Using the current rates from one carrier, same product, to the two different strategies for the S&P 500, a 25% Participation rate, and a 4.5% Cap, the breakeven is 18%. This means that the Cap rate does better if the index performance is below 18%, and the Participation rate does better if it's above 18%. This is a way to capture what you think will happen in the future and gauging which strategy seems to be a better fit and make more sense.

Client Use of Fixed Index Annuities Examples

Many people are using this as a fixed income replacement. The nice thing about thinking of an FIA within the fixed income allocation is that it works well before retirement, before income planning, and into retirement for a chunk of the money within the fixed income allocation. Even if you have a client interested in income later or some income planning but isn't quite ready for it, the FIA is a suitable place to put that money.



Right now, we see fixed annuities competing against bank CDs because they provide higher yields. Those looking for 1-2% extra yields on top of a fixed annuity and who have some flexibility to accept lower yields.

We did a study a few years ago when we compared guaranteed income from different types of annuities that provide guaranteed income. One of the things we found was very often, an FIA, especially when there's some deferral period, was providing more guaranteed income even than a deferred income annuity, which is purpose-built for that. In addition, the deferred income annuity doesn't have any liquidity.

Key Takeaways

- An FIA is a fixed annuity that has the possibility of a little more upside. The performance of an FIA is fixed income-like with the potential of greater yield depending on market performance.
- Proprietary indices can provide valuable performance characteristics and renewal rate stability.
- **Risk tolerance and investment goals** will play a role in the selection of a crediting strategy.
- **Outlook about future index and market performance** will play a role in the selection of a crediting strategy.
- The income guarantee can be valuable and comes at the cost of yield.

About [Tamiko Toland, Director, Retirement Markets, CANNEX]

Tamiko is Director, Retirement Markets for CANNEX Financial Exchanges and is a Certified Financial Education Instructor (CFEI). Her focus is the individual and institutional annuity market in the U.S. and Canada. She is a thought leader with 20 years of experience tracking trends and key issues on retirement income, synthesizing commentary and analysis for broad audiences and specific clients. Tamiko got her start as a trade journalist focusing on fixed and variable annuities and variable life but shifted to research and thought leadership to better focus on the challenges and opportunities of retirement. She is known for her dynamic presentations with a unique perspective on the industry and the forces that are shaping it.

Tamiko specializes in presentations on annuities of all kinds (especially variable and fixed indexed annuities, with special focus living benefits; including registered index-linked annuities, AKA structured/buffer/variable indexed); standalone living benefits (aka synthetic annuities); retirement income.

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Situational Social Security

Marc Kiner, CPA, National Social Security Certificate Holder, National Social Security Association and Jim Blair, National Social Security Certificate Holder, National Social Security Association

Editor's note: This article is an adaptation of the live webinar delivered by Marc Kiner and Jim Blair in 20219. Their comments have been edited for clarity and length.

You can read the summary article here as part of the 2nd Qtr 2021 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

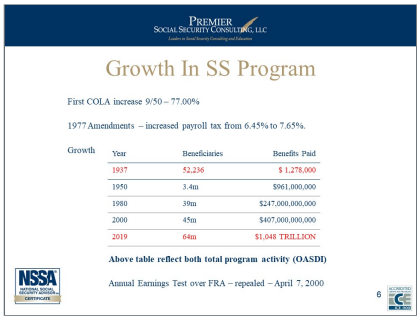
By Marc Kiner, CPA, National Social Security Certificate Holder, National Social Security Association and Jim Blair, National Social Security Certificate Holder, National Social Security Association

We are contributing authors to the *2021 Social Security & Medicare Facts* book published by The National Underwriter Company. Almost a thousand questions, over 700 pages on Social Security Medicaid, and related topics. It's an excellent resource for advisors who need to look up answers to questions about Social Security.

The Growth in the Social Security Program

The program has certainly grown over time. The law passed in 1935, but it took a couple of years for payments to be made. The first year we saw payments was in 1937, with 52,000 people receiving benefits, totaling $1,278,000. In 2019 we had 64 million beneficiaries, or people receiving benefits, and the Social Security Administration paid out over a trillion dollars.

If it's good for the government to put people into Medicare Advantage, it's good for the carrier to get them to Medicare Advantage, and it's good for the agent to get them to Medicare Advantage, it typically is not good for the consumers. It's critical to understand that if you follow the money trail, you can understand better why it's portrayed the way it is and why many people walk away with Medicare Advantage.



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Growth In SS Program

First COLA increase 9/50 – 77.00%

1977 Amendments – increased payroll tax from 6.45% to 7.65%.

Growth

Year	Beneficiaries	Benefits Paid
1937	52,236	$ 1,278,000
1950	3.4m	$961,000,000
1980	39m	$247,000,000,000
2000	45m	$407,000,000,000
2019	64m	$1.048 TRILLION

Above table reflect both total program activity (OASDI)

Annual Earnings Test over FRA – repealed – April 7, 2000

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Since the year 2000, the number of beneficiaries has increased by about 19 million people. Still, the amount of money paid out has more than doubled from $407 billion to over a trillion dollars. So, it's a huge program. It's essential for many people, and it's something that many people are going to depend on when they do retire.

Ida May was the first recipient of a monthly benefit of $22.54 in January 1940. She lived to the ripe old age of 100. It is a lifetime benefit, and people are living longer. According to the Social Security administration today, a male in his 60s has a life expectancy of right around age 84, and a female in her 60s has a life expectancy around age 87. The other thing they tell us is that about half of those people can expect to live to their upper 80s or early 90s, and a quarter of those folks live to be 95 or older.

Situational Social Security Overview

Regardless of their situation, people have different options available to them when they can start their benefits. Single folks probably have the fewest. We're looking at 62, full retirement age, maybe age 70.

For married folks, we're looking at a lot of different scenarios. Are they close in age? Are they far apart in age? What are their earnings? Is one a higher earner, and the other one was a stay-at-home mom or dad? Or are they both higher earners or one's higher earner and the other middle income? So, there are all sorts of sit which will determine when they will start their Social Security benefits.

In many cases, we'll have public employees involved. In many states like Ohio, for instance, public employees have opted out of Social Security. They have their own retirement program, but many of these folks are still eligible for retirement or benefit from someone else's work record. That public employee pension will affect those Social Security benefits.

For married couples, if one was born on January 1, 1954, or earlier, they can take advantage of the restricted application. The restricted application allows them to receive a monthly benefit payment based on their spouse's record while they're waiting to start their own benefit, be it at age 70 or whatever age they're considering.

Minor children under the age of 18 can also collect benefits, such as a child still in high school between 18 and 19, or, and this may be the one that's the most common, a disabled child. Suppose a child was disabled before the age of 22. In that case, they are eligible to draw benefits off of their parent's work record, whether the parents are receiving retirement disability or that parent passed away.

You may have clients that are divorced. They may be able to draw off more than one ex-spouse, and they may change from one ex to another.

Your clients may be surviving spouses. They can collect from one or more deceased spouses or one or more deceased ex-spouses.

There's also an opportunity to receive a nice lump sum check. Six months' worth of retroactive benefits is available to folks after reaching full retirement age. If you have a client that is age 67 or 68, they can file for benefits effective six months prior and get a nice lump sum check. Full retirement age ranges from age 66 and 2 months to age 67.

How Can You Help Your Clients Maximize Their Benefits?

Remember that Social Security may be a joint lifetime benefit. Generally, upon the passing of the husband, the wife will step in his shoes. If he took benefits early, that reduction would last two lifetimes; if he waits beyond full retirement age or goes up to age 70, that increase may last two lifetimes also.

Can your clients file that restricted application? Are your clients single? Married? Are they survivors? Are there kids involved? Are your clients divorced? How do you coordinate your client's spousal benefits? This is what we call thinking outside the box.

The restricted application must be in your Social Security toolbox for those born before January 1, 1954. The restricted application allows you to file off your spouse's benefits, leaving your benefits to grow by earning delayed retirement credits. Let's say I'm eligible for $2,000 off my work record. Let's also say I can get $1,000 off my wife's. I can file a restricted application at my full retirement age and collect $1,000 a month. Then at age 70, I turn my benefits on, which might have grown by delayed retirement credits from $2000 to $2,640 a month. So I've collected $48,000 in spousal benefits, and I've earned delayed retirement credits.

Strategies for married couples include:

1. *One spouse waits to age 70 to collect benefits*. It very well could be both, but generally, it's going to be the husband. Only about 4% of people wait to age 70 to collect their benefits. So, it's not likely that all of your clients will wait to age 70, but more of your clients than the general public may wait to age 70.
2. *Maximizing surviving spouse benefits*. The later the higher earner can wait from age 66 to 70, they can maximize surviving spouse benefits.
3. *Coordinating of Spousal Benefits*.

If you have a married couple that might be five-plus years difference in age, maximizing surviving spouse benefit probably makes more sense. If you have a married couple where one was born by 1954, then the restricted application needs to be on the table.

You might have a married couple that is closer in age. If so, maximizing surviving spouse benefits may not be as important. If the wife is older than the husband, we're probably not even looking to maximize surviving spouse benefits.

A married couple might have children you want to factor in, such as kids up to ages 18 or 19. A child may be eligible for benefits once a parent begins their benefits.

What is the Significance of Full Retirement Age?

People turning 62 this year, meaning they were born in 1959, their full retirement age is 66 in 10 months. For people who turn 62 next year, their full retirement age is 67.

Full retirement age is the age where you can collect 100 percent of what Social Security calls your PIA, Primary Insurance Amount, which is also 100 percent of your benefit. If you're 62 or older and want to retire, they're going to use your full retirement age, month, and year of retirement to determine how many months early you are applying for benefits. This will tell us how much of a reduction you're going to see in your benefit amount. Also, if you delay past full retirement age, you earn delayed retirement credits, so your benefits will be increased. The number of months would be determined by the number of months you wait past your full retirement age.

Reaching full retirement age also ends the annual earnings test. The earnings test applies to folks who want to take their Social Security benefits, who are under their full retirement age, and who also work. But once you reach full retirement age, this earnings test will no longer apply to that individual, and they can work and earn as much as they want and still draw all their Social Security benefits.

Thirty-five years of earnings are used to compute your Social Security benefit. Social Security indexes those wages for inflation. They'll bring all the wages you earned starting with that very first job you had at Wendy's or McDonald's through the year you attain age 59. They're going to apply an inflation factor to that. This doesn't mean your earnings starting with the year you turn 60 aren't counted. They are counted, but just for whatever it is that you actually earned and not indexed for inflation. The return on investment for paying FICA taxes, folks, is generally very low, and many times it's zero. So, don't assume that if your clients continue to work w
receiving a benefit, their benefits will go up. If they go up, they go up by pennies or dollars, but they won't go up by a whole lot.

This chart shows you the **percent** of full retirement age benefit you'll receive at age 62. For your clients who are turning 62 this year, they would receive 70.8 percent of their benefits.

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Full Retirement Age/Reduction

Year of Birth	Full Ret. Age	% at Age 62
1937	65	80%
1938	65 & 2 months	79.2%
1939	65 & 4 months	78.2%
1940	65 & 6 months	77.5%
1941	65 & 8 months	76.7%
1942	65 & 10 months	75.8%
1943-1954	66	75%
1955	66 & 2 months	74.2%
1956	66 & 4 months	73.3%
1957	66 & 6 months	72.5%
1958	66 & 8 months	71.7%
1959	66 & 10 months	70.8%
1960 & later	67	70%

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If somebody starts their benefits early, does their benefit go up to 100 percent at their full retirement age? No. The whole point was, if you take your benefit at 62, wait to full retirement age, or even wait till age 70, the amount of money you receive in Social Security on average should be about the same. Once you take a reduced benefit, it is permanently reduced.

Anytime you're receiving a benefit before full retirement age, there's a limit as to how much you could earn before Social Security withholds some of your benefits. This is called the Annual Earnings Test. At age 62, the earnings test is $18,960 a year. For every $2 you earn over that amount, you'll lose $1 in benefits. If your clients lose benefits due to the earnings test, when they turn forward with time and age, Social Security will recompute their benefits and give them more money each month, so the benefits withheld are not really lost. You do get that money back over time. This annual earnings test goes away the month that you turn full retirement age.

Delayed Retirement Credits and Social Security

If you wait to collect your Social Security benefits beyond full retirement age, you get 8 percent more per year. This is a permanent increase in benefits. When you pass, you increase the survivor benefit as well.

You don't have to wait till your birthday to get a percent more. For each month you're beyond full retirement age, your benefits go up by two-thirds or 1 percent per month. So, if your full retirement age is 66 and you claim at 62, it's a 25 percent haircut. If your full retirement is age 66 and you wait to age 70 to collect, you get 32 percent more benefits from delayed retirement credits. Waiting till age 70 from 62 is a 76 percent increase in your Social Security benefit.

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Delayed Retirement Credits Rates

Yr of Birth	Yr Incr	Mo Incr
1943 on	8.0%	2/3 of 1%
1941-1942	7.5%	5/8 of 1%
1939-1940	7.0%	7/12 of 1%
1937-1938	6.5%	13/24 of 1%
1935-1936	6.0%	½ of 1%
1933-1934	5.5%	11/24 of 1%

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25

Spousal benefits should be a primary factor in deciding when to claim benefits. For my wife to collect off my work record, she must be at least age 62. I must be receiving either a retirement or a disability benefit. I could be receiving a disability benefit at age 55. As long as my wife is age 62, she can collect off my work record as long as I am receiving a benefit.

What if I want to wait to age 70 to get those delayed retirement credits? Then she has to wait until I'm 70 to turn my benefits on before she's eligible for a spousal benefit off my work record. How much are spousal benefits? It's 50 percent of the PIA. The PIA, the Primary Insurance Amount always equals what you would receive at your full retirement age.

Divorced Spouse Benefits

There are a couple of categories of divorced spousal benefits. For the first one, Social Security wants to know if you are single. If you're married, you cannot draw off from benefits based on your ex-spouse. But if your ex is married and you're not, you can still draw off of them if you are age 62 or older. You had to be married to your ex-spouse for ten years or more. This has to have been continuous, with the only exception being if you're divorced in one year and remarry that same person by the end of the following year, they'll disregard the divorce. But otherwise, it's got to be continuous. Your ex-spouse also has to be receiving either retirement or a disability Social Security benefit.

There's a second category called the Independently Entitled Divorced Spouse. A lot of the requirements are the same. You still have to be single. You still had to be married to your ex for ten years or more, but now both of you must be age 62 or older. If you've been divorced for two years or longer, you can file on your ex-spouse's record, even though they haven't applied for Social Security benefits. So, if your ex is still working and has no intention of applying for Social Security benefits anytime in the near future, you could still draw off of their work record and receive an ex-spousal benefit.

Surviving Spouse Benefits

Widows, widowers, and surviving divorce-spousal benefits are available. You will receive one hundred percent of what the deceased was receiving or eligible to receive when you reach your full retirement age.

If you file at age 60, it doesn't matter your full retirement age; you take that 28½ percent reduction. You can take the survivor spouse at 60, switch to your own benefit at age 62 if it's higher, but you could also wait through your full retirement age. You can even wait as late as age 70, earn your delayed retirement credits, but still, in the meantime, you have money coming in.

Now, if the survivor benefit is the higher of the two, you can take your own at 62, taking a reduced retirement benefit. Then at your full benefit age, switch to the survivor benefit and still get 100 percent of what the deceased was receiving/you're eligible to receive. The one thing that people need to keep in mind when they're thinking of these situations is that the earnings test does apply. So, if the individual wants to file for survivor benefits at age 60 or their own benefits at age 62, if they're still working, they will have to be aware of the earnings test.

It is actually possible to draw the widows, widowers, and surviving divorced spouse benefits as early as age 50 if you become disabled within seven years of your spouse's death. The 28½ percent is still the maximum reduction. But if you wait until full retirement age, you'll receive one hundred percent of the benefit. Now we call it full benefit age. There is a difference between full retirement age for retirement and widows and widowers benefits.

Key Takeaways

1. Everyone's Social Security situation is unique and different. We want you to know the main rules and strategies for single, married, divorced, and surviving spouses. Understand the questions to ask to open up opportunities. You need to ask the right questions.
2. The biggest question that we went over that you need to ask is, "When were you born? By 1954?" Then you know, the restricted app is available to you.
3. Learn the language of baby boomers. Understand that if you want to connect to baby boomers, understand that Social Security is their universal language.
4. Ninety percent of recipients do not maximize their benefits. They have no clue what their options are.

About Marc Kiner, CPA, National Social Security Certificate Holder, National Social Security Association and Jim Blair, National Social Security Certificate Holder, National Social Security Association

Marc Kiner has 30 years experience in public accounting. His primary areas of service were to privately held businesses and individuals.

Recognizing a need in the marketplace for enhanced advisor knowledge for Social Security filings, Marc sold his practice in 2012 to concentrate on Social Security.

Marc is co-founder of the National Social Security Advisor Certificate Program. The National Social Security Advisor Certificate Program received accreditation from The Institute in Credentialing Excellence, (ICE), in December 2017. NSSA® is the only accredited Social Security education program in the nation.

Marc provides Social Security consulting and education services.

He empowers advisors and their clients to take control and to maximize their Social Security benefits.

Marc educates advisors across the country about Social Security, thereby increasing their value to clients.

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