Our Updated Survey on Group Life Insurance & Other Survivor Benefits

Fifty-four percent of Americans have some life insurance coverage. For the first time ever, more people have employer-sponsored group life insurance rather than individual life insurance, according to the most recent survey conducted by LIMRA. Group life coverage is made available to employees at almost all size companies, with a relatively small amount provided at no cost to those who enroll. However, this group benefit generally is not viewed as important by most employees as group medical or even long-term disability coverage.

While the “average” amount of life insurance that individuals maintain is around $168,000, industry experts typically recommend that individuals should have enough life insurance coverage to replace seven years of their income. Nearly one in three Americans believes they need more life insurance coverage. How much coverage do you have?

Of course, there is no magic number of insurance that is right for everyone - family situation, age, health, other assets and liabilities are just some of the factors likely to influence how much insurance an individual should consider maintaining. Furthermore, saving for retirement is a greater priority for a large majority of workers. Often, a major life event (marriage, birth of child) will trigger a review of the adequacy of coverage – although, most should review their needs periodically – and this includes reviewing beneficiary designations under all policies.

We recently updated our informal survey on the life insurance coverage provided to employees and family members at 350 companies where Ayco provides financial counseling or financial education services. We also reviewed those companies which still provide a company-paid death benefit or executive-only insurance.

The following types of insurance or survivor coverage are now being offered by our survey group compared to what was offered in our 1998 survey (totals will exceed 100% due to multiple offerings):
**Background & History** – A predecessor of life insurance were “burial clubs” established in ancient Rome which covered the cost of members’ funeral expenses and helped family members. The first company to offer life insurance was the Amicable Society for a Perpetual Assurance Office, founded in London in 1706. Each member made an annual payment based on their age. At the end of each year, a portion of all contributions were divided among the wives and children of any deceased members.

In the U.S., the sale of life insurance began in the 1760s with the creation of the Presbyterian Minister’s Fund in Philadelphia. Benjamin Franklin was instrumental in establishing it several years after he had created the Insurance of Houses from Loss of Fire, the first mutual fire insurance company in America. In the 1870s, military officers founded The Army and Navy Mutual Aide Associations to assist widows and orphans left stranded in the west after the Battle of the Little Bighorn and families of U.S. sailors who died at sea. Montgomery Ward was one of the first companies to offer group life insurance to employees in 1875.

Life insurance policies are legal contracts where the insurer promises to pay a designated beneficiary a stated amount of money upon the death of the insured person in exchange for payment of a premium. A contract can provide that certain other events can trigger a payment of a portion or all of the benefit, such as a terminal illness. The two major categories of insurance contracts include:

- **Protection Policies** - These are designed to pay a benefit, typically in a lump sum, in the event of a specified occurrence such as death. This is generally referred to as term insurance.

- **Investment Policies** – In addition to the death benefit, these contracts allow for the growth of a portion of the premium payment. The common forms of these policies are whole life, universal life and variable life policies.

In general, basic employer-paid and supplemental employee-paid group term life plans, are subject to ERISA rules. These include disclosure, reporting, and fiduciary liability rules. (There is a narrow exception in Dept. of Labor regulations where the employer’s function is limited). In contrast, Group Universal Life and Group Variable Life policies typically involve premiums paid entirely by a participant and therefore, are exempt from most ERISA rules.

**Group Term Life**

Almost all of the companies in our survey group offer group term life insurance to their employees, as well as eligible dependents. Those that do not have replaced term life coverage with voluntary universal or variable life insurance. Nearly all companies provide, at no cost, a certain amount of basic non-contributory coverage, with about one-half of our survey group placing a dollar limit on the amount of this basic term coverage. At nearly one-third of the companies surveyed, group term life insurance is part of a $125 cafeteria plan.

A significant advantage of group term coverage offered by almost all employers is the ability to enroll and possibly later increase coverage (usually in small increments) without underwriting or proving good health. In addition, most employers provide a certain amount of basic coverage for their full-time employees and offer additional coverage that employees can purchase at group rates paid through convenient payroll deduction. But because group term coverage typically is a multiple of salary only and disregards other elements of compensation, it may not provide sufficient coverage for higher-paid executives.

**Basic Term Coverage** - Of those companies with basic term coverage, the amount provided to active employees at no cost is as follows:

![Basic Term Coverage Chart](chart.png)

*Employee may elect multiple of salary or $50,000

**Supplemental Term Life Coverage** – Just over 90% of the surveyed group offer supplemental term life coverage in addition to basic life. This coverage is elective and fully paid for by an employee with after-tax dollars. An employer can elect to treat supplemental group term life paid entirely by employees as not "carried" by the employer. Thus, employees should have no imputed income for supplemental coverage. (However, the benefit remains governed by ERISA, as confirmed by a recent federal case.)
For those employers that offer elective supplemental term coverage, the maximum coverage amounts are as follows:

Approximately 60% of the survey group have a “living benefit” or accelerated death benefit feature in their group term life plan. This allows a terminally ill employee to elect to receive a portion of the death benefit paid prior to death. Like life insurance benefits, living benefits are not subject to income taxes upon receipt.

**Group Term Maximum Dollar Amount**

A large majority of companies in our survey group have a dollar maximum for basic and any supplemental term coverage elected. Here is the aggregate maximum for group term coverage for those with a maximum:

From an employer's perspective, an advantage of a GUL program is that administration is outsourced. The employer may only have to deduct policy premiums from pay and transmit them to the insurer. A significant advantage for employees is that this insurance coverage is portable, so that an employee may elect to continue coverage following termination of employment for any reason. However, recent historically low interest rates have impacted the cost of universal life policies, especially for those with contracts in force for more than 10 years.

**Group Universal (GUL) or Variable (GVL) Life Insurance**

Forty percent of our survey group offers GUL or GVL insurance on a voluntary basis in addition to group term coverage or in place of elective supplemental term life. An employee may commonly elect to insure a spouse and/or children if the employee elects coverage. Premiums are almost always paid entirely by the employee with after-tax dollars. Several policies now offer long-term care (LTC) “riders”. These are not a substitute for LTC insurance (and are not approved in all states), but do provide a potential valuable benefit for those willing to pay the additional cost. At some companies, variable life insurance with equity investment vehicles is available. The maximum amount of coverage for those companies offering this type of insurance, subject to a dollar maximum, is as follows:

**Executive-Only or Heritage Split-Dollar Life Insurance**

Prior to the enactment of the Sarbanes-Oxley Act (SOX) of 2002, over one-third of our survey group offered split-dollar life insurance to select key executives. But a company's payment of premiums under a collateral assignment
contract would be treated as an impermissible loan under SOX; as a result, virtually all public companies have eliminated such programs or gone to a bonus arrangement where the executive pays the entire premium with the company making a special bonus payment to reimburse a portion of the cost. Currently, only about 8% of our survey group retain vestiges of executive-only life insurance. Typically, these contracts are for a limited grandfathered group of executives, although, there are a handful of companies that do offer whole life or variable life coverage to key executives. Who pays the cost can vary and can have tax implications.

**Dependent Life Insurance**

In addition to providing coverage for employees, an overwhelming majority of companies offer coverage for a spouse/domestic partner and children. Generally, this is term insurance, unless the company offers group universal life with coverage available for dependents. The employee almost always pays for any such coverage and is the automatic beneficiary of death benefits payable. An employer may provide or pay for up to $2,000 of coverage for a spouse (including same-sex spouse) or child without imputed income. This amount is considered a de minimis fringe benefit.

Here are the maximum coverage amounts available for dependents among this group. These are expressed as dollar amounts and a spouse’s coverage cannot exceed that of the employee:

<table>
<thead>
<tr>
<th>Spouse/Partner</th>
<th>Child</th>
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<tbody>
<tr>
<td>Under $100K</td>
<td>15%</td>
</tr>
<tr>
<td>$100K</td>
<td>15%</td>
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<tr>
<td>$100K−$200K</td>
<td>15%</td>
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<tr>
<td>$150K−$200K</td>
<td>15%</td>
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<tr>
<td>$250K</td>
<td>15%</td>
</tr>
<tr>
<td>$300K or More</td>
<td>15%</td>
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</tbody>
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**Accidental Death & Dismemberment (AD&D) Insurance**

Almost all of the survey group provides AD&D coverage to employees, usually in an amount equal to the basic life coverage paid for by the company. There is no imputed income to an employee for any AD&D coverage paid for by an employer. In addition to this basic AD&D coverage, just over 70% of the survey group offer employees the choice of purchasing additional AD&D coverage for themselves and eligible family members.

**Retiree Life Insurance**

While most companies continue to provide a limited amount of term life insurance to eligible retirees – often with staggered reductions in coverage amounts beginning at age 65 - there is no requirement that such coverage be offered or made available. In fact, within the past several years, we have seen several companies – approximately 10% of our survey group - reduce or eliminate altogether term life insurance coverage for retirees. This is one reason that some companies utilize universal life coverage; those employees who want to continue coverage after retirement or termination of employment can do so with the cost paid entirely by the retiree.

When group life coverage is reduced or ends (for any employee, not just a retiree), the individual can convert coverage to an individual policy - although due to the cost and availability of less expensive individual coverage, this makes little economic sense for anyone who is healthy.

Under ERISA, employers have an obligation to provide information about the right to convert group term coverage to an individual policy on a timely basis to those eligible. A recent federal court decision illustrates the consequences of not providing this information (Erwood vs. Life Insurance Co. of NA and Wellstar Health System). Erwood was disabled and arranged a meeting with his employer’s benefit representative to discuss continuing all welfare benefit coverage. However, he was never provided sufficient information on converting his $750,000 group term life to an individual contract. When he died within a year, his widow was denied the insurance benefit when the insurer confirmed that coverage ended upon the end of his employment leave. She then sued his employer. A federal court in PA recently upheld her claim of an ERISA fiduciary breach and imposed a surcharge on the employer equal to the $750,000 death benefit that converting the insurance would have provided.

**Survivor Income Benefit**

These are programs intended to provide a surviving spouse or dependent children with an ongoing stream of income for a stated period of time following the death of an employee. Typically, the periodic payment is a percentage of the employee's final salary. Payments may continue until the spouse's remarriage, reaching a stated age (e.g., 65) or for a stated number of years. It can be argued that these programs are representative of a past paternalistic era of
employer-employee relations. But, because they are ERISA benefits, it can be difficult for employers to eliminate them. Fewer than 2% of our survey group have such grandfathered coverage.

**Company-Paid Death Benefit**

We continue to see a relatively small number of companies maintain a company-paid death benefit. This is not an insured benefit; hence the proceeds are income taxable to the beneficiary and deductible by the company. Almost always, these programs only provide a relatively small benefit upon the death of an active employee. One advantage of these programs is that there is no imputed income during the lifetime of the employee.

**Pension Plan Death Benefits**

More than a generation ago, when defined benefit pension plans were the primary retirement plan offered to employees, a handful of pension plans provided a lump sum death benefit which was in addition to any joint and survivor benefits. Typically, the amount of this special death benefit was one times pay. These pension death benefits were not funded by insurance and are now rare in both qualified and nonqualified plans. ERISA’s anti-cutback rule generally prevents qualified pension plans from reducing or eliminating certain accrued vested benefits earned by plan participants. However, a federal court ruled several years ago that a company could eliminate its pension death benefit for future retirees.

**Divorce and Life Insurance Benefits**

In the event of a legal separation or divorce, the parties may agree to change beneficiaries for group term or any other life insurance. This can be included in a domestic relations order approved by a state court. What hasn’t always been clear is whether such a provision can be included in a Qualified Domestic Relations Order (QDRO). The DOL has indicated that a QDRO may impact company-paid survivor benefits (ERISA Op. Letter 2000-09A). This has been the matter of litigation, with some federal courts indicating that it is effective and others concluding it is not.

See last month’s *Digest* for an example of a court decision finding a separation agreement the basis of the payment of a group term insurance benefit to a child of the parties to the agreement rather than a different designated beneficiary.

**Income Tax Treatment**

While life insurance death benefits received by a beneficiary are not income taxable (per IRC §101), the cost of life insurance paid for by an employer or paid by an employee with pre-tax dollars through a cafeteria plan can result in imputed income. Non-discriminatory group term life, up to $50,000, under a policy carried directly or indirectly by an employer can be provided without imputed income, while coverage in excess of $50,000 results in imputed income using the IRC §79 tables. A bill was introduced last year that would increase this tax-free company-paid benefit to $375,000. However, it was not included in the new tax law.

Income associated with group term life is included in wages reported in boxes 1, 3, 5 of the Form W-2 and also reported in box 12 with Code C. An employer need not withhold federal income taxes on this income, but should withhold Social Security and Medicare taxes for active employees. There is similar tax reporting for coverage provided to former employees (with a limited exception for those who retired prior to 1984 or those at least age 55 in 1984), but there is no requirement for the employer to withhold income or Social Security taxes. The amount of any uncollected Social Security tax for active employees is to be reported on the Form W-2 with a code M in Box 12 and code N for uncollected Medicare Tax.

Generally, all term life insurance offered by an employer is to be treated as a single policy for purposes of calculating imputed income – with a reduction for any coverage paid for by an employee.

But in a private ruling (PLR 201542003), the IRS confirmed that if an employer offers supplemental term life insurance which employees pay for with after-tax dollars, an employer can treat the basic non-contributory coverage and the optional coverage as separate. This would mean that employer would not need to combine the total coverage elected under both plans to calculate any imputed income to the employee. This can be particularly beneficial where the premium cost for the supplemental life is less than the Table 1 rates under IRC §79.

Any premiums paid for by an employer for whole or universal life insurance should be reported as taxable income, but based on the amount paid rather than using the §79 tables.
Forfeiture Clause in Top-Hat LTIP Plan is Upheld

Restrictive covenants, including non-compete, forfeiture, and clawback clauses, have become commonly incorporated into long-term incentive plans and executive employment agreements. They also can be included in nonqualified deferred compensation plans and top-hat retirement plans. How and whether such clauses will be enforced is another matter. It can be both costly and time consuming on both parties. Here’s a recent example that illustrates these points.

Earl Owens and Joseph Espat were employed by Western & Southern Life Insurance Company. Both participated in the company’s Long-Term Incentive and Retirement Plan. To be eligible for this plan, an employee had to be in the top 5% of annual compensation measured during the previous year. Awards under the plan included performance units, as well as other benefits payable annually after an eligible employee retired. The plan contained forfeiture provisions, one of which provided that the right of a participant or their beneficiary to receive future payments of performance units would be forfeited if the participant entered into a business or employment arrangement competitive with that of the company within three years of termination of employment, or acted in any other way which, had the participant still been employed, would have provided the company with “cause” to terminate their employment. In this regard, Western & Southern had a policy that employees would be subject to termination if they sold insurance policies for another company.

Owens retired in 2010 and Espat in 2012. Both began receiving periodic payments from the plan after they retired. However, both also then became appointed by other life insurance companies and began selling their policies. When Western & Southern became aware of this, they sent letters to each explaining that they had forfeited their rights to future payments from the plan and the company demanded repayment of amounts already paid. When neither Owens nor Espat responded, the company sued in Ohio state court, Owens and Espat then sued the company in Federal court seeking payment of benefits under the plan. (This further illustrates the cost of these actions. The Ohio state court eventually dismissed the lawsuit by the company finding that this was an ERISA cause of action which belonged in Federal court.)

Both parties agreed that the plan constituted a top-hat employee benefit plan as defined under ERISA. The plan administrator confirmed that Owens and Espat had violated the plan’s non-compete provisions. A question for the federal court to decide was whether the plan administrator had abused its discretion in denying benefits. When the District Court held in favor of the company, Owens and Espat appealed. Recently, the 6th Circuit U.S. Court of Appeals issued its opinion agreeing with the lower court’s determination (Owens & Espat vs. Western & Southern Life Insur. Co. and WSLI Long Term Incentive & Retention Plan).

Owens and Espat argued that they had not violated the non-compete clause because they were not employees of the other insurance companies, but rather independent agents. In addition, both argued that they did not target the same buyers and did not sell the same type of insurance policies so that the finding of the plan administrator could not be supported. The court, however, referred to the definition of “employee” in the American Heritage Dictionary as a person who works for another in return for financial or other compensation, and concluded that the fact that they may not have been actual employees should not be determinative. The court also used the dictionary definition of competition as a “rivalry between two or more businesses striving for the same market”. Thus, the court agreed with the plan administrator that the actions taken violated the restrictive covenants that were in the plan document.

Owens & Espat then also argued that the plan may not have been a top-hat plan and that the company had not, therefore, met the proper disclosure requirements if the plan was determined not to be a top-hat plan. However, the court quickly rejected this argument inasmuch as the former employees had agreed multiple times in the original lawsuits that the plan constituted a top-hat plan – so they could not have their cake and eat it too.

Finally, they argued that even if the plan is considered a top-hat plan, the forfeiture provisions are unenforceable based on the fact that the company failed to meet the proper disclosure requirements. While top-hat plans are not exempt from all of ERISA’s reporting and disclosure requirements, one method of satisfying these requirements is for the plan administrator to file a brief statement with the Secretary of Labor within 120 days of the plan becoming subject to ERISA, providing plan documents upon request. Western & Southern had met this requirement and
therefore the court agreed with the lower court decision finding in favor of the company. Another example of how employees and even former employees should be cognizant and aware of all restrictive covenants, including forfeiture provisions.

**Understanding the New Federal Tax Withholding Rules**

Federal income tax rates will decrease for many U.S. taxpayers this year. There also will be an associated adjustment in federal tax withholding rates – although understanding, putting in place, communicating, and adjusting to the revised federal income tax withholding rules will be a challenge for employers and employees. Associated with the tax law changes of P.L. 115-97 are transitional new tax withholding rules. The IRS recently issued guidance on the new rules in Notice 2018-14. They also updated the 2018 withholding tables that will coordinate with the Form W-4 that employees have furnished to employers. The IRS is currently in the process of revising its Form W-4 to reflect changes in the tax rules, although these are not expected to be released until after February 15th.

The general idea of these withholding rules are to have the employer withhold federal taxes roughly equal to the individual’s federal tax obligations. There are several alternative withholding methods that employers can utilize for regular pay including the wage bracket method, the percentage method, as well as alternative methods for automated payroll systems described in IRS Pub. 15-A.

If an individual fails to timely submit a Form W-4 to an employer, the default withholding rule considers the individual to be married and claiming three withholding allowances. Those rules will continue for 2018 according to Notice 2018-14. There is a temporary suspension of the rules that require employees to furnish a new Form W-4 to their employer in the event of a change of status that reduces the number of withholding allowances.

Federal tax withholding rules not only are complicated but vary depending on the compensation being paid. For example, while employees submit a Form W-4 to determine the number of exemptions and the amount of tax withholding that may be claimed for salary payments, there are different withholding rules that apply to supplemental wages.

Supplemental wages include annual bonus payouts, commissions, overtime, long-term incentive plan income, the payment from nonqualified deferred compensation plans and nonqualified retirement plans, severance pay, sick leave, awards, prizes, payments for nondeductible moving expenses, and the imputed income from non-cash fringe benefits. Basically, this represents taxable income that is not “regular” wages or salary.

- **Supplemental Wage Withholding Changes**

While not mandatory, employers may withhold income taxes from supplemental wage payments at a flat rate. This rate will depend on the aggregate amount of all supplemental wages paid to date – and these amounts have changed this year from those in place previously. For aggregate supplemental wages of up to $1M, that rate was 25% last year, and will reduce to 22% for 2018. However, employers were given the discretion to continue withholding at the higher 25% optional flat rate through February 15, 2018 due to the last-minute enactment of recent tax reform - P.L. 115-97.

When supplemental wages exceed $1M, the flat rate becomes the highest federal tax rate – 37% for 2018, down from 39.6% last year. A practical issue is how to handle a supplemental wage payment (e.g., annual bonus payout, nonqualified stock option exercise, restricted stock vesting, performance award payment) when a portion of the award is under $1M and the remainder is above $1M. IRS regulations permit employers to apply the highest federal marginal rate to the entire amount of any single payment that results in the $1M threshold being exceeded. Alternatively, the award can be bifurcated with only the amounts in excess of $1M having withholding at the highest marginal rate.

IRS regulations and other guidance indicate that employers are to ignore any employee request for additional withholding above the highest marginal tax rate and also must ignore any request to increase or decrease the required flat rate for supplemental wages up to $1M, unless the employer utilizes the “aggregate” withholding procedure. Under the aggregate procedure, when supplemental wages are paid at the same time as regular wages, the Form W-4 submitted by an employee may apply to both regular and supplemental wages. However, the IRS has indicated that this aggregate procedure cannot be requested only for supplemental wage payments.
Periodic Retirement Payments
Withholding on payouts from qualified retirement savings arrangements scheduled over life expectancy or a defined fixed period of time are generally calculated as if the payments were wages. However, recipients have an opportunity to increase or waive federal withholding using Form W-4P (Withholding Certificate for Pension or Annuity Payments). If no withholding election is made, the same default rules apply as with a Form W-4.

In contrast, non-periodic payments or distributions from retirement plans (401(k), 403(b), IRAs) are subject to a fixed withholding percentage, unless the recipient elects to have no withholding – for example, if distributions are to be rolled over tax-free. But the fixed amount varies based on the type of plan. For employer plans (401(K), 403(b)), this rate is 20%; for IRAs, it is 10%.

Share Withholding Dilemma
Most companies allow or even require shares of stock that otherwise would have been distributed upon the exercise of nonqualified stock options, the vesting of restricted stock or the payout of RSUs or performance awards in shares of stock to be withheld by the company, with cash then paid to the IRS. The company would then be able to reissue any shares so retained.

Share withholding is subject to the supplemental wage withholding rules, but also has accounting implications to the company. In 2015, the Financial Accounting Standards Board (FASB) amended ASC 718 to allow employers to withhold shares up to the maximum (rather than the minimum) individual tax rate without triggering variable accounting treatment for the shares. With the maximum rate having dropped to 37% for 2018, a practical question that companies may be dealing with is whether to cap the share withholding maximum when aggregate supplemental wages exceed $1M to 37% to avoid the risk of variable accounting treatment. This matter may need to be clarified by FASB as the IRS already has provided flexibility on the tax withholding aspect of this problem.

SEC Section 16
A U.S. District court in Oklahoma recently dismissed a lawsuit seeking to recover §16(b) short-swing profits from a company’s CEO and General Counsel associated with share withholding elections on RSU distributions (Olagues vs. Muncrief, Cameron, and WPX Energy). The plaintiff shareholder alleged that since the share withholding election was discretionary with the company, it constituted a matchable “sale” of company stock by the insiders which could lead to a §16(b) violation if there was a matchable purchase within six months. However, the court agreed with the company and the corporate officers that while authorized share withholding is reportable on a Form 4 filing, it is an exempt transaction for §16(b) liability purposes. So, hopefully this bugaboo allegation (which has been bandied about over the past year), will now abate.

Correction of Errors and Penalties
If an employer withholds more than the correct amount from an employee’s pay, the employer is to repay or reimburse the employee any excess before the end of the year. Failure to do this results in the employer having to report and pay the excess amount to the IRS when filing Form 941 for the quarter (or Form 944 for the year) in which too much was withheld.

An employer which fails to withhold at the proper rate or fails to pay the withholding to the IRS on a timely basis is subject to penalties under IRC §6672.
Did You Know...

- U.S. life expectancies declined in 2016 for the first time in nearly a generation. According to the most recent data on civilian worker deaths from the Bureau of Labor Statistics, there was an average of 3.6 deaths per 100,000 full-time employees in 2016. The most dangerous jobs with the highest fatal injuries on the job include:

  1. Logging workers
  2. Fishermen and related workers
  3. Aircraft pilots and flight engineers
  4. Roofer
  5. Trash and recycling collectors
  6. Iron and steel workers
  7. Truck and sales drivers
  8. Farmers, ranchers, and their workers

- All of the players in the Super Bowl who are not Minnesota residents will have to file a Minnesota non-resident income tax return and pay the MN “Jock Tax”, as will those paid to entertain at halftime. All but nine states have a comparable tax on professional athletes who play events their state, although these calculations vary considerably, including based on the sport itself. CA originated this tax in 1991 to tax the earnings of Chicago Bulls players who played the LA Lakers in the NBA finals. The states with the highest non-resident tax rates include: CA, HI, OR, IA, MN, NJ.

- Eighteen states with state income taxes automatically conform to federal tax law provisions, including changes that are enacted, while 19 states must affirmatively approve federal changes to align their state tax rules

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