



BERNSTEIN

Special Needs Planning for the High-Net-Worth Family



Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

WHY ESTABLISH A SPECIAL NEEDS TRUST?

Having a family member with special needs can present many joys and many financial challenges. Parents of a special needs child are often particularly concerned with providing for the child after both parents have passed away. As such, most families want to create an estate plan that will ensure their special needs relative has the necessary resources to maintain his or her care. However, doing so could also jeopardize that person's access to valuable government benefits. So what is a family to do?

One way to ensure that your special needs family member remains financially secure is to establish a special needs trust ("SNT").¹ Designed specifically for a disabled beneficiary, these trusts must contain fairly restrictive provisions in order to qualify as SNTs. Therefore, it is crucial to understand why you may want to establish one and how the trust should be funded in light of other family needs and financial goals. Bernstein's planning framework can illuminate some of the choices and trade-offs you may face in the process.

WHY FUND A SPECIAL NEEDS TRUST?

Special needs trusts serve two main purposes: 1) to preserve a disabled family member's access to government benefits, and 2) to protect the trust assets so that they are available for the disabled family member's needs.

Preserving Access to Benefits

Owning as little as \$2,000 in assets or receiving limited amounts of income can disqualify a special needs person from receiving important government benefits such as Supplemental Security Income (SSI) and Medicaid.² While certain assets are not included in this limit—such as a house and a car—other assets, including cash or securities, are.³ Assets held in a special needs trust, however, will not impact the beneficiary's eligibility for means-tested benefits so long as the beneficiary does not have

authority to revoke or terminate the trust, or to direct the use of the trust assets.⁴ It's important to note that distributions from an SNT should never be made directly to the beneficiary, as this is considered income and could result in a reduction or termination of benefits.⁵ Rather, payments should be made directly from the trust to the provider of the goods and services.

Special needs trust planning is critical for a family who depends on government benefits to provide for their family member. The question for high-net-worth families becomes: Is it necessary to establish an SNT, and be bound by its restrictions, when the family likely has sufficient funds to provide for a disabled family member without government benefits? The answer, in many cases, is yes.

¹For the sake of brevity, throughout this paper a special needs trust is sometimes referred to as an "SNT." In addition, unless otherwise specified, all references to SNTs in this paper are to third-party special needs trusts, which are discussed below.

²For example, Supplemental Security Income (SSI), which provides cash to meet basic needs for food, clothing, and shelter for aged, blind, and disabled people, is not available for individuals who own more than \$2,000 in countable assets, such as bank accounts and securities, in their own name. See 42 U.S.C. § 1382(a)(3)(B) (2015). Qualifying for SSI can be a prerequisite for accessing other benefits. In most states, someone who qualifies for SSI is automatically eligible for Medicaid, the ABLE Act (discussed below), and other important benefits. Thus, as discussed more below, establishing a special needs trust to protect access to government benefits can be important, even for a high-net-worth family, because the disabled family member's needs could change, and because certain desirable benefits may not be available to the disabled family member unless the family member is SSI eligible.

³42 U.S.C. § 1382b (a) (2015)

⁴Social Security Administration's Program Operations Manual System (POMS) SI 01120.200.D.2

⁵42 U.S.C. § 1382 (a)(3)(A) (2015)

Funding for Food and Shelter

Assets in an SNT can be used to pay for a wide variety of goods and services, from clothing and home maintenance to entertainment and travel. While most distributions from the SNT will not interfere with SSI benefits, there is one category that may: distributions made for food and shelter.

The purpose of SSI is to provide for a disabled person's basic needs: food and shelter. If a disabled person receives support for food and/or shelter⁶ from sources other than SSI, their SSI benefits may be reduced. The Social Security Administration refers to this as “in-kind support and maintenance” (ISM), and it is considered unearned income in the month the benefit is received. This is true whether the food and shelter are paid for by a family member, offered to the disabled person at no cost, or provided for by distributions from an SNT.⁷

Knowing this, a trustee must take care prior to making such distributions. Unfortunately, the maximum monthly federal SSI benefit⁸ of \$733 is unlikely to cover all of a person's food and housing expenses. Additional support from the SNT may be required.

Fortunately, SSI benefits aren't reduced dollar for dollar based on the full value of the ISM received. Rather, ISM is valued based on the lesser of the actual value of the benefit received or one-third of the monthly federal benefit rate.⁹ As such, regardless of the amount of support the SNT provides for food and shelter, SSI benefits will only be reduced by one-third, or approximately \$244, in the month the ISM is received. Once the SSI benefits have been reduced for ISM, they can't be reduced any further. The trust could then provide additional support for food or shelter that month without resulting in additional reductions to SSI payments.

A high-net-worth family may have sufficient funds today, and may even have sufficient wealth to provide for their family member over that person's lifetime. However, what if the family suffers a significant financial reversal? What if the individual's needs change and therapies and treatment become exponentially more expensive? Sometimes, certain programs or benefits are only available to those who qualify for government benefits, even if the family is willing and able to pay for them. Structuring a disabled beneficiary's trust as a special needs trust leaves all options open so that government benefits can be accessed, if necessary, at a later date.

Protecting Assets for a Disabled Family Member's Needs

Establishing a special needs trust for your disabled family member protects the assets and ensures they will be available for that person's care. Even if a disabled individual is capable of managing his or her assets today, that may change as the disability progresses. SNTs provide a mechanism for managing the assets irrespective of the disability. Furthermore, holding the assets in trust protects the assets from the disabled family member's creditors and unsavory individuals who may try to unduly influence him or her.

⁶Shelter includes, but is not limited to, rent, mortgage payments, property taxes, electricity, water, sewer, and garbage services (POMS, SI 00835.465).

⁷POMS, SI 00835.001

⁸As of 2016; Social Security Administration: <https://www.ssa.gov/oact/cola/SSI.html>

⁹ISM can either be valued based on the value of the one-third reduction (VTR) rule (POMS, SI 00835.200) or the presumed maximum value (PMV) rule (POMS, SI 00835.300). The VTR rule will result in a reduction of benefits by the lesser of the actual benefit received or one-third of the federal benefit rate, while the PMV rule will result in a reduction of benefits by the lesser of the actual benefit received or one-third of the federal benefit rate plus \$20.

It is not uncommon for parents of a special needs child to leave all of their assets to their children without disabilities or to other surviving family members, with instructions to take care of the disabled individual. Parents employ this approach to make sure that their disabled child is not disqualified from government benefits. However, this strategy is fraught with risk. If the “able” heirs do not have a sense of obligation toward their disabled family member, then the disabled individual can be left without the resources for necessary care. Even if the surviving family is committed to caring for the disabled person, leaving the assets to the “able” heirs subjects the assets to the claims of *their* creditors—which includes spouses. Parents can protect assets from these risks and ensure that the assets will be available for their child’s needs if they establish a special needs trust.

Parents can ensure that assets will be available for their child by establishing a special needs trust.

The SNT trustee’s duties, such as tax reporting, record keeping, and benefits management can be complex. Selecting an appropriate trustee for a family member’s special needs trust is an important decision, which can be impacted by family dynamics. In some cases, naming an independent corporate trustee, such as a bank or trust company, is ideal because it assures professional management and avoids a situation in which a disabled family member is dependent on the decisions of another family member. The preferred trustee, whether individual or corporate, will also be determined based on the type of special needs trust the family determines is best for the disabled family member.

TYPES OF SPECIAL NEEDS TRUSTS

There are three categories of SNTs, namely, first-party special needs trusts, third-party special needs trusts, and pooled special needs trusts.

First-Party Special Needs Trust

A first-party special needs trust is established with property owned by the disabled individual and must be set up before the individual turns 65.¹⁰ Examples of property include inheritances, divorce settlements, and personal injury awards. Certain assets, such as Social Security Disability Insurance (SSDI) income and SSI payments and applicable veterans’ benefits and federal retirement benefits cannot be assigned to a first-party special needs trust.¹¹ Importantly, first-party SNTs are generally subject to “payback” rules that require the trust to reimburse the state for medical expenses after a beneficiary dies.¹²

Third-Party Special Needs Trust

A third-party special needs trust is created with assets of a person other than the disabled beneficiary, also known as the grantor. Unlike a first-party SNT, third-party special needs trusts sidestep the “payback” provision for repayment of medical expenses. In addition, there is no maximum age for the beneficiary. A third-party SNT can be established during the grantor’s lifetime or following the grantor’s death.

Since there is no limit on the value of assets that can be contributed to a third-party special needs trust, a third-party SNT can be the most meaningful source of financial support in the beneficiary’s life. In addition, the ability of the grantor to name remainder beneficiaries allows the assets in trust to continue on as a legacy for other family members.

¹⁰42 U.S.C. § 1396p(c)(2)(B)(iv)(2016)

¹¹POMS, SI 01120.200.G.1.c

¹²42 U.S.C. § 1396(d)(4)(A); POMS, SI 01120.203.B.1.h.(2016)

Pooled Special Needs Trust

The pooled special needs trust is a third classification of SNTs that can either be funded by the disabled individual or by a third party. A pooled trust, sometimes called a “(d)(4)(C),” combines, or “pools,” the assets of many beneficiaries, and the assets are managed by a nonprofit organization.¹³ Pooled trusts are typically chosen by families who do not have sufficient assets to justify a stand-alone special needs trust. They may be established for beneficiaries of any age.¹⁴ In addition, subject to applicable state law, medical expenses of a deceased beneficiary do not need to be reimbursed as long as the beneficiary’s assets remain in the pooled trust for other disabled beneficiaries.¹⁵

WHEN SHOULD YOU ESTABLISH AND FUND A SPECIAL NEEDS TRUST?

Once a family has determined that a special needs trust is appropriate, the focus then turns to when the trust should be established. A key question is whether the trust should be created during the lifetime of the grantor, often a parent, who is providing for a special needs family member, or following the grantor’s death.

If a grantor decides to establish a lifetime SNT, how should that trust be funded? It depends on the size of the grantor’s estate, remaining applicable exclusion,¹⁶ and cost basis of existing assets. Sometimes a married grantor has used much of his or her applicable exclusion or wants to keep as much applicable exclusion as possible to cover assets in the grantor’s estate and receive a cost basis step-up at the death of the grantor’s

surviving spouse. In that case, the family should consider wealth transfer techniques that use little or no applicable exclusion to fund the SNT. For example, a short-term rolling grantor retained annuity trust (GRAT) strategy, with the remainders passing to a special needs trust, provides an excellent funding mechanism. *Display 9* and *Display 10* (on pages 18 and 19, respectively) demonstrate the power of a short-term rolling GRAT strategy in this context.

For other families, even families with means, funding a special needs trust during lifetime is not feasible. The assets might be required to meet the current or future needs of the family. Delaying the funding of the trust enables the family to preserve as much flexibility as possible. In that event, it makes more sense to wait until the death of the grantor or the grantor’s surviving spouse.

Whether a special needs trust is established during lifetime or at death, family members should coordinate their plans for disabled individuals.¹⁷ For example, grandparents who wish to benefit a special needs grandchild should be counseled to structure that grandchild’s trust share as an SNT or to direct the distribution of the grandchild’s share to a special needs trust established by the child’s parents or other relatives. Providing an outright distribution of the disabled child’s share could disqualify the grandchild from benefits. While the family could create an SNT after the distribution was made, the trust would have to be structured as a first-party special needs trust, which, as discussed above, would be subject to undesirable “payback” provisions.

¹³See U.S.C. § 1396(d)(4)(C)(2016)

¹⁴*Id.*

¹⁵*Id.*

¹⁶See § 2010 of the Internal Revenue Code of 1986, as amended (“Code”), and the Treasury Regulations (“Treas. Reg.”) thereunder.

¹⁷Some families draft a “Letter of Intent” to highlight other important issues related to their disabled family member’s care. In this document, families can describe their disabled family member’s personality (e.g., cognitive profile, social preferences, behavioral sensitivities), communication skills, favorite foods/activities/objects, and routines. This letter can be used to identify the most important people in the disabled family member’s life, such as family, friends, caregivers, therapists, educators, and physicians. The letter can also outline the family’s long-term hopes for the disabled family member so that future caregivers can help to realize those dreams.

WHAT ASSETS SHOULD BE USED TO FUND A SPECIAL NEEDS TRUST?

Once a family decides to establish a special needs trust, the focus turns to identifying the most appropriate assets for funding. Liquid assets—such as cash, stocks, and bonds—are desirable, but aren't always available. What if a family's wealth largely comprises retirement plans or illiquid assets, such as real estate or a family business? Special care must be taken with these assets to ensure that the property can be managed for the disabled family member without disqualifying him or her from accessing valuable government benefits.

The rules governing IRAs are complex—and that complexity is magnified when an SNT is involved.

Retirement Assets

It is not uncommon for the bulk of a family's wealth to be held in qualified retirement plans or in an individual retirement account (IRA). Leaving IRA assets to a disabled family member outright may disqualify the disabled individual from benefits, and the individual may not be capable of managing the assets. One solution is to fund a special needs trust with non-IRA liquid assets for the disabled family member and leave the illiquid assets and retirement benefits for other relatives. This works when there are sufficient other assets but is not a solution when IRAs make up the majority of the estate.

Is it possible for an SNT to be designated as the beneficiary of an IRA? Yes, but if the family desires “stretch” treatment (meaning that the IRA distributions will be calculated over the disabled person's lifetime), then the IRA beneficiary designation must specifically name the SNT as the beneficiary.¹⁸ Furthermore, the trust must provide for individual, contingent beneficiaries. If the contingent beneficiary is a charity, for example, then IRS rules require a “look through” to the disabled person and the charity, with a life expectancy of zero, and will require the IRA proceeds to be paid one of two ways:

- To the SNT over five years (if the owner died before his or her required beginning date) or
- Over the deceased owner's remaining actuarial life expectancy (if the owner died after his or her required beginning date).¹⁹

This pitfall can be avoided by naming individual beneficiaries (e.g., other children) as the contingent beneficiaries to receive any trust funds remaining after the disabled person's death.

Furthermore, “stretch” IRA treatment is not available for successor beneficiaries named on an IRA beneficiary designation who inherit an IRA account after the primary beneficiary's death. If the surviving spouse is the primary beneficiary and the special needs trust is the contingent beneficiary, then the SNT will not be able to elect “stretch” treatment over the disabled person's lifetime unless the surviving spouse elects to roll over the IRA into his or her own IRA and then name the special needs trust as the primary beneficiary.²⁰

¹⁸Treas. Reg. § 1.401(a)(9)-5

¹⁹*Id.*

²⁰*Id.*

The rules governing IRAs are complex in their own right, and the complexity is magnified when a special needs trust is named as a beneficiary of an IRA. It is critical to obtain competent legal and tax advice when naming beneficiaries of an IRA, especially when the beneficiary is an SNT, to ensure that the designations carry out the family's wishes.

Real Estate

A disabled family member can own a primary residence in his or her name without being disqualified from receiving SSI.²¹ However, it is often desirable for a special needs trust to own the home instead, so that the designated trustee can manage the property on the disabled family member's behalf.²² Sufficient cash will need to be contributed to the SNT so that expenses related to the property can be paid.

If a special needs trust purchases a home in which the beneficiary resides, the beneficiary will be treated as receiving in-kind income during the month in which the trust buys the house, and the beneficiary's SSI benefit will be reduced accordingly for that month. In all subsequent months, the special needs trust can spend whatever is required to maintain the residence without affecting the beneficiary's SSI benefits, but any payments associated with shelter, such as mortgage or utility payments, will reduce the beneficiary's SSI benefit.²³ (See "Funding for Food and Shelter" on page 3.)

The determination of whether a special needs trust should own real estate on a disabled family member's behalf is not always straightforward. A family contemplating such a transaction should consult with qualified counsel specializing in special needs planning to evaluate the available options.

ABLE ACT ACCOUNTS AND SPECIAL NEEDS TRUSTS

On December 19, 2014, the Achieving a Better Life Experience (ABLE) Act (the "Act") was passed into law, providing significant tax-advantaged savings to people with disabilities. While this groundbreaking legislation represents a huge step forward, it has also left many people wondering how it might change the future of planning for special needs individuals.

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While the importance of the ABLE Act shouldn't be diminished, these accounts are not necessarily a silver bullet.

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Inspired by 529 college savings plans, the Act enables people with disabilities to maintain tax-advantaged savings accounts, known as "ABLE accounts," without impacting their access to government benefits. Normally, if a person with disabilities has assets held in his or her own name in excess of \$2,000, he or she will be automatically disqualified from receiving important benefits such as SSI and/or Medicaid.²⁴ However, assets held in an ABLE account are not included for the purpose of determining eligibility, so long as the balance does not exceed \$100,000.²⁵ If the balance does exceed \$100,000, benefits may be suspended but are not necessarily terminated.

The Act allows a disabled person to be listed as the ABLE account owner and make contributions for himself or herself. In addition, the assets in the account will grow *tax-free* as long as distributions are used for "qualified disability expenses."²⁶

²¹Additional limits may apply if a special needs trust beneficiary receives Medicaid.

²²If the trust is a first-party special needs trust, the real estate will be subject to "payback" requirements at the disabled person's death. Thus, it may not be advisable for a first-party special needs trust to own real estate.

²³Refer to footnote 9

²⁴POMS, SI 01110.003.A.2

²⁵POMS, SI 01130.740.C.3

²⁶Code § 529A(a) and § 529A(c)(1)(B)

Qualified expenses include things such as medical expenses, assistive technology, employment training, housing, education, and other disability-related expenses as defined by the IRS.²⁷ As is the case with college savings plans, earnings on non-qualified distributions will be subject to income tax in addition to a 10% tax penalty.²⁸

**Before thinking about how and when
to fund the SNT, first determine the
appropriate funding amount.**

As you might imagine, there is a lot of excitement brewing over this new program. The increased savings ability and independence offered by ABLÉ accounts are likely to have a very positive impact on both the financial well-being and quality of life for people with disabilities. In fact, many people are asking if the ABLÉ Act legislation is going to reduce or even eliminate the need for special needs trusts. While the importance of this new legislation shouldn't be diminished, these accounts are not necessarily a silver bullet, for a number of reasons:

Eligibility Requirements. In order to qualify for these unique savings accounts, the person must meet the same disability standards required to qualify for SSI and Medicaid, as defined by Title II and Title XVI of the Social Security Act, or file a disability certification with the state. In addition, the disability must have occurred prior to age 26.²⁹

Limitations on Contributions. While contributions to the account may be made by anyone, including the person with disabilities, the annual aggregate contribution amount *from all sources* is limited to \$14,000 (as defined by the federal annual exclusion limit).³⁰

Account Size Limitations. The total account size will be subject to the state's 529 college savings account limits. While these limitations vary state by state, they range from \$235,000 to over \$400,000.³¹ However, once the account value exceeds \$100,000, SSI benefits may be suspended. If the account drops back below \$100,000, benefits could be reinstated, assuming the person hasn't become otherwise ineligible. Importantly, Medicaid benefits will not be impacted as a result of assets held in an ABLÉ account, even if SSI benefits are suspended.³²

Medicaid Payback. As is the case with first-party special needs trusts, assets remaining in the ABLÉ account upon the death of the designated beneficiary will be subject to the "pay-back" rules. Medicaid payments made by the state on behalf of the designated beneficiary since the inception of the ABLÉ account would be required to be repaid to the extent there are sufficient funds in the account.³³ Any remaining assets could then pass to the beneficiary's heirs.

Control of Assets. Assets held in an ABLÉ account may be under the direct control of the disabled person. While this may offer life-changing independence for some, it may not be appropriate for others, depending on the nature of the beneficiary's disability.

From a long-range planning perspective, the most significant drawback to these accounts is the limit on annual contributions and the \$100,000 threshold. With the relatively small annual contribution amount, the account may never grow to a size that would provide adequate financial support to a beneficiary with a long time horizon. Even if the account did grow large enough through diligent ongoing contributions and savvy investment choices, the beneficiary may lose access to important programs such as SSI.

²⁷Code § 529A.(e)(5)

²⁸Code § 529A.(c)(3)(A)

²⁹Code § 529A.(e)(1)

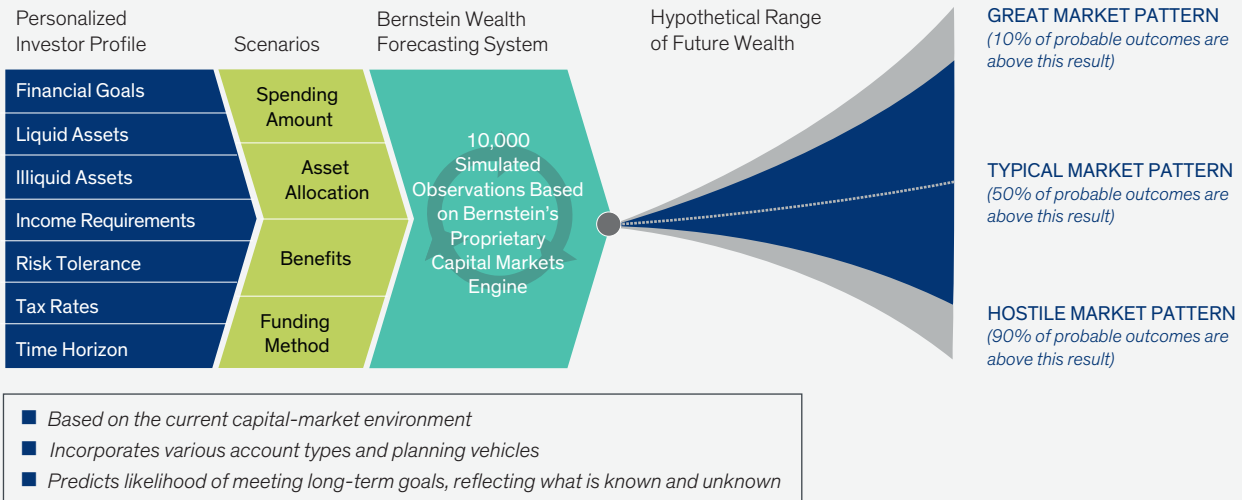
³⁰Code § 529A.(b)(2)(B); see also Code § 2503(b)(1) and Code § 2503(b)(2)

³¹Code § 529A.(b)(6)

³²Pub. L. 113-295, Div. B, Title I, § 103, December 19, 2014, 128 Stat. 4063

³³Code § 529A.(f)

DISPLAY 1: BERNSTEIN'S WEALTH FORECASTING SYSTEMSM



The Bernstein Wealth Forecasting System is based upon our proprietary analysis of historical capital-market data over many decades. We look at variables such as past returns, volatility, valuations, and correlations to forecast a vast range of possible outcomes relating to market asset classes, not Bernstein portfolios. While there is no assurance that any specific outcome suggested by the model will actually come to pass, by quantifying the possibilities of achieving financial goals under changing, and sometimes extreme, capital-market conditions, the tool should help our clients make better choices. See Notes on Wealth Forecasting System on page 20.

Source: AB

Ignoring these limitations for a moment, a family must also think about how much wealth is appropriate for the designated beneficiary to have direct control over. A smaller spending account could provide a sense of financial freedom and independence, but being responsible for a pool of assets designed to meet the beneficiary's lifetime spending needs may not be advisable. For these reasons, ABLE accounts are likely a good complement to, but not a replacement for, SNTs.

HOW CAN BERNSTEIN HELP?

Once you've decided that a special needs trust should play a role in your estate plan, what next? How much will you need to fund it with? Are you on track to be able to fully fund your SNT? If so, when and how should it be funded? These are all complicated questions. Fortunately, using our proprietary Wealth Forecasting SystemSM, we can help bring some clarity to these issues by quantifying the financial impact that decisions you make today may have over time.

Sizing the Special Needs Trust

Before thinking about how and when to fund the SNT, you first have to determine an appropriate funding amount. We advise our clients to fund the trust with an amount that can support the beneficiary's lifetime inflation-adjusted spending needs with a very high degree of confidence. We call this amount "core capital."

To determine the beneficiary's core capital needs, we must first understand the level of spending the trust will need to support, the beneficiary's spending horizon, and the appropriate level of risk for the trust. Using our Wealth Forecasting System, we can then solve for the amount of funding that will sustain the beneficiary's lifetime spending needs with a high level of confidence even if we experience higher-than-expected inflation and poor market outcomes (*Display 1*).

DISPLAY 2: SPENDING NEEDS WILL VARY BASED ON INDIVIDUAL CIRCUMSTANCES



| | |
|---------------------|-------------|
| ■ Clothing | \$200/month |
| ■ Cable/Phone/Ins. | 300 |
| | |
| ■ Transportation | 200 |
| ■ Household Needs | 100 |
| ■ Maintenance | 100 |
| ■ Personal Care | 75 |
| | |
| ■ Entertainment | 100 |
| ■ Travel | 300 |
| ■ Professional Fees | 300 |
| | |
| ■ Housing Costs | 1,800 |
| ■ Food | 700 |



| | |
|---------------------|-------------|
| ■ Clothing | \$250/month |
| ■ Cable/Phone/Ins. | 400 |
| ■ Therapy | 800 |
| ■ Transportation | 300 |
| ■ Household Needs | 300 |
| ■ Maintenance | 100 |
| ■ Personal Care | 150 |
| ■ Pet Care | 75 |
| ■ Entertainment | 200 |
| ■ Travel | 500 |
| ■ Professional Fees | 1,600 |
| ■ Companion | 1,000 |
| ■ Housing Costs | 1,800 |
| ■ Food | 850 |



| | |
|------------------------|-------------|
| ■ Clothing | \$300/month |
| ■ Cable/Phone/Ins. | 400 |
| ■ Therapy | 1,000 |
| ■ Transportation | 300 |
| ■ Household Needs | 400 |
| ■ Maintenance | 200 |
| ■ Personal Care | 200 |
| | |
| ■ Entertainment | 300 |
| ■ Travel | 800 |
| ■ Professional Fees | 3,400 |
| ■ Companion | 4,500 |
| ■ Housing Costs | 3,000 |
| ■ Food | 1,000 |
| ■ Medical Specialists | 500 |
| ■ Communication Equip. | 300 |

*For illustrative purposes only.
Source: AB*

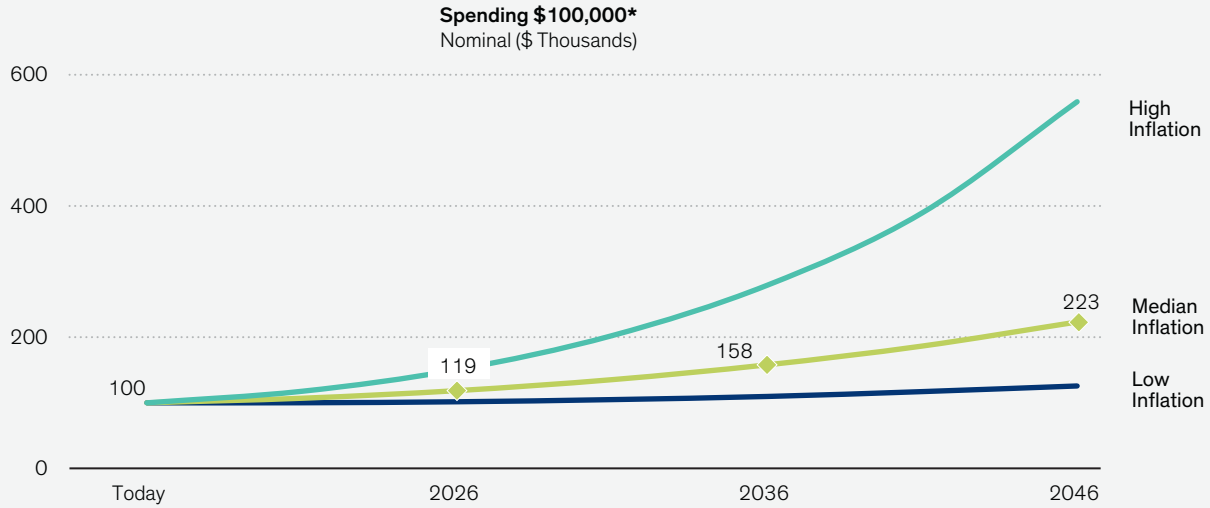
Spending typically has the largest impact on estimating core capital. When sizing the trust, we must take into account the impact that inflation might have on the beneficiary's spending needs. Incidentally, it might also be one of the most difficult tasks. Depending on the nature of the family member's disability, spending needs could be as basic as housing costs, food, and utilities, along with some travel and entertainment. Other individuals may have more complex needs that require additional financial support, such as paying for special therapies, medical specialists, or communication equipment (*Display 2*).

You must also consider if the person's needs are likely to change over time as the disability progresses or the condition declines. Plus, you will want to take into account how much spending will be offset by government benefits such as SSI and Medicaid and how benefits might in turn be impacted by additional support offered by the trust.

Once spending needs have been determined, we can begin to size core capital requirements. For example, imagine we have a beneficiary with a 30-year time horizon and a trust that will have an asset allocation of 60% global stocks and 40% bonds. In addition to government benefits, the beneficiary will need annual support of \$100,000, *inflation-adjusted*. It's important to take into account the impact that inflation might have on the beneficiary's spending needs.

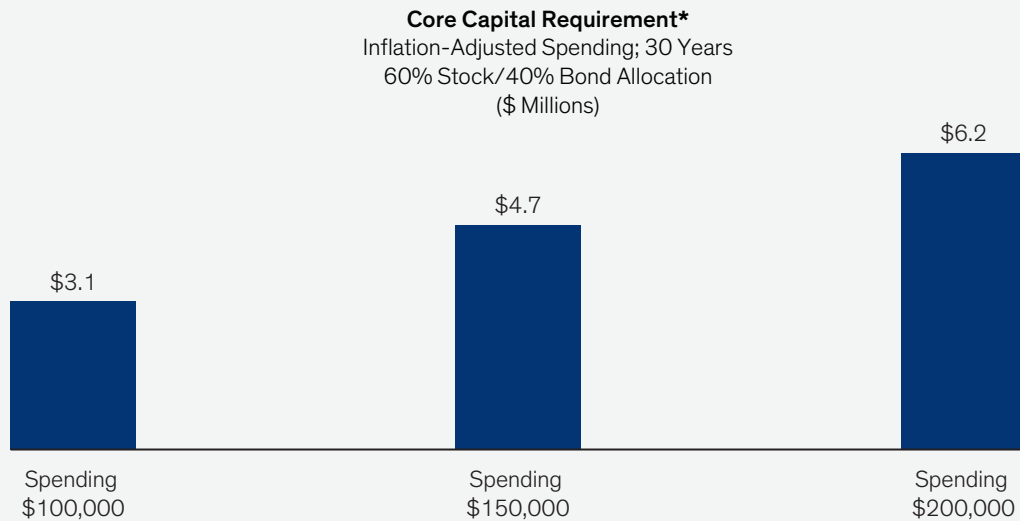
While inflation has been relatively benign of late, inflation spikes can occur with little notice and have a devastating impact on a person's purchasing power. Based on our projections of a typical inflationary environment, over the next 30 years the same beneficiary would need annual distributions of \$223,000 just to maintain her current lifestyle needs—more than double her current spending (*Display 3*). And if inflation runs higher than expected, she could need substantially more! We estimate the trust will need to be funded with \$3.1 million (*Display 4*).

DISPLAY 3: PROJECTED IMPACT OF INFLATION ON SPENDING



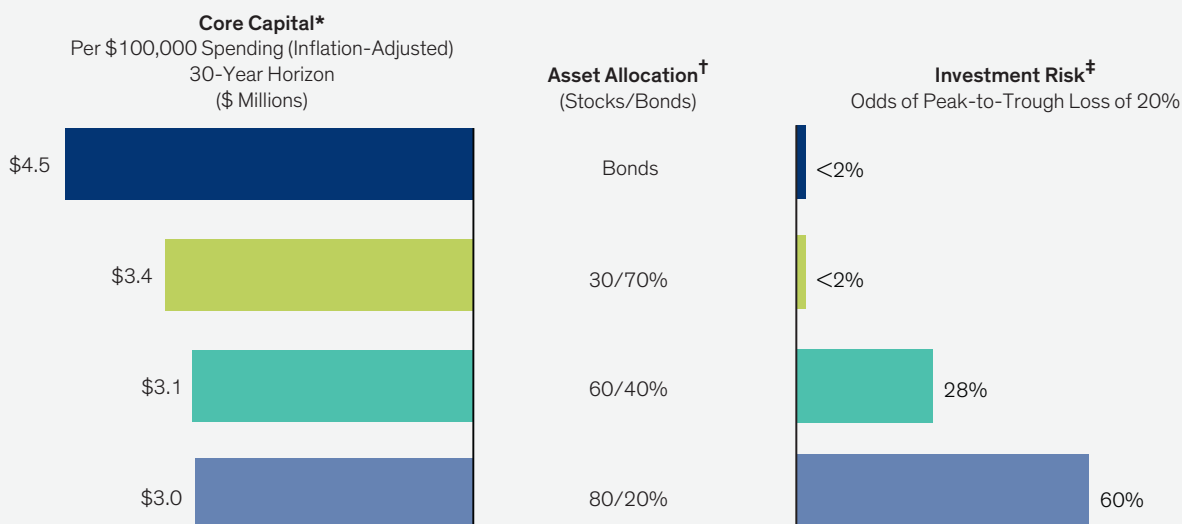
*Spending amount is shown based upon 10th ("High"), 50th ("Median"), and 90th ("Low") percentile outcomes for inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20. Source: AB

DISPLAY 4: CORE CAPITAL REQUIREMENT INCREASES WITH HIGHER SPENDING



*Core capital is defined as the amount of money needed today to support annual inflation-adjusted spending of \$100,000, \$150,000, or \$200,000, respectively, over the next 30 years with a 90% level of confidence from a portfolio invested in 60% globally diversified stocks and 40% intermediate-term diversified municipal bonds; assumes top marginal federal income tax rates and a 6.0% state income tax rate. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20. Source: AB

DISPLAY 5: HIGHER ALLOCATIONS TO EQUITIES REDUCE FUNDING REQUIREMENTS . . . BUT INCREASE EXPECTED VOLATILITY



*Core capital is defined as the amount of money needed today to support annual inflation-adjusted spending of \$100,000 over the next 30 years with a 90% level of confidence; assumes top marginal federal income tax rates and a 6.0% state income tax rate.

†“30/70” means 30% globally diversified equities and 70% bonds; “60/40” means 60% globally diversified equities and 40% bonds; “80/20” means 80% globally diversified equities and 20% bonds. Bonds are modeled as intermediate-term diversified municipal bonds.

‡Probability of a 20% peak-to-trough decline in pretax, pre-cash-flow cumulative returns within the next 20 years. Because the Wealth Forecasting System uses annual capital-market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years.

Based on Bernstein’s estimates of the range of returns for the applicable capital markets as of March 31, 2016. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20.

Source: AB

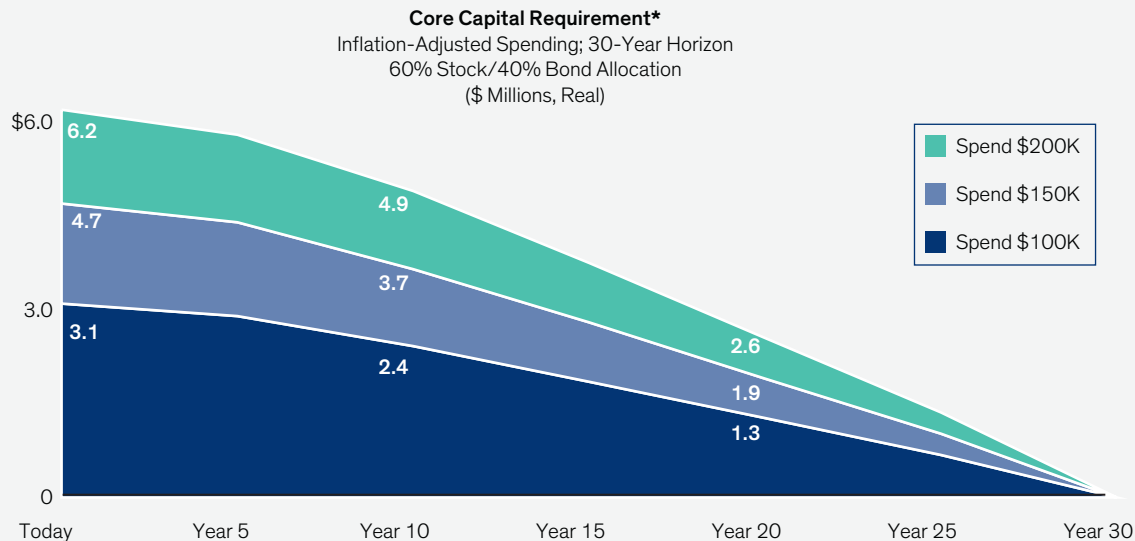
to account for the impact of high inflation and difficult market cycles. If the spending requirement is double the anticipated annual spending of \$100,000, or \$200,000, the SNT will need to be funded with \$6.2 million; and to support \$150,000, \$4.7 million will be required.

Core capital also depends on how the funds are invested. The core capital amounts referenced above are all invested in a moderate portfolio of 60% stocks and 40% bonds. As stated previously, if the trust needs to sustain \$100,000 of spending at a moderate allocation for a 30-year horizon, we estimate that the trust will need \$3.1 million. An all-bond portfolio, on the other hand, will require significantly more wealth to support the

same level of spending, because the return expectations for this portfolio are lower. Conversely, moving to a more growth-oriented portfolio of 80% stocks and 20% bonds will reduce the required funding level, but only modestly (*Display 5*).

Asset allocation’s impact on core capital is only one side of the story. While the more growth-oriented portfolio has the lowest funding requirement, it also has the highest volatility. We quantify volatility as the odds of experiencing a 20% peak-to-trough decline at some point over a 20-year period. While the odds of a 20% loss are negligible for the all-bond portfolio, there is about a one-in-four chance for the 60/40 portfolio, and these odds more than double for the growth-oriented portfolio.

DISPLAY 6: CORE CAPITAL REQUIREMENT DECLINES OVER TIME



*Core capital is defined as the amount of money needed to support annual inflation-adjusted spending of \$100,000, \$150,000, or \$200,000, respectively, over the next 30 years, with a 90% level of confidence from a portfolio invested in 60% globally diversified stocks and 40% intermediate-term diversified municipal bonds; assumes top marginal federal income tax rates and a 6.0% state income tax rate. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20.
Source: AB

One of the other variables complicating the SNT funding picture is the uncertainty surrounding when the beneficiary will need to start drawing upon the trust. While she may have a 30-year horizon today, her parents expect to be around for many years to come and will be able to continue to provide for her directly. Assuming they live for another 20 years, our beneficiary will be 20 years older and therefore have fewer years of additional spending for which the trust will need to provide. As you might expect, core capital declines over time, because as time passes, there are fewer spending years ahead that the portfolio needs to support.

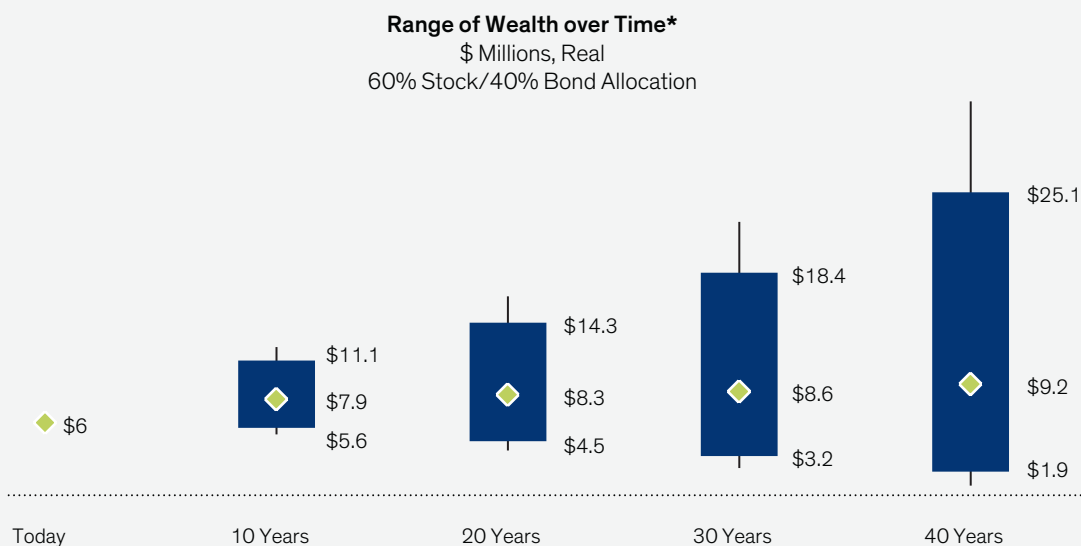
Let's continue with the example of a beneficiary who needs \$100,000 annually and has a 30-year time horizon. If she needed to start spending from the trust today, the trust would need to be funded with \$3.1 million, assuming a moderate allocation. But if her parents continue providing support for another

10 years, the trust will need only \$2.4 million (inflation-adjusted) (Display 6). And if they provide support for 20 years, they could fully fund the trust with just under \$1.3 million. This declining need can make the funding amount a bit of a moving target, which increases the importance of proper planning.

Funding Your SNT

Now that you've determined how much with which to fund your SNT, the next question is whether you can fully meet this need. Let's look at an example. Barb and Chris are in their mid-50s. Their only child, Sarah, is in her late teens, has special needs, and is projected to live another 50 years. Barb and Chris spend about \$100,000 annually to support Sarah but estimate that these costs will increase to \$150,000 once they are no longer around. They plan to fund an SNT for her, and based on their family history, they expect to live into their mid-90s. Assuming they fund the SNT 40 years from now, we estimate that the

DISPLAY 7: IN TYPICAL MARKETS BARB AND CHRIS ARE LIKELY TO HAVE MORE THAN ENOUGH WEALTH TO FULLY FUND THE SNT IN 40 YEARS



*Based on an initial portfolio of \$6 million invested in an allocation of 60% globally diversified stocks and 40% intermediate-term diversified municipal bonds, plus pretax inflation-adjusted salary income of \$600,000 for the next 10 years, declining to \$200,000, in today's dollars, for the subsequent five years; pretax pension income of \$50,000, grown by 2% annually, beginning in 2026; and Social Security benefits of \$40,000 annually, inflation-adjusted, for each spouse beginning in 2031; net of annual living expenses of \$250,000, inflation-adjusted, for the duration of the analysis and a \$60,000 annual fixed mortgage payment for the next 10 years. Assumes top marginal federal income tax rates and a 6.0% state income tax rate.

Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20.

Source: AB

trust will need to be funded with \$1.9 million (in today's dollars) in order to provide at least 10 years of spending support for Sarah.

Before determining if they can fully fund the SNT, we need to make sure Barb and Chris's own financial needs are likely to be met by their \$6 million portfolio. They both intend to work for another 10 years, earning a combined salary of \$600,000, which will adjust with inflation. Chris will likely continue working

part-time until age 70.³⁴ In addition, they will receive some modest Social Security income³⁵ and pension income.³⁶ Their living expenses, in addition to their financial support for Sarah, total \$310,000, which includes a monthly mortgage payment of \$5,000 that will be fully paid off in another 10 years.³⁷ Using our Wealth Forecasting System, we are able to project Barb and Chris's range of wealth over time. After 40 years, we estimate their wealth will have grown to \$9.2 million in typical markets (*Display 7*).

³⁴Assumes Chris will serve as a board member earning \$200,000 pretax in today's dollars.

³⁵Assumes that in 2031, each spouse will receive \$40,000 in annual pretax, inflation-adjusted Social Security income.

³⁶Assumes annual pretax pension income of \$50,000, grown by 2% per year, beginning in 2026.

³⁷Mortgage payments are fixed, while remaining living expenses are assumed to adjust with inflation.

In fact, over their mortality-adjusted life span,³⁸ there is a 96% chance that they will be able to meet their own spending needs while supporting Sarah along the way. What about the SNT? Remember, we estimate that Sarah will need \$1.9 million. If markets are typical, Barb and Chris could fully fund the SNT four times over! While it's likely that they will have more than enough to fund the trust, they don't want to take any chances. Providing for Sarah after they are gone is critically important, and they are not willing to gamble on hoping for typical market conditions. Fortunately, in their case, even under hostile market outcomes, they are likely to have enough wealth to fully fund the trust.

If a beneficiary starts spending from the trust sooner, he or she will need more capital than expected.

The fact that Barb and Chris will continue to earn a substantial salary for the next 15 years greatly contributes to the success of their plan. This enables them to continue to grow their portfolio over time, even after spending and inflation. But what if Barb and Chris were to suffer an untimely death? Would they be able to fund the SNT for Sarah sooner? Remember, Sarah

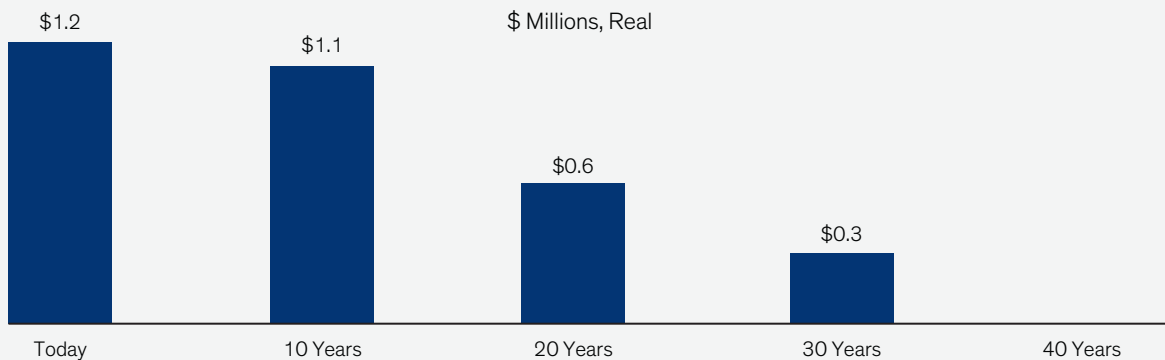
needs \$1.9 million 40 years from now, but if she starts spending from the trust sooner, she will need more capital. If she started spending from the trust 20 years from now, she would actually need \$5.1 million. And if she began spending from it today, she would need \$7.2 million. But Barb and Chris only have \$6 million. If they had to fund the trust tomorrow, they would be \$1.2 million short. How can they protect themselves from the risk of an early death?

Fortunately, there is an investment solution designed to do just that: life insurance. By using our Wealth Forecasting System, we can determine how much life insurance Barb and Chris will need at any point in time. The difference between the SNT funding amount and what the portfolio is expected to have over time, assuming poor market returns, represents the "insurance gap." While the gap is large today, the longer they are able to keep working and building their portfolio, the smaller the funding gap becomes, until it is reduced to zero (*Display 8*). Now that we know how much insurance is needed, we can turn to Barb and Chris's insurance advisor to create a customized insurance plan to help fill in this gap. Once we have the proposal, we can return to our analysis to evaluate the impact that the insurance premiums have on the portfolio. For most working investors, these premiums are generally modest and therefore have a limited impact.³⁹

³⁸Based on the joint life expectancy for a 55-year-old male and a 55-year-old female according to the Society of Actuaries RP-2000 mortality tables. To reflect that affluent individuals live longer than average, we subtract three years from each individual's age (e.g., a 65-year-old is modeled as a 62-year-old).

³⁹A 20-year term life insurance policy typically costs between \$1,000 and \$1,500 a year per \$1 million in coverage, depending on your age and health conditions.

DISPLAY 8: SNT FUNDING SHORTFALL DECLINES OVER TIME*



*The SNT funding shortfall is defined as the difference between the amount of funding the SNT will require to support inflation-adjusted spending of \$150,000 annually with a 90% level of confidence at any point in time, and the inheritance the SNT could expect to receive assuming poor market outcomes. All values are listed in today's dollars. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20.

Source: AB

Poor Drafting Can Lead to "Crummey" Results

People with a particularly large estate may want to consider creating an irrevocable life insurance trust (ILIT) in order to keep the life insurance proceeds from being included in their estate for estate tax purposes. In the case of an ILIT, the grantor makes cash gifts to the trust and the cash is used to pay the life insurance premiums. ILITs can be combined with SNTs by naming the SNT as the beneficiary of the ILIT. If structured properly, the ILIT's assets will not be considered those of the disabled child and will not interfere with his or her SSI and Medicaid benefits.

However, if the ILIT isn't structured properly, the disabled person could be disqualified from receiving benefits. The issue is the commonly used "Crummey" powers, which provide the beneficiary with a limited right to withdraw the assets that have been gifted to the trust. They are often included in an ILIT to ensure the gifts made to the

trust qualify as annual exclusion gifts rather than using up the grantor's lifetime applicable exclusion.⁴⁰ Most beneficiaries will waive their right to withdraw the gifts so that the trust has the necessary funds to pay the insurance premiums. However, in the case of a special needs person, the Social Security Administration views that right to withdraw assets (even if not exercised) either as a gift or as income in the month the payment is transferred to the trust—and potentially as an asset the following month—thereby disqualifying the person from benefits.⁴¹

The good news is that there is a relatively easy solution. In most cases, the withdrawal right can be limited to other non-disabled beneficiaries of the ILIT (often siblings of the special needs person). Alternatively, the grantor can fund the trust by using the grantor's remaining applicable exclusion.

⁴⁰The annual exclusion refers to a provision of the Code under which the first \$14,000 (as of 2016) of property transferred in a given year by a donor to an individual or certain types of trusts is excluded from the computation of the donor's taxable gifts in that year [Code § 2503(b)(1) and Code § 2503(b)(2)].

⁴¹POMS, SI 01120.200.D.1.a

When to Fund Your SNT

For many people, funding an SNT at death makes a lot of sense. Having to administer the trust during your lifetime, file trust tax returns, and deal with the compressed tax brackets associated with the irrevocable trust are all additional burdens that many would choose to avoid. But for those who are exposed to a meaningful estate tax liability, choosing to fund an SNT during their lifetime may prove to be the better option.

Take Linda and David, for example, both in their mid-60s. They have a total net worth of \$33 million, including \$18 million in low-basis real estate, \$14.5 million in liquid taxable assets, and \$500,000 in a Roth IRA. Their liquid wealth, invested in a moderate 60/40 allocation, along with their Social Security income,⁴² is more than enough to meet their lifetime spending needs of \$350,000 per year, adjusted for inflation. They have three children, one of whom has special needs. Their special needs child, Chase, is in his 30s and is currently able to live independently. He also is able to work part-time but still receives a modest amount of support through SSI.

Linda and David plan to divide their estate evenly among their three children upon their passing, but plan to target their liquid, taxable assets to the SNT for Chase and the real estate and Roth IRA to their other two children. They planned to wait to transfer assets until their death since their children currently have no need for the assets. However, their attorney has

warned them that even though they have not used any of their combined \$10.9 million applicable exclusion, leaving all of their assets in their estate could expose them to a meaningful estate tax liability.

While they'd like to reduce their estate tax liability by doing some lifetime gifting, they also know how valuable the step-up in cost basis will be on their low-basis real estate. As such, their attorney is recommending that they use a portion of their liquid assets to fund a rolling grantor retained annuity trust (GRAT) strategy where the SNT is the beneficiary of the GRATs. This will allow them to preserve their applicable exclusion and get a step-up in basis on the real estate assets while reducing their estate tax liability. Using our Wealth Forecasting System, we are able to forecast how each strategy is likely to impact the amount of wealth they are able to transfer to their children.

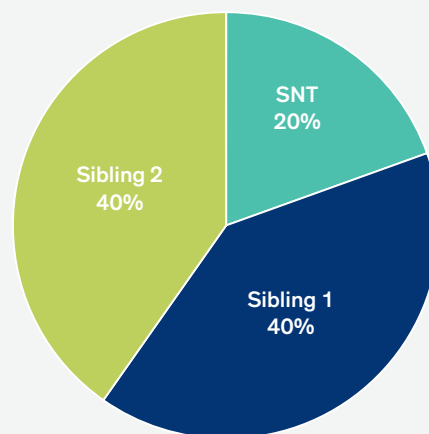
Under their current estate plan, we project that in 30 years they will have a total estate valued at nearly \$34 million, after all spending, taxes, inflation, and a \$9.2 million estate tax liability. Given that the estate tax liability will need to be paid from the liquid taxable assets, the net estate will include approximately \$18 million of real estate, \$1.8 million in a Roth IRA, and \$4.8 million of taxable assets. This leaves the SNT with less than \$5 million, while the other two children will each receive almost \$10 million (*Display 9, next page*).

⁴²Assumes combined pretax Social Security benefits of \$52,000 annually, inflation-adjusted.

DISPLAY 9: LINDA AND DAVID'S CURRENT PLAN MAY LEAD TO A DISPROPORTIONATE DISTRIBUTION OF WEALTH AMONG THE THREE SIBLINGS . . .

\$ Millions, Real

| | Year 30 |
|--------------------------------------|----------------|
| Liquid Taxable Assets | \$14.0 |
| Roth IRA | \$1.8 |
| Real Estate | \$18.0 |
| Pre-Estate-Tax Family Wealth* | \$33.8 |
| <i>Estate Taxes[†]</i> | <i>\$(9.2)</i> |
| Liquid Taxable Assets | \$4.8 |
| Roth IRA | \$1.8 |
| Real Estate | \$18.0 |
| Post-Estate-Tax Family Wealth | \$24.7 |



Numbers may not sum due to rounding.

*Assumes \$350,000 in annual inflation-adjusted spending, offset by \$52,000 of annual pretax Social Security benefits and an overall allocation of 60% globally diversified stocks and 40% intermediate-term bonds; assumes a 6.0% state income tax rate. Assumes real estate appreciates at the rate of inflation or 3.0% over the next 30 years.

†Assumes federal estate tax rate of 40% is applied to the amount by which the estate exceeds their remaining inflation-adjusted \$10.9 million combined applicable exclusion.

Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20.

Source: AB

Suppose they take their attorney's advice and commit \$8.5 million to 10 years of a two-year rolling GRAT strategy, sourced from the global stocks in their taxable portfolio.⁴³ With the rolling GRAT strategy the family is able to transfer and grow a material amount of wealth outside of their estate, reducing their estate tax liability by over \$3 million. This reduces the burden on the remaining taxable assets and increases the amount of

wealth passing to the SNT to over \$8 million, while each of the other two children receives about \$10 million (*Display 10*).

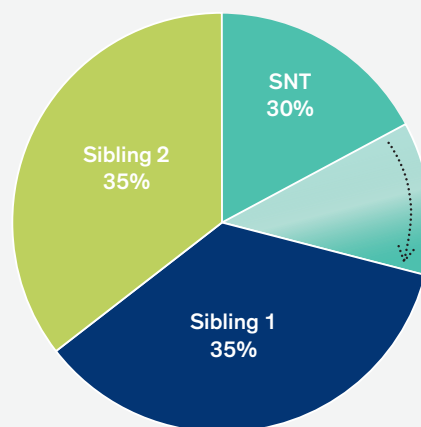
Through careful planning, Linda and David are able to not only reduce their estate tax liability but more evenly distribute their wealth among their children.

⁴³All GRATs are zeroed-out using an initial § 7520 rate of 1.4%. GRATs funded after the first year of the analysis are zeroed-out using Bernstein's projection of the § 7520 rate at that time. GRATs are asset-split sourced from global equities.

DISPLAY 10: . . . BY INCORPORATING LIFETIME WEALTH TRANSFER TECHNIQUES, THEY ARE ABLE TO REDUCE THEIR ESTATE TAX AND IMPROVE THE DISTRIBUTION OF WEALTH TO THEIR CHILDREN

\$ Millions, Real

| | Year 30 |
|--------------------------------------|----------------|
| Liquid Taxable Assets | \$5.8 |
| Roth IRA | \$1.8 |
| Real Estate | \$18.0 |
| Pre-Estate-Tax Family Wealth* | \$25.6 |
| <i>Estate Taxes†</i> | <i>\$(5.8)</i> |
| Liquid Taxable Assets | — |
| Roth IRA | \$1.8 |
| Real Estate | \$18.0 |
| Post-Estate-Tax Family Wealth | \$19.8 |
| Assets Transferred Through GRAT‡ | \$8.1 |
| Total Family Wealth | \$27.9 |



Numbers may not sum due to rounding.

*Assumes \$8.5 million of global stocks from their taxable portfolio are carved out and committed to a series of two-year, asset-split rolling GRATs for a period of 10 years. Assumes \$350,000 in annual inflation-adjusted spending, offset by \$52,000 of annual pretax Social Security benefits and an overall allocation of 60% globally diversified stocks and 40% intermediate-term bonds; assumes a 6.0% state income tax rate. Assumes real estate appreciates at the rate of inflation or 3.0% over the next 30 years.

†Assumes federal estate tax rate of 40% is applied to the amount by which the estate exceeds their remaining inflation-adjusted \$10.9 million combined applicable exclusion.

‡All GRATs are zeroed-out using an initial Section 7520 rate of 1.4%. GRATs funded after the first year of the analysis are zeroed-out using Bernstein's projection of the 7520 rate at that time. GRAT remainders are reinvested into a special needs trust with an allocation of 70% globally diversified stocks and 30% intermediate-term diversified municipal bonds; assumes a 6.0% state income tax rate.

Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 31, 2016. Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on Wealth Forecasting System on page 20.

Source: AB

THE BENEFIT OF SPECIAL NEEDS TRUST PLANNING

A special needs trust can provide for the needs of a disabled family member without preventing that individual from receiving valuable government benefits. However, an SNT needs to be established and funded carefully to ensure that the disabled

beneficiary's needs are met and that the assets are managed appropriately. Bernstein's analysis can help families and their advisors evaluate funding strategies, invest the assets appropriately, and maintain the SNT so that the trust achieves the ultimate goal of providing for a person with special needs. ■

NOTES ON WEALTH FORECASTING SYSTEM

- 1. Purpose and Description of Wealth Forecasting System.** Bernstein's Wealth Forecasting SystemSM is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our planning tool consists of a four-step process: (1) Client-Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals, and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long-term, and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: our proprietary model that uses our research and historical data to create a vast range of hypothetical market returns, which takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of probable returns and asset values the client could experience are represented within the range established by the 5th and 95th percentiles on "box-and-whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not guarantee results or establish the boundaries for all outcomes. Estimated market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized. The information provided here is not intended for public use or distribution beyond our private meeting. Of course, no investment strategy or allocation can eliminate risk or guarantee returns.
- 2. Retirement Vehicles.** Each retirement plan is modeled as one of the following vehicles: traditional IRA, 401(k), 403(b), Keogh, or Roth IRA/401(k). One of the significant differences among these vehicle types is the date at which mandatory distributions commence. For traditional IRA vehicles, mandatory distributions are assumed to commence during the year in which the investor reaches the age of 70.5. For 401(k), 403(b), and Keogh vehicles, mandatory distributions are assumed to commence at the later of (1) the year in which the investor reaches the age of 70.5 or (2) the year in which the investor retires. In the case of a married couple, these dates are based on the date of birth of the older spouse. The minimum mandatory withdrawal is estimated using the Minimum Distribution Incidental Benefit tables as published on www.irs.gov. For Roth IRA/401(k) vehicles, there are no mandatory distributions. Distributions from a Roth IRA/401(k) that exceed principal will be taxed and/or penalized if the distributed assets are less than five years old and the contributor is less than 59.5 years old. All Roth 401(k) plans will be rolled into a Roth IRA plan when the investor turns 59.5 years old to avoid minimum distribution requirements.
- 3. Rebalancing.** Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs, and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio is expected to be maintained reasonably close to the target allocation. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will diverge from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

4. Expenses and Spending Plans (Withdrawals). All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses, which will have capital gains tax implications.

5. Modeled Asset Classes. The following assets or indexes were used in this analysis to represent the various model classes:

| Asset Class | Modeled as: | Annual Turnover |
|----------------------------------|---|-----------------|
| Int.-Term Diversified Municipals | AA-rated diversified municipal bonds of 7-year maturity | 30% |
| US Diversified | S&P 500 Index | 15% |
| US Value | S&P/Barra Value Index | 15% |
| US Growth | S&P/Barra Growth Index | 15% |
| US Low Volatility Equity | MSCI US Minimum Volatility Index | 15% |
| US Small-/Mid-Cap | Russell 2500 Index | 15% |
| Developed International | MSCI EAFE Index (Unhedged) | 15% |
| Emerging Markets | MSCI Emerging Markets Index | 20% |
| High-Risk International | Country Fund | 15% |

6. Volatility. Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed in the Capital-Market Projections section at the end of these notes. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.8%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgment that the volatility of fixed income assets is different for different time periods.

7. Technical Assumptions. Bernstein's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of March 31, 2016. Therefore, the first 12-month period of simulated returns represents the period from March 31, 2016, through March 31, 2017, and not necessarily the calendar year of 2016. A description of these technical assumptions is available on request.

8. Tax Implications. Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

9. Tax Rates. Bernstein's Wealth Forecasting System has used various assumptions for the income tax rates of investors in the examples in this paper. See the assumptions in each example (including footnotes) for details. The federal income tax rate is Bernstein's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. For 2014 and beyond, the maximum federal tax rate on investment income is 43.4% and the maximum federal long-term capital-gains tax rate is 23.8%. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital-gains taxes. The state tax rate generally represents Bernstein's estimate of the top marginal rate, if applicable.

10. Capital-Market Projections

| | Median 30-Year Growth Rate | Mean Annual Return | Mean Annual Income | One-Year Volatility | 30-Year Annual Equivalent Volatility |
|----------------------------------|----------------------------|--------------------|--------------------|---------------------|--------------------------------------|
| Int.-Term Diversified Municipals | 3.2% | 3.4% | 3.4% | 3.7% | 7.8% |
| US Diversified | 7.2% | 8.8% | 2.9% | 16.3% | 19.9% |
| US Value | 7.5% | 9.1% | 3.5% | 16.0% | 19.5% |
| US Growth | 6.9% | 8.9% | 2.4% | 18.1% | 21.3% |
| US Low Volatility Equity | 7.2% | 8.4% | 4.2% | 14.2% | 16.9% |
| US Small-/Mid-Cap | 7.4% | 9.5% | 2.6% | 18.7% | 22.2% |
| Developed International | 8.1% | 10.2% | 3.5% | 18.1% | 20.9% |
| Emerging Markets | 6.2% | 10.2% | 4.1% | 26.1% | 28.5% |
| High-Risk International | 8.2% | 11.2% | 2.4% | 22.0% | 25.0% |
| Inflation | 3.0% | 3.5% | n/a | 1.1% | 11.6% |

Based on 10,000 simulated trials each consisting of 30-year periods. Reflects Bernstein's estimates and the capital-market conditions as of March 31, 2016.

Data do not represent past performance and are not a promise of actual future results or a range of future results.

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NOTES ON THE BERNSTEIN CAPITAL MARKETS ENGINE

The Bernstein Capital Markets Engine is a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation and produces a probability distribution of outcomes. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability.

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