GREENLEAF® TRUST

Perspectives

A Greenleaf Trust Newsletter

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William D. Johnston
Chairman, Greenleaf Trust

Servant Leadership 4

2019 Mid-Year Market Review 6

Employer Review of Retirement Plan Benefit 9

Topics for your Non-Profit Committee Meetings 11

Repurposing Life Insurance Policies 14

Partnerships for Impact – the Nonprofit Perspective 18

Economic Commentary

Recently, I had the opportunity to speak to two different groups of educational leaders about the implications of artificial intelligence on employment and global economies, principals and superintendents of K–12 systems as well as leadership in post-secondary community college systems. I was able to share with them some relevant information produced by the global consulting firm McKinsey. Annually, McKinsey presents to their Global Institute issues that they think will impact the global economy in the forward period of time. Their research findings were summarized in a January 2017 publication titled "A Future That Works: Automation, Employment and Productivity." This executive summary was later followed by their December 2017 publication titled "Jobs Lost, Jobs Gained: Workforce Transitions in a Time of Automation." For those with a strong appetite for labor statistics (I admit to being one of those), the study in its entirety is very interesting and somewhat provocative. As you can imagine, the implications of artificial intelligence are profoundly and simultaneously positive and negative. This holds true for the very nature of work and therefore how we prepare future generations. The velocity of change in AI has significant challenges for our current workforce as well.

McKinsey's research suggested that almost half of the activities that people are currently paid $16 trillion in wages to do in the global economy have the potential to be automated, using and adapting currently demonstrated technology. Their research included analysis of 2,000 work activities across 800 occupations. It is often difficult to get our arms around large numbers, and most of us don't deal in trillions of dollars on a regular basis, but to put the figure quoted in the McKinsey study ($16.0 trillion) in perspective, the entire United States Economy just crossed over that amount in 2016. Further, their research suggested that the forecasted automation through artificial intelligence could take place as soon as 2030.

Adoption of automation generated by forms of artificial intelligence will be determined by many factors to include technical, social, economic and demand driven inputs. The ability to replicate work

Commentary, continued

and outcomes is, by itself, not enough to create change in the nature of work. Change initiatives and change management occur when the benefits of doing so have increasing push or pull values. Is the autonomous vehicle advancement being driven by technology, or is the societal and economic push for autonomous vehicles driving the technology advancement? Forecasts of automation have been unusually suspect given the overarching assumptions by most labor economists that the ability to transfer technology digitally allows for rapid replacement of humans with robots, especially in jobs that are both physical and predictable. It isn't that the assumption has proved false, rather it is the duration of the change cycle that has missed the mark. McKinsey's data offers a prediction that we will see an increasing velocity of change in the physical and predictive job classifications, and labor statistics seem to validate that perspective. Artificial intelligence is not absent on the shop floors of global assembly lines; rather, the artificial intelligence is being used on the shop floor by human labor for enhanced productivity (fewer hours of labor producing more output), safer industrial practices, fewer lost time injuries and better worker health. As demands for even greater productivity, economies of production scale and workplace safety grow, the next phase of artificial intelligence will appear as the human component of predictable and physical is eliminated.

> "McKinsey's data offers a prediction that we will see an increasing velocity of change in the physical and predictive job classifications..."

The assumption that lost jobs (as in type of work) will not be replaced by new job classifications has proven, over the history of our economy, to be a false one. Robots have been a part of the manufacturing and assembly line process for many decades. While it is true that robotic welders have replaced human assembly welders, the advanced manufacturing processes of engineering, mechanical solution application, logistical software integration, materials selection and fluid dynamics necessary to create and develop the robotic welder also created career pathways and jobs that previously did not exist. Headline news in agricultural communities in our country during the 1950s claimed that the loss of agricultural jobs in our country would be irreplaceable, and much of that same sentiment has been prevalent in discussions about the loss of assembly jobs within many manufacturing sectors. The individual human condition and challenge cannot be ignored in these large shifts in labor demands and dynamics. We know from studies of displaced workers that, if effective resources of retraining are not applied promptly to the workers' new status, the chances of a successful transition to steady employment at comparable wages diminishes rapidly.

Given the assumption of the growth in artificial intelligence as well

as a growth in the velocity of adaptation into the work place, how does public policy enhance opportunity for both the preparation for the workplace of the future as well as the development of effective transition resources for the current generation of workers facing job skill obsolescence?

Unfortunately, our history of doing both of the above is not great. While the United States spends the highest amount on K–12 education among OECD (Organization for Economic Cooperation and Development Countries) we are next to last in our federal and state dollars supporting post-secondary education. Our federalist democracy doesn't facilitate central planning when it comes to education. Unfortunately, artificial intelligence cross cuts not only country borders, but also state boundaries and zip codes. The advancement, and in fact proliferation, of artificial intelligence in all that we do requires that our solution to workforce preparation and training be aimed at that very broad and global market place. It is no longer true that if your zip code resides in the industrial midwest that you will somehow be insulated from shifting workplace dynamics created in Freiberg, Germany or any other place on our globe. Additionally, your access as a citizen to education and training to adequately prepare you and your children should also not be zip code dependent.

Access to information needs to be elevated to the status of a civil right. Those with information have power and those without it lose ground every day. The ability to have and use data is powerful and is often referred to in socioeconomic writing as the information or knowledge class. The research compiled by McKinsey for its Global Economic Conference in January 2017 was not all negative. While it identified the labor dynamics of jobs lost due to AI, it also laid the foundation for the opportunities of jobs changed and jobs gained. The important and potentially liberating information for educators was focused around the job classifications that have a far more difficult time being automated. As I read the lists of those jobs, I couldn't help but ask myself, wouldn't children and parents be much better off knowing the future that was before them rather than adjusting to it when it "happened to them" in real time? Focusing on that list of jobs also confirmed to me that the preparation for them required access to information at an early age, and having the ability not just to read, but to translate the reading to lifelong learning. In both cases it is also clear that if we are to close the gaps between those that have opportunity and those that don't, our challenge in the global workplace of the future makes the task even greater. I am reminded of that almost daily, now that I am a grandfather to four precious souls. I am amazed at how

"Access to information needs to be elevated to the status of a civil right."

Commentary, continued

they are attracted to information devices and that how, at a very early age, they begin the process of cell phone and iPad manipulation. Within brief periods of contact they intuitively seek out responses. The reality is that they have grandparents and parents who are of the knowledge and information class and as such have a head start on the foundation that is required to be built for all current and future generations. Access to the McKinsey Global Study is available to all on the internet (https://www.mckinsey.com). I highly recommend it.

Michael F. Odar, CFA
President

Servant Leadership

It seems fitting to me that a man whose last name was Greenleaf first coined the term "servant leader" in 1970. Robert Greenleaf's concept was that a servant leader focuses primarily on the growth and well-being of people and the communities to which they belong. While traditional leadership generally involves the accumulation and exercise of power by one at the "top of the pyramid," a servant leader shares power and puts the needs of others first. Simply put, when you have a servant mindset, it is not about you.

"…a servant leader shares power and puts the needs of others first."

The philosophy behind servant leadership has been the mentality of leadership at Greenleaf Trust since we started in 1998. Our goal has always been to hire talented people and provide them with a workplace culture that values, challenges, supports and empowers them. Servant leadership plays a big role in that workplace culture.

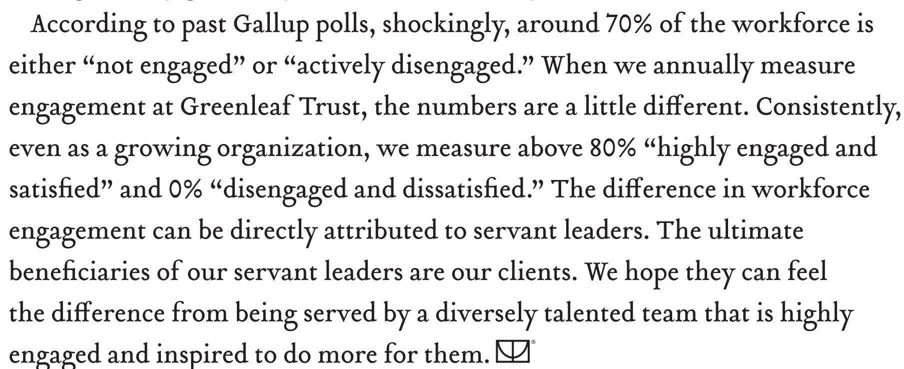
To be clear, not all leaders at Greenleaf Trust lead people. Many are technical leaders who lead by example and provide inspiration to others through their specific roles and actions. We believe that leading people is not necessarily a promotion but rather a career path. Those that lead people need to prioritize their team's needs before their own. Their role in part is to enhance the relationship between those that they lead and the organization. They need to remove self-interest and personal glory from their motivation and focus on the growth and development of those they lead.

One way that we do this is through quarterly coaching. Every teammate at Greenleaf Trust has a trusted coach whose responsibility is to help those they lead become their best. Beyond informal daily interactions and discussions, coaches sit down formally one-on-one with those they lead on a quarterly

Greenleaf Trust executive leadership team cooks and serves lunch for team.

basis to discuss their impact, growth, and development. The coaching sessions are intentional, collaborative and candid. Feedback is real. Open-ended development opportunities are discussed and planned. Teammates leave those sessions feeling supported knowing that their coach understands their strengths and is an advocate for their growth. Successful coaches have a servant mindset; they are humble, emotionally intelligent, authentic, empathetic and strategic. They genuinely care about those they lead.

"Successful coaches have a servant mindset; they are humble, emotionally intelligent, authentic, empathetic and strategic."



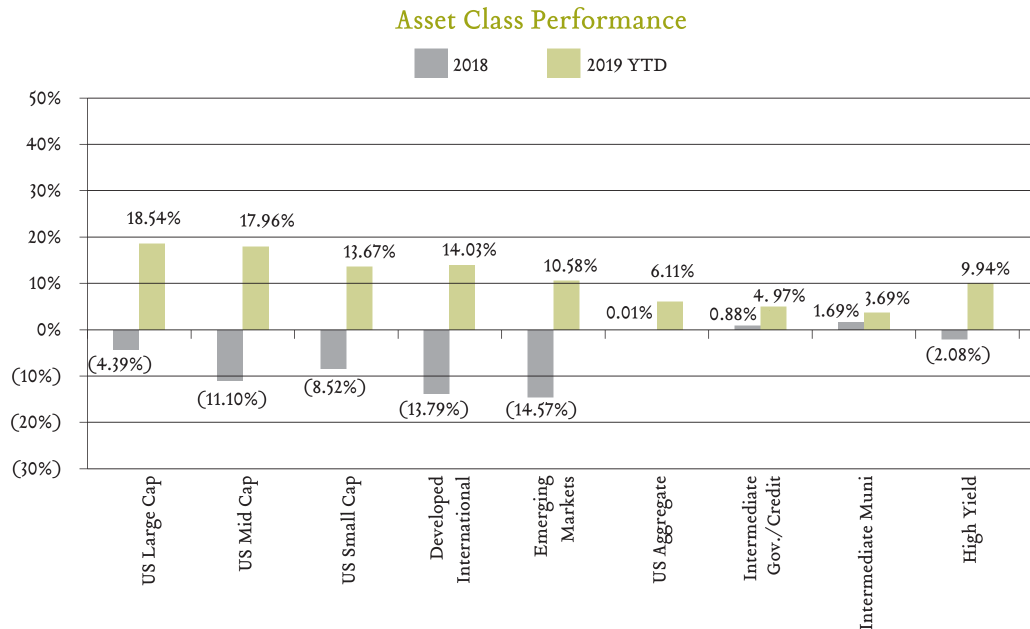
According to past Gallup polls, shockingly, around 70% of the workforce is either "not engaged" or "actively disengaged." When we annually measure engagement at Greenleaf Trust, the numbers are a little different. Consistently, even as a growing organization, we measure above 80% "highly engaged and satisfied" and 0% "disengaged and dissatisfied." The difference in workforce engagement can be directly attributed to servant leaders. The ultimate beneficiaries of our servant leaders are our clients. We hope they can feel the difference from being served by a diversely talented team that is highly engaged and inspired to do more for them.

Nicholas A. Juhle, CFA®
Vice President
Director of Research

2019 Mid-Year Market Review

In our 2018 year-end seminar we recapped a period where almost every major asset class posted disappointing returns as investors grew increasingly concerned by the prospect of a global economic slowdown. We also provided our outlook for the key themes we expected to influence markets in the near- term, and the capital market assumptions shaping our longer-term expectations. Having recently passed the half way mark in 2019, we offer some perspective on the start to the year and our outlook.

Asset Class Performance



Source: Bloomberg

"Having recently passed the half way mark in 2019, we offer some perspective on the start to the year..."

Throughout 2018, but particularly in the 4th quarter, investors became increasingly anxious about the prospect of a recession, reacting sharply to any data point or headline that could signal a slowdown. While many of the economic concerns contributing to the 2018 experience remain, most asset classes have recovered significantly in the first half of 2019.

- Global Equities: In 2018, global equities declined 9%. Domestic large caps fared "best" (down 4%) while developed international and emerging market stocks posted double-digit declines. Year-to-date, global equities are up more than 16% led by domestics (+18%) and followed by developed international (+14%) and emerging markets (+11%).
- Fixed Income: In 2018 rates were largely on the rise. From a starting yield of 2.40% on the US 10-year treasury, rates peaked at 3.24% in November and closed the year at 2.68%. As a result, bond returns were either flat or negative in 2018. In 2019, rates have moved lower, briefly falling below 2.00%. As a result, bond markets have rallied significantly

year-to-date. Key sources of uncertainty in 2018 included Federal Reserve Policy and US/China trade negotiations. Unsurprisingly, these themes continued to carry significant influence year-to-date.

- Federal Reserve: The Fed raised interest rates four times in 2018 and projected two additional rate hikes in 2019 when the year started. Investors have been paying close attention to Fed language and posturing given a significant disconnect between the Fed's outlook and forward rate expectations implied by the bond market. By the end of the first quarter, policymakers reduced expectations from two rate increases to zero. Policymakers continue to forecast no rate changes in 2019, but the market is pricing in 2-3 cuts this year. Increasingly dovish rhetoric from the Fed suggests an accommodative bias, but we expect continued application of the flexible, data-driven approach to decision-making.
- Trade Policy: Evolving US trade policy and its reception by trading partners introduced uncertainty and fears of an all-out trade war between the US and China in 2018. In December, President Trump agreed to delay threatened tariff increases while negotiations proceeded. By the beginning of May, a trade deal seemed imminent when officials unexpectedly moved to increase tariffs, citing slow progress in trade talks. President Trump and China's Xi Jinping recently met on the sidelines of the G20 Leaders Summit where they agreed to resume negotiations and hold off on implementing additional tariffs. Visibility is limited, but we believe a negotiated deal remains the most likely outcome.

Having crossed the ten-year mark in June, the current economic expansion is officially the longest on record. Exiting 2018, we were perplexed by markets that seemed to anticipate immediate recession despite data that described a healthy economic backdrop. We have continued to monitor key recession indicators in 2019 and consistent with our late-cycle positioning, we observe some mixed signals.

- Yield Curve: An inverted yield curve (short-term yields exceed longer-term yields) has historically been a useful indicator of future economic growth. The yield curve inverted 4-24 months prior to each of the last seven recessions – there were also two false positives. In March of this year the yield curve inverted, triggering this indicator for the first time since the great recession. The curve remains inverted today.
- Unemployment: The labor market is another indicator of recession risk as rising unemployment can foreshadow economic contraction. The unemployment rate has historically bottomed nine months before the onset of a recession. Unemployment currently stands at a 49-year low of 3.6%, but it is difficult to identify a trough in real time.
- Real Retail Sales: Consumer spending makes up the majority of US GDP, so real year-over-year declines in retail spending can indicate

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Mid-Year Market Review, continued

that a recession is near. In December 2018, real retail sales declined 0.3% triggering this indicator, but growth has rebounded in 2019 averaging +1.4% year-to-date.

In 2018, real US GDP grew 2.9%, up from 2.2% in 2017 and 1.6% in 2016. It would be unrealistic to expect the economy to sustain 3.0% growth in 2019, which by definition, means that we expect growth to slow this year. In the first quarter of 2019, real GDP increased 3.1% and forecasts suggest growth closer to 2% in the second quarter. We expect a full year growth rate of 2.0%-2.5% - slower than 2018, but not recessionary.

As for the market experience going forward, we share our updated capital market assumptions below. Our forecasts represent our expectations for average annualized returns for each asset class over the next ten years. Over the next decade, there will be years where returns exceed our expectations and years where returns trail our expectations. We believe any attempt to pick and choose which years to participate is a fool's errand.

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Asset Class	10 Year Expected Return (Nominal)	10 Year Expected Risk (Standard Deviation)
US Large Cap	5.0%	14.0%
US Small Cap	7.5%	19.0%
Developed International Equities	6.5%	17.0%
Emerging International Equities	8.5%	22.0%
Core Fixed Income	2.5%	4.5%
Non-Core Fixed Income	4.1%	10.0%
Diversified Alternatives	5.1%	7.5%
Cash	2.1%	0.5%

Source: Greenleaf Trust, as of 6/30/2019

We continue to recommend most of our clients hold a full weight to global equities in accordance with their individualized risk profile and we remain marginally more constructive on international equities. Concurrently, we are less constructive on the outlook in fixed income markets and believe a modest underweight in favor of an allocation to diversifying strategies (alternative assets) remains prudent.

Despite an ever-changing landscape, our disciplined approach and long-term orientation serve us well in our quest to create comprehensive investment solutions that help our clients reach their financial goals. Investment decisions are made in alignment with our documented investment philosophy and always with the intention of serving our clients' best interests.

Employer Review of Retirement Plan Benefit

Christina E. Sharp
Senior Relationship Specialist

What employers can do to help employees to utilize benefits as they near and enter retirement.

For many years, you have helped employees save for their retirement by offering an employer sponsored retirement plan benefit. You have encouraged savings through ensuring education sessions were held, individual consultations were available, and maybe even set up automatic enrollment to increase participation and start employee savings immediately upon eligibility. And perhaps you have provided employer contributions to add to their retirement savings. You feel like you have been focused on retirement readiness for your employees, and to save, save, SAVE.

And suddenly, as you are reviewing your 401(k) plan and workforce demographics, you realize you have many employees who are age 55 plus and nearing retirement. In fact, you may have employees beginning to ask you about their retirement plan withdrawal options, and their potential annual income in retirement. You begin to wonder what you can do as an employer to help employees nearing retirement make decisions, and to have options to hopefully manage their savings wisely in retirement.

"…you may have employees beginning to ask you about their retirement plan withdrawal options, and their potential annual income in retirement."

Employees have a lot of information to sort through, and decisions to make when retiring. And often at retirement, employees have many tasks that need to be completed such as signing up for Medicare, finding supplemental health care, applying for Social Security, transitioning their responsibilities to a co-worker and perhaps even moving. If the employee does not need money from their retirement plan immediately, it may give them peace of mind to know they do not have to make a decision right at the moment of retirement. They may leave their money in the retirement plan provided their account balance is greater than the plan established minimum balance.

When the employee is ready to begin withdrawing retirement plan savings, their withdrawal options are dependent upon how the employer has structured the retirement plan document. At times, the plan document is set up where the only option is for the participant to take a lump-sum distribution of their entire account. And, if the participant does not roll the distribution over into an IRA within 60 days, they will have to pay income taxes on the distribution, and they have lost the benefit of tax-deferred compounding by cashing it out all at once.

If a lump-sum distribution is the only option offered within the retirement plan, and the employee rolls over their account to an IRA, there may be a cost disadvantage. Often the investments in an IRA are retail share classes, which have higher annual expenses than institutional share class funds usually

"…the employer can assist employees nearing retirement make decisions by having Greenleaf Trust come on-site to offer a Retirement Readiness education session for employees…"

offered in retirement plans. There may be transaction or load fees associated with the investments offered with the IRA, and if the employee wishes to have assistance through a financial advisor there may be another fee with the IRA. Also, if the employee retires between age 55 and 59½, there is a 10% penalty fee for withdrawals taken from an IRA that is not applicable to a 401(k) plan. Yet, if the employee desires more investment options, then rolling their account over to an IRA may be the best choice.

However, what if the employee likes the 401(k) plan investment choices, believes the fees are reasonable, values the support and guidance offered through the education team call center, and wants to avoid the hassle of moving their account? Is there an option for the employee to leave their account balance in the 401(k) plan? Yes, if the retirement plan document is written to allow partial or systematic withdrawals from retirement accounts. For example, a partial withdrawal is when a participant submits a distribution request for $2,500 and then comes back at a later date to request another distribution for the same or different dollar amount. A systematic withdrawal is when a participant establishes a specific dollar amount to be distributed periodically, such as quarterly.

In addition to having the retirement plan document written to allow partial and systematic withdrawals, the employer can assist employees nearing retirement decisions by having Greenleaf Trust come on-site to offer a Retirement Readiness education session for employees over age 50 or nearing retirement. This education provides a timeline for preparing for retirement, some Social Security and Medicare information, and withdrawal rate and asset allocation considerations.

Additionally, our Participant Services Team offers individual consultations to provide your employees a private review of their account investments and savings projections. If you wish to have any more information on this topic, please contact the Retirement Plan Division within Greenleaf Trust.

Topics for your Nonprofit Committee Meetings

Mark A. Jackson, CFA
Senior Wealth Management Advisor

Volatility in the financial markets has increased, and the returns that we expect from equity and fixed income markets globally are lower than over the recent market cycles. What are the topics that should be on the meeting agenda for the Finance and Investment Committees for nonprofits?

Sustainable Spending Rates

One of the more difficult decisions facing a non-profit: What amount is required annually from the investment portfolio to support operations and does this withdrawal rate allow for the long-term growth of portfolio assets?

Private foundations have a particular challenge versus endowments held by public charities. Private foundations are required to distribute at least 5% annually or face penalties and may have fewer capital raising opportunities. Endowments for public charities have more flexibility to adjust spending rates, may have a longer, or even perpetual, time horizon and may have opportunities to raise additional endowment dollars.

The question we often hear is whether or not a non-profit should focus on income generation to support a spending rate, rather than referencing a long-term, total return on the invested assets. Our view is that by focusing solely on income, the growth of the portfolio may be constrained and this may reduce the long-term growth of the assets and the potential, sustainable withdrawal rate from the portfolio. Set the spending rate too high and cutbacks may be required during market downturns. Set the rate too low and mission critical spending and programs may not receive all of the dollars needed.

> "The question we often hear is whether a non-profit should focus on income generation to support a spending rate…"

Typical spending rate formulas include the following:

- Set a dollar amount of withdrawal and adjust this amount annually for inflation. This is a simple calculation but does not take into consideration the performance of the financial markets and the impact on the sustainability of the portfolio during a prolonged period of lower market returns.
- Set the withdrawal rate as a percent of the portfolio value and adjust the amount annually for inflation, with a maximum and minimum withdrawal rate defined, also adjusted for inflation. An annual decision is whether to use the spending amount defined by the formula or an amount defined by the maximum or minimum distribution to account for market performance.
- Set a withdrawal rate as a percent of the portfolio value over a rolling

Topics for Non-Profit Committee Meetings, continued

period, for example, three or five years. This smooths the withdrawals and allows for consistent withdrawals during periods when the market is rising or falling.

Our research team's capital market assumptions for the next 10 years project annual returns for US equities of 5.0%, developed international equity market returns of 6.5%, emerging market returns of 8.5%, fixed income returns of 2.5% and returns from cash equivalents of 2.1%. The annual returns from non-core fixed income and alternatives are in line with these estimates. Inflation will likely return to 2% or more per year. The typical asset allocation for a non-profit may lead to a projected annual return of 5.0%. If the investment objective for the non-profit is for the portfolio value to grow on an inflation-adjusted basis after considering the withdrawal rate and expenses, there could be a shortfall. A tool for quantifying this shortfall is a Monte Carlo analysis.

While beyond the scope of this article, an advantage to the Monte Carlo simulations is that in addition to budgeted withdrawals, projections for additional capital contributions, both amounts and timing, are included in the analysis. If withdrawals are forecast for specific projects or expenditures, or if differently budgeted annual withdrawals are considered, those amounts are also included in the analysis. The objective is to determine the ability of the investment portfolio to support a sustainable level of annual distributions.

"The investment policy statement, [IPS] … is ideally reviewed annually and includes the non-profit's mission, investment objectives and constraints."

Investment Policy Statements

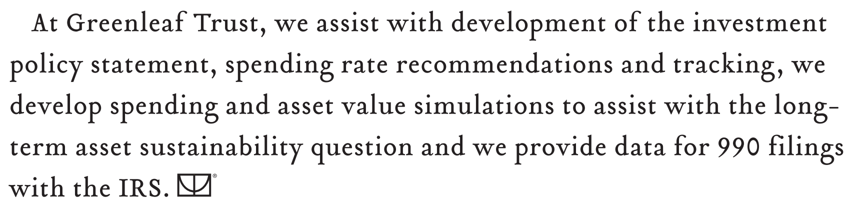
Spending policies and investment strategies are connected. A portfolio withdrawal rate may define a required return for a portfolio but it also sets the time horizon for the portfolio. For example, if a non-profit expects to have higher withdrawals and distributions over the short term, the time horizon for the portfolio may be shorter and the ability to tolerate market volatility may be lower.

The investment policy statement, or IPS, is the document that connects the spending policy with the investment strategies. The IPS is ideally reviewed annually and includes the non-profit's mission, investment objectives and constraints. It should include references to the spending rate, the need for inflation protection, the non-profit's risk tolerance, the time horizon for the portfolio, tax considerations, liquidity needs and any unique needs and circumstances. The methods and time frame for measuring the success of the investment strategies are included and in addition to financial market benchmarks, include measurements against the spending objectives. For example, a common benchmark related to spending objectives is a return in excess of the spending rate, plus inflation and expenses. Another spending objectives benchmark is a future portfolio value equal to or in excess of the amount needed to

sustainably support a given dollar amount of withdrawals.

Over the life of the investment portfolio for a non-profit entity, the asset allocation or amount invested in equities, fixed income, cash and other investments, determines the success of the investment strategies and is more important than the individual security selections. The asset allocation targets and ranges are included in the IPS, along with the permitted asset classes. A typical asset allocation may be 70% equities, 25% fixed income and 5% cash. However, with near-term market volatility expected to remain high and future asset returns lower than those recently experienced, non-profit fiduciaries are debating whether to change the allocation to riskier assets such as equities. This decision should be made in conjunction with the expected portfolio withdrawal rate and the ability to control those withdrawal rates. The Monte Carlo analysis, including potential portfolio performance using a range of asset allocations, will help with the decision.

"... asset allocation targets and ranges are included in the IPS, along with the permitted asset classes."



At Greenleaf Trust, we assist with development of the investment policy statement, spending rate recommendations and tracking, we develop spending and asset value simulations to assist with the long-term asset sustainability question and we provide data for 990 filings with the IRS.

George F. Bearup, J.D.
Senior Trust Advisor

Repurposing Life Insurance Policies

Over the decades many families purchased life insurance, either to act as an income replacement vehicle when the breadwinner died, or to provide immediate liquidity to pay federal estate taxes on the breadwinner's death. With the 2017 Tax Act's temporarily doubled federal estate tax exemption amount to $11.4 million per individual, many believe that they no longer need to maintain their existing cash surrender value life insurance policies to pay federal estate taxes on their death. That conclusion may be accurate. Then again, surrendering an existing life insurance policy to access its cash surrender value may not be a wise move to make at this time. Before an existing life insurance cash value policy is surrendered, the policy owner should consider other options to repurpose the life insurance policy.

The doubled federal estate tax exemption amount is only temporary. The doubled exemption amount will disappear in 2026. At that time, the transfer tax exemption is scheduled to drop back to around $5.5 million per individual. Added to this uncertainty as to the true amount of estate tax exposure is that many of the Democratic presidential candidates are pushing for a federal estate tax exemption amount of $3.5 million per person. It is possible that the federal estate tax exemption will be an even lower amount, and suddenly appear well before 2026 arrives. Consequently, a wait-and-see approach to dealing with existing life insurance policies makes a lot of sense if the purpose of the life insurance is tied to provide liquidity to pay federal estate taxes on the insured's death.

"…explore repurposing the cash value life insurance policy, especially if the owner is now retired and the income-replacement features of the policy are no longer needed."

The next consideration is to explore repurposing the cash value life insurance policy, especially if the owner is now retired and the income-replacement features of the policy are no longer needed. Some possible new uses of an existing cash value life insurance policy include:

- Income Taxes: While cash value life insurance is not usually an effective wealth accumulation vehicle due to the normally high sales charges and the imbedded mortality costs of the insurance, there are several tax advantages that continue to make life insurance an effective wealth accumulation vehicle. If the policy is maintained in force until the insured's death, usually the entire death benefit paid is income tax-free. In contrast, if the insurance policy is surrendered and its cash value is recovered, the excess of the cash surrender value over the aggregate amount of premiums that were paid over the years is taxable as ordinary income to the policy owner. While the policy could be surrendered for its current cash surrender value, income taxes have to be figured in with regard to the net amount received. In short,

simply surrendering the policy ought not be the first choice of the policy owner.

- Freeze the Death Benefit: Instead of a complete surrender of the life insurance policy, if the owner no longer wants to continue to pay policy premiums, it may be possible to 'freeze' the existing life insurance policy with no further premium payments, thus freezing the death benefit to be paid. However, with no future premiums paid, the death benefit would then be lower, but those reduced death benefits would still be income tax-free on the insured's death.
- Tax-Free Exchange: If the policy has been in-force for several decades it may have features or inherent mortality expenses that are no longer competitive with current rates. It is possible to engage in a tax-free like-kind exchange of life insurance policies (the exchange from the existing insurer to a new insurer) to convert the old, stale, policy to a new policy. The new policy might even provide a larger death benefit, or one with new benefit guarantees that did not accompany the old policy. Alternatively, the new policy may offer a much older maturity date as to when the policy ends, e.g. going from age 100 to 121 at the same or possibly a lower cost. In short a more efficient life insurance policy might be obtained through a life insurance policy exchange under IRC 1035 that provides the same death benefit but at a lower cost.
- Sale of the Policy Under a Life Settlement: The life insurance policy might be sold in a life settlement transaction in a secondary market for more than the policy's current cash surrender value. The price paid could be more than the cash surrender value but less than the death benefit that will be paid under the policy's terms. These sales are usually with regard to insureds who are over the age 65 and who have some health problems. Some types of insurance policies are more likely to be the subject of a 'sale' while others types will attract less interest by buyers. While initially these transactions dealt with policies with a death benefit of more than $1.0 million, currently policies with smaller death benefit commitments are now more commonplace. If an existing cash surrender value policy is 'sold' (not surrendered) to a third party, the price received is taxed using the following principles: (i) the cost basis (premiums previously paid by the policy owner) are income tax-free; (ii) the difference between the policy's cost basis and the policy's current cash surrender value is taxed as ordinary income to the owner; and (ii) if the policy owner receives more than the current cash surrender value as the sales price, the excess is taxed to the owner at capital gains tax rates. While life settlement transactions admittedly had a relatively sordid early history, they are now subject to a highly regulated financial market that requires many disclosures and imposes

"It is possible to engage in a tax-free like-kind exchange of life insurance policies (the exchange from the existing insurer to a new insurer) to convert the old, stale, policy to a new policy."

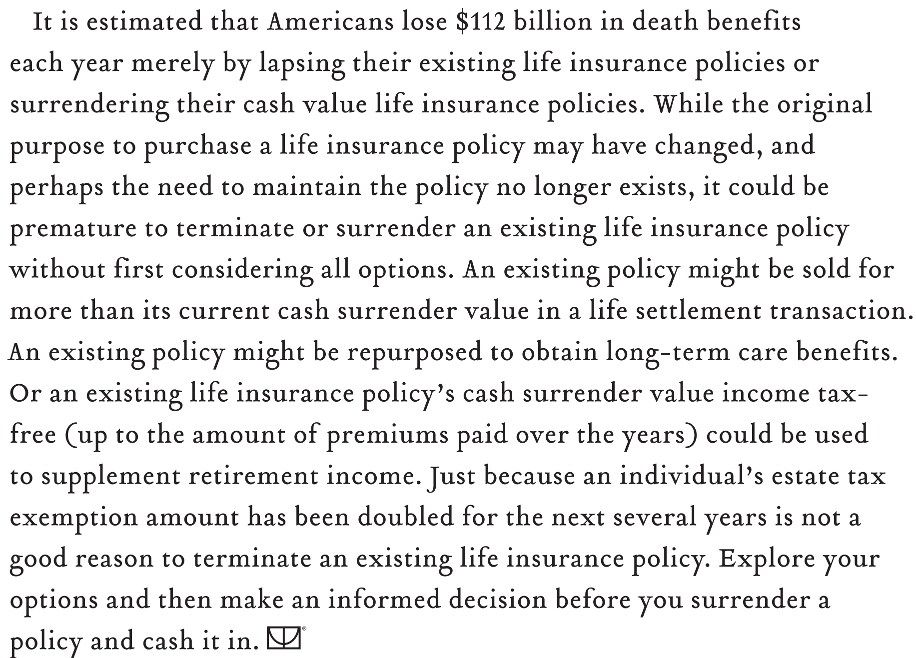
Repurposing Life Insurance, continued

fiduciary principles to protect selling policy owners.

- Long Term Care Substitute: We all worry about escalating long-term care expenses in our retirement years. While long-term care insurance policies are available to be purchased, they are very expensive to maintain. Consider that John Hancock, Mass Mutual and Genworth have each raised their long-term care insurance premiums by 60%-to-70% in recent years, in turn causing many insured to reconsider the continued use of long-term care insurance policies. The other drawback to the purchase of a long-term care policy is the possibility that the policy owner will spend thousands of dollars in premiums on a long-term care insurance policy that he or she will never use. The insurance industry has responded to this concern. Many life insurance companies now sell life insurance products that combine life insurance with long-term care benefit riders to pay for expenses that Medicare and private health insurance do not cover. The amount that is not used to pay long term care benefits ends up being paid to the life insurance policy beneficiaries on the insured's death with the death benefit reduced to reflect the lifetime long-term care expenses paid by the policy. Such a policy might be obtained through a life insurance policy exchange, or perhaps the existing policy could be sold in a life settlement transaction with the sales proceeds used to purchase a new life insurance policy with a long-term care rider.
- Retirement Income: If the policy owner is concerned about outliving his or her income in their retirement years, in a policy exchange, the life insurance policy can be exchanged for an annuity policy that will pay lifetime income to the annuitant. Like a surrender of the cash surrender values, the premiums previously paid for the life insurance policy are returned tax-free with the balance of the monthly annuity payment being taxed as ordinary income. While there are substantial commissions normally associated with the purchase of an annuity, it is possible to avoid exorbitant commissions if the existing life insurance policy is exchanged for a lifetime annuity.

"If the policy owner is concerned about outliving his or her income in their retirement years… the life insurance policy can be exchanged for an annuity policy that will pay lifetime income to the annuitant."

Every couple of years the policy owner should request in-force illustrations from the issuing insurance company with regard to the life insurance policy in order to re-project the policy's expected performance based on current and guaranteed values. Policy illustrations with different premium payment options should be requested from the insurance company to demonstrate projected outcomes under various premium payment scenarios, including how long before the policy would lapse if the owner ceased to make any further premium payments.



It is estimated that Americans lose $112 billion in death benefits each year merely by lapsing their existing life insurance policies or surrendering their cash value life insurance policies. While the original purpose to purchase a life insurance policy may have changed, and perhaps the need to maintain the policy no longer exists, it could be premature to terminate or surrender an existing life insurance policy without first considering all options. An existing policy might be sold for more than its current cash surrender value in a life settlement transaction. An existing policy might be repurposed to obtain long-term care benefits. Or an existing life insurance policy's cash surrender value income tax-free (up to the amount of premiums paid over the years) could be used to supplement retirement income. Just because an individual's estate tax exemption amount has been doubled for the next several years is not a good reason to terminate an existing life insurance policy. Explore your options and then make an informed decision before you surrender a policy and cash it in.

"It is estimated that Americans lose $112 billion in death benefits each year merely by lapsing their existing life insurance policies or surrendering their cash value life insurance policies."

Partnerships for Impact – the Nonprofit Perspective

Karen A. Bouche, CTFA
Executive Vice President
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A strong nonprofit sector is critical to the success of any community. Yet, there is an inherent power dynamic that enters many of the conversations between funders and the potentially fund-receiving nonprofits which can hinder the development of open and trusting relationships. To truly provide impactful support to our community, funders must recognize this dynamic and work toward building authentic relationships with open and honest dialogue.

So how do you work toward this authentic relationship? First, recognize that both funders and nonprofits are needed in reaching their shared goal. Those with wealth are looking to fund programs and organizations who are working to address the needs which the funder sees as important. The nonprofits are transparent about their missions, goals and who they seek to help. When the two parties' missions and desired impact goals align, it should be a beautiful partnership. It sounds simple, but conflict can occur unintentionally. To help overcome this, it requires intentional focus on seeking understanding, not evaluating or judging, during conversations. No one is served well if the nonprofit fears saying the "wrong" thing and being denied funding. Discussing only the nonprofit's successes and programs that went well are certainly more comfortable to talk about; however, when a funder seeks true understanding of the work and allows the nonprofit to share its struggles and failures, they are able to reshape and continuously improve their programs which should lead to better results in the long run.

"It is also important to be mindful of the position of the nonprofit. They are running a business..."

It is also important to be mindful of the position of the nonprofit. They are running a business. They have clients with needs, staff that require support, and funders that are willing to partner, but many times with varying, and even contradictory, requirements. They may have very few reliable sources of revenue. Federal and State funding can change drastically year to year. Grants from Foundations are often made for a one year period of time and must be applied for again, sometimes with onerous reports required to show evidence of success in their work. Donations from individuals and others can change with little warning. On the expense side, there are often more requests for support than the organization has funds for. As any business would do, they work to control expenses, improve efficiency and increase income. This can lead to hiring part-time staff in lieu of full-time, difficulty in offering competitive wages and benefits to employees, settling for donated or low-cost office space, using older computer and security equipment, reducing

programs offered or the number of people it is offered to, and an overall environment of doing as much as possible with their limited resources.

Nonprofit workers must seek a daily balance of serving the needs of their clients, fundraising, and ensuring that their own family and personal needs are met. How many US workers are we talking about? According to a study released in 2019, there were 12.3 million paid workers employed by US nonprofit establishments, or 10.2% of the total US private workforce. For comparison, the US's largest employer, Walmart, as of 2018 had approximately 2.3 million employees worldwide.

This collective nonprofit workforce has incredible potential to make a positive impact within our communities. They are doing so in an environment of unpredictable income, growing needs and a desire to provide greater support to their staff. When funders find an organization that shares their mission and impact goals, and they have sought true understanding of the nonprofit's work and their plan for impact, it then turns to trust in the leadership and ability to implement their plan of action. So the relationship continues post-funding, allowing the nonprofit leader to share, openly without fear, the parts of their programming that didn't go perfectly or failed. True partnerships will allow for adjustments as they learn and grow.

Keeping the end client, that both the funder and nonprofit are wanting to support, top of mind is imperative. It is also important to remain mindful that mandating excellence in the nonprofit's outcomes, low cost administration, and reporting in each funder's preferred format, may be unrealistic. I believe there is an achievable and needed balance between measuring impact and true partnerships. With an understanding of the nonprofit's work, their successes and their challenges, and open, clear communication, together the funders and nonprofits can make a difference!

"According to a study released in 2019, there were 12.3 million paid workers employed by US nonprofit establishments, or 10.2% of the total US private workforce."

Stock Market Pulse

Index	6/30/19	Total Return Since 12/31/2018
S&P 1500	676.38	18.37%
Dow Jones Industrials	26,599.96	15.40%
NASDAQ	8,006.24	21.34%
S&P 500	2,941.76	18.54%
S&P 400	1,945.51	17.96%
S&P 600	953.25	13.67%
NYSE Composite	13,049.71	16.36%
Dow Jones Utilities	810.66	15.45%
Barclays Aggregate Bond	111.35	5.84%

P/E Multiples	6/30/2019
S&P 1500	19.4x
Dow Jones Industrials	17.0x
NASDAQ	31.8x
S&P 500	19.3x
S&P 400	19.5x
S&P 600	22.4x

Key Rates

Rate	
Fed Funds Rate	2.25% to 2.50%
Tbill 90 Days	2.05%
T Bond 30 Yr	2.53%
Prime Rate	5.50%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	676.38	19.4x	1.89%
S&P 500	2,941.76	19.3x	1.91%
Dow Jones Industrials	26,599.96	17.0x	2.22%
Dow Jones Utilities	810.66	21.5x	3.06%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.64%

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