TIMING IS EVERYTHING: ESTATE PLANNING IN THE PANDEMIC ERA
WE'RE WRITING THIS PAPER IN the midst of one of the most trying times this country has ever faced. Who has the inclination right now to think about legacy planning? And yet...this is a perfect time to take stock of our gift and estate strategies, not only because the global pandemic has taught us yet again that we never know what’s around the corner but because it has enforced on many of us more leisure time than usual. It’s unwanted leisure for sure, but time nonetheless to check that we’ve identified our estate goals and are moving toward achieving them. And once the health crisis passes (which can’t come soon enough), it will still be the right time to plan for our futures. It’s always the right time to do that.

Not Just for Multimillionaires

One other introductory remark: Estate planning is thought by many to be a task only for the rich, or indeed super-rich. After all, fully $11.58 million of your property can pass to your beneficiaries free of estate taxes this year (or gift taxes, if bequests aren’t to your liking), and $23.16 million for married couples. That leaves only a tiny sliver of Americans who need to worry about federal estate taxes. So yes, some of the trusts and other advanced estate-planning strategies we touch on here are primarily for the benefit of very wealthy donors. But not all the strategies, by a long shot.

Plus, the Tax Code can change with little notice. As it is, the current stratospheric estate-/gift-tax exemption, which will adjust to yet higher levels in the next few years in accord with inflation, is scheduled to revert to $5 million/$10 million for couples in 2026, unless Congress intervenes. That’s still a high level, but those are only the federal exemption levels. Many states impose their own estate taxes, often with a much lower exemption ceiling than the federal rates. And unlike the federal exemption, on the state level most estate-tax exemptions aren’t portable, which means that one spouse’s exemption doesn’t roll over to the other spouse.¹ If your state exemption is $3 million and your husband dies with $1 million, you don’t get the advantage of the extra $2 million in most states.

But we’re still missing the point: Estate planning is about much more than sidestepping estate tax. It’s full-dress preparation for the years ahead of you and the imprint you’ll make on the family members, friends, and causes that are dear to you, whether your net worth is $50,000 or $50 million, and whether you’re 30 years old or 80. It’s never too early or too late to start or modify your estate plans.

A Document Checklist

The most important thing about estate planning is the planning part, which begins with having the right documents, assuring that they’re accessible (not only to you but your beneficiaries), and reviewing them at least every few years with an eye toward making any necessary changes.

Estate planning is nothing if not customized, so any list of documents that we can present is only a general guideline. Further, terminology is different from state to state, and the provisions of some of the health-related documents below may be rolled up in single documents, so it’s more important to concentrate on what these forms are about than what they’re called. That said, we believe that the documents below should be part of almost everyone’s estate plan:

¹. The portability of the federal estate- and gift-tax exemptions isn’t automatic. It must be elected on an estate-tax return. And the unlimited marital rollover of assets, which is a prerequisite for portability, applies only when both spouses are U.S. citizens—though it can be made available to a non-citizen surviving spouse through a specialized trust.
A Will

Even if you simply want to leave all your assets to your spouse, we’d advise spelling out your wishes in a last will and testament. At the least, you’ll want to name beneficiaries in the event that your spouse predeceases you or you die together. And if you have minor children, you should name the person you’d like to serve as guardian should that become necessary. You can also name a guardian in certain trusts, but wills are the more usual vehicle, and many families don’t need or want to have trusts.2

A living will

This document—which goes by different names in different states—is one of the essentials, in our view. It spells out your wishes about end-of-life health care: how much medical intervention you want, if any, if your situation becomes dire.

A durable medical power of attorney (a “health-care proxy”)

This is also a requirement, as we see it. It names the person who will make health-care decisions for you if you become unable to do so. If you’re married, that person is likely to be your spouse. But you need to designate whomever he or she is, or else your family and your doctors will be tied up in unproductive conversations. (“Durable” means that the power of attorney remains in place regardless of your medical state.)

An HIPAA Privacy Authorization Form

As you probably know, the Health Insurance Portability and Accountability Act of 1996 has placed a premium on the privacy of all patients, so you need to make sure that your health-care providers and insurers can speak about your condition with the person or people you designate. That’s the purpose of this authorization. As with your living will and durable medical power of attorney, you should share this document with your doctors.

A durable financial power of attorney

In the event you become incapacitated, you’ll want to have someone you trust handling your finances, your bill-paying, your insurance, and so forth. This form names whom you want to act in your stead and the specific tasks you’re charging him or her with, whether that list is broad or narrow.

Pre-printed forms exist for all these documents. But before you use any of them—particularly a will—we advise that you consult with a trust-and-estates legal expert.

One other piece of advice, which applies not only to these documents but to your full estate-planning blueprint: Discuss your key decisions with your family members and others important to you. This applies to your financial information as well. You needn’t disclose asset amounts if you don’t want to—but the people who need to know should know where your accounts, insurance policies, and pensions are held, who your professional advisors are, and what your user names and passwords are to key on-line sites. Leaving people named in your documents in the dark is inviting them to flail about when time is most precious, open old wounds among themselves, and try to ignore your wishes.

2. However, wills need to go through probate, which can be a lengthy process, and is always public. A living, revocable trust [a trust that takes effect in your lifetime and that you can change or undo at your pleasure] can also detail your wishes and your bequests. A trust is less apt to be successfully challenged than a will, so there’s a greater chance that your wishes will be honored. But it’s also more costly and time-consuming to set up.
Giving Your Best

Delivering gifts is critical in many estate plans, perhaps most plans. And the good news is that the government promotes gift-giving in several ways. First, you can give up to $15,000 in 2020 to each of as many beneficiaries as you like free of gift tax, $30,000 for married donor couples. These annual gift-tax exemptions have been adjusted upward frequently in light of inflation.

What many donors may not realize is that they can give these amounts to as many recipients as they like. So, for example, if you’re married and have four grandchildren and a beloved first cousin, you can give them a total of $150,000 this year ($30,000 each x 5) and pay no gift tax. And the gift-tax exclusion is unlimited for gifts to qualified charities (as determined by the IRS; almost all public charities are “qualified”) and for many medical and tuition expenses—as long as those gifts are directly to the institutions and not, say, to individual patients or students. For many donors, the annual-gift provision more than adequately meets their gifting objectives.

But in addition to the annual-gift provisions, donors are entitled to a lifetime “unified credit”—meaning it applies to gift and estate taxes combined—that in 2020 is the $11.58 million/$23.16 million for couples that we mentioned earlier. Again, these limits (though they may be adjusted downward in coming years) are above and beyond the annual-gift exemption limits.

Giving raises several questions:

• To whom do you wish to give?

• How much do you want to/can you give? Remember, in almost all cases, your welfare needs to be secure before you think about gifting. Before you decide on gift amounts, detailed conversations with a financial advisor are in order about your future security and comfort. And before deciding on any lifetime gifts or irrevocable trusts specifying gift amounts after your death, make sure that you’re incorporating very conservative assumptions—i.e., poor market returns—for asset growth in your investment portfolios.

• Would you rather give lifetime or testamentary gifts, or a combination of both?

• How do you wish to give? Sending off a check is obviously quick and simple, but there may be a larger wealth transfer for your recipients and a bigger tax benefit for you in some of the more-complicated alternatives.

• Which assets do you wish to give—cash or securities? More on that shortly.

3. The lifetime gift- and estate-tax exemption also covers the generation-skipping transfer tax (GSTT); see “Who Do You Trust?,” page 9.
Good News in Stimulus Act
Not surprisingly, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed late in March this year, includes several provisions that promote charitable giving. Income-tax filers who will take the standard deduction\(^4\) will be able to deduct up to $300 of cash donations to charity for tax years starting in 2020 (i.e., returns that will be due in 2021). This deduction will be “above-the-line,” meaning that it will come directly off gross income in arriving at adjusted gross income (AGI). The deduction will likely be $600 for married couples filing jointly, although that isn’t totally clear yet. This is a significant change, since charitable deductions were previously available only to taxpayers who itemized.

Not that itemizers were forgotten in the CARES Act. For the 2020 tax year, the limit on deductible cash contributions to public charities has been raised from 60% of AGI to 100% of AGI.\(^5\) Note that this increase applies only to cash contributions. The limit for securities and other assets you’ve held for more than a year—usually appreciated stock, but also real estate and other property—remains at its prior levels.\(^6\) Those levels are generally either 30% or 20% of AGI, depending on the charitable vehicle.\(^7\)

And so 2020 is a favorable year for charitable giving; if you have charitable interest and you’re thinking about giving, this could be a good time to act. The new provisions also raise a question: Since cash is singled out for an extra tax benefit, is cash the best asset to donate this year?

No Capital-Gains Pain with Stocks
For many donors to charity, writing a check is the best way to go, and this year, with increased income-tax deductibility, it can be an even better choice. But that’s not the end of the story if you’re holding a stock or other appreciated asset. First, though the deductible contribution is limited to a smaller percentage of AGI, it’s based on the security’s fair market value at the time of donation—not its cost basis. That can be a big advantage for owners of highly appreciated stock, including employees and ex-employees with large amounts of their company stock that they acquired at a very low cost basis.\(^8\)

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4. The standard deduction for 2020 is $12,400 for single taxpayers or married taxpayers filing separately, and $24,800 for married couples filing jointly. An additional deduction is available for taxpayers if they or their spouses are 65 or older or blind, or both.

5. Deductions that are not fully usable in 2020 can be carried forward for the next five years, as was always the case, but after 2020, the carry-forwards on cash contributions will again be limited to 60% of AGI.

6. Shares of property or business interests potentially eligible for discount can be particularly appropriate as funding assets, since they may appreciate substantially, but they also carry higher risk. They probably shouldn’t be the only assets used.

7. These changes apply to Individual taxpayers. In addition, the income limit for 2020 on charitable deductions for corporations has been increased from 10% of taxable income to 25%, and the limit on charitable contributions of food from a taxpayer’s trade or business has been raised from 15% to 25% of taxable income.

8. Employer stock is usually subject to lock-up provisions; stockholders who wish to gift them need to check their liquidity. Stock options can also be gifted to charity, usually Incentive Stock Options. However, they can be gifted only after the employee’s death, which raises complications related to their holding period and the transfer mechanism.
The benefit of donating appreciated stock is removing its embedded risk from your portfolio while it’s still at an elevated price without having to consider capital-gains taxes. And though you could have given it to a family member or someone else instead, (a) you’d be transferring the risk of holding a single stock, no matter how good the company, to your beneficiary, and (b) if the recipient chooses to sell the stock when it’s still appreciated, he or she would owe long-term capital-gains tax (15% was the most common bracket in 2020, but rates go up to 23.8%). How much gains tax the recipient would pay would depend on the price of the stock when it was sold and its cost basis. The cost-basis part gets tricky: If the appreciated stock arrived in the recipient’s hands while the donor was alive, the recipient’s cost basis is the donor’s original basis, not its fair market value when received. This can translate into a large cap-gains-tax bill for the recipient. If the stock arrived as a bequest, its cost basis is considered to be its fair market value at the date of the donor’s death.

Let’s assume that you’re thinking of giving appreciated stock to charity this year. Is it a good idea when the market has been so volatile? Probably so, because the risk of your gain diminishing (further than it probably already has) or turning into a loss is greater than in a more-typical year. By selling an appreciated stock now, you lock in the gain (without paying tax on it) and own a less-concentrated portfolio. It would be a win-win situation for you and your selected charity, who can immediately sell the stock if they wish, pay no gains tax (charities generally don’t pay income or capital-gains taxes), and use the proceeds to diversify their holdings.

But of course, no estate-planning strategy is one-size-fits all; you should consult with your financial advisor and estate professional before making any gifting decisions.

**Close-Up: Charitable Lead Trusts**

If you’re interested in giving to charity, the estate-planning options are plentiful, including several that serve both charitable and non-charitable (typically family) beneficiaries in the same vehicle. One of these is a Charitable Lead Trust (CLT), so named because the trust documents provide first for the charity or charities of interest to the donor. When the contribution to charity is complete, the non-charitable beneficiary or beneficiaries—who may include donors themselves—receive the remainder of the trust assets. Most CLTs are set up for a specified number of years of the donor’s choosing, but they can also encompass the donor’s lifetime and potentially someone else’s as well, typically a spouse’s.

Because there’s no limitation on how much must be donated to charity or for how long, and because CLTs can give not only to individual charities but also donor-advised funds, private foundations (see Page 9), and other charitable entities, they’re flexible vehicles. In addition, virtually all cash and non-cash assets can be suitable as contributions, but since the donor will want to see the fund increase in value, growth assets like stocks are usually preferred. Regardless of the asset(s) chosen, CLTs tend to function best with larger contributions. Indeed, donors wishing to give small amounts to charity would seldom want to deal with the complexity of CLTs.

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9. However, if a CLT donor dies during the term of the trust, a portion of the trust will be recaptured by the grantor’s estate and subject to income and estate tax.
Two Key Decisions for Donor

A CLT is an irrevocable trust, so it’s typically difficult, if not impossible, to backtrack once it’s established, which can be either in the donor’s lifetime or via his will as a testamentary trust. That said, donors have two other important decisions to make: Should they set up a grantor trust or a non-grantor trust? And do they want to pay a fixed amount each year to charity or a percentage of the trust’s value, recalibrated at the beginning of each year?

Grantor/Non-Grantor:

With a grantor trust, the donor retains more power, and often serves as the trustee (the trust’s “manager,” as it were, who assumes fiduciary responsibility for the beneficiaries). Because a grantor trust is retained in the donor’s estate as his or her own property, the donor receives an immediate income-tax deduction on his or her contribution. That deduction is based on the present value—the value today—of the trust’s future payments to charity, assuming growth at a certain rate. The interest rate that’s used is called the Section 7520 Rate (from a section number in the IRS Tax Code), which itself is based on an intermediate-term government-bond rate. The lower the Section 7520 Rate, the higher the present value, because with lower growth, the present value of the stream of payments to charity is closer to its future value.

At the same time, a high present value on the payments to charity means that less of the remainder will be subject to gift or estate tax. A higher income-tax deduction and a lower “hurdle rate” for delivering the remainder unencumbered by gift or estate taxes are exactly what CLT donors hope for. Said another way, CLTs do better in low-interest-rate environments, like today’s.

All that said, most CLTs are set up as non-grantor trusts. Low interest rates are as favorable for non-grantor trusts as for grantor trusts. But non-grantor trusts are their own entities; they live outside the estates of grantors and pay taxes at the rates for trusts. The donor of a non-grantor trust receives no income-tax deduction in his or her own name, though there’s a limited income-tax benefit for the trust itself. But with non-grantor trusts, donors trade off income-tax benefits for larger gift- and estate-tax benefits for their non-charitable beneficiaries. If donors expect or know that they’ll face a large taxable event the year they establish the trust, they may want to fund a grantor trust for the immediate tax deduction. Otherwise, they’re probably more likely to migrate to a non-grantor vehicle.

CLATs and CLUTs:

If CLT distributions to charity are set up as a fixed dollar amount each year, based on the trust’s original value, the CLT is known as a Charitable Lead Annuity Trust, or CLAT. As the name indicates, a CLAT provides its charitable beneficiary with an annuity at a level that the donor establishes. If the CLT distributions to charity are set up as a set percentage of the trust’s value recalibrated at the beginning of each year, the trust is a Charitable Lead Unitrust, or CLUT.

10. If the donor is the remainder beneficiary, he or she has a greater inducement to establish a grantor trust. But even in that case, if reducing the size of his or her estate is a goal for the donor, he or she is likely to choose a non-grantor trust.

11. CLATs can also be structured with annuities that increase each year.
There’s no “better” or “worse” choice. CLATs tend to do somewhat better than CLUTs when interest rates are low, and the reverse when rates are higher—though both constructions are preferable to many other vehicles in low-rate environments. Further, while by definition a CLUT can never run dry (its distributions simply become lower and lower), a CLAT can be emptied of funds in poor markets. And the pattern of returns matters a lot: If a CLAT is hit with big losses early on, it may not be able to avoid running out of money even if the market later recovers significantly. Of course, CLATs are hardly unique in their response to market volatility, and in dismal markets the value of a CLUT can come close to zero.

Meanwhile, in robust markets, a CLAT has more return potential, since its fixed annuity payments to charity are based on the trust valuations when it was established and the market was considerably lower. So CLATs are somewhat higher than CLUTs in risk and return. As you’d expect, CLTs, whether set up as CLATs or CLUTs, aren’t a panacea. But they’re a viable gifting vehicle, especially in the current low-rate landscape, for donors with charitable intent who also wish to give to people—sometimes including themselves.

For a look at some non-charitable trusts, see “Who Do You Trust?,” pages 9-11.

More Ways to Give

The charitable-giving landscape is a rich one. Below are some popular alternatives beyond CLTs. Some are structured to give only to charity, others to serve a dual gifting purpose. Some are more appropriate when substantial assets are involved and/or require significant administrative time from donors.

Charitable Remainder Trust (CRT)

In many ways, the mirror image of a CLT. This type of trust, which is offered as both a Charitable Remainder Annuity Trust and a Charitable Remainder Unitrust, first sends an income stream to non-charitable beneficiaries and then delivers the remainder to the charity or charities designated by the donor. It is less flexible than a CLT, with a term that cannot exceed 20 years if fixed, or the lifetime of the donor, and a required minimum payout to charity. Its income-tax deductions and estate-tax benefits, like those of a CLT, depend on the prevailing Section 7520 rate, but with a CRT, higher-interest-rate environments are better.

Charitable Gift Annuity

A contract between a donor and a charity. The donor’s gift, which is usually sizable, is set aside by the charity in a reserve account and invested; the charity receives its gift at the end of the donor’s life or his or her spouse’s. The donor receives a fixed payout based on his or her age and the amount of the contract. These annuities provide an income stream, for the donor’s lifetime; an immediate partial tax deduction; and possible gift- and estate-tax benefits.

Donor-Advised Fund (DAF)

A popular vehicle for donors looking only to make a charitable gift, not to give to other beneficiaries as well. Donors give assets of their choice to a fund maintained by a charity or a financial-services company working with charities. The assets inside the fund grow tax-free, leveraging donor gifts. Donors can recommend charities (though their recommendations aren’t binding) and their contributions are eligible for an immediate income-tax deduction, potentially even before they choose charities. DAFs are an efficient vehicle for donating to multiple charities, and typically don’t require a high minimum commitment.
Pooled Income Fund
A type of charitable trust that pools donor resources. Donors receive regular income distributions for life, whose amounts depend on their contribution and the performance of the funds; an immediate partial income-tax deduction; and the removal of fund assets from their estates. After the donor dies, his or her remainder interest in the fund goes to one charity or more, which he or she may have recommended to the fund.

Private Foundation
An alternative geared to high-net-worth donors with pure philanthropic intent who are also usually interested in involving their families over multiple generations, even into perpetuity. A private foundation can contribute to a very wide range of charities, offers its contributors an immediate income-tax deduction and, like many other charitable vehicles, the potential elimination of capital-gains taxes on appreciated securities that are donated and an estate-tax benefit. Establishing a private foundation is complicated and typically expensive.

Many vehicles are irrevocable, so it’s key for donors to consult with trust experts and make sure they understand the requirements, advantages, and disadvantages of any choice they’re thinking of making.

Who Do You Trust?:
Sometimes it seems that there are as many trusts as drops of water in an ocean. In your estate planning, you may want to take a look at one or more of the trusts below—a small sample of what’s available to you (in addition to the charitable-giving trusts we discuss on pages 6-9).

Some of these trusts are always irrevocable once they’re established; others may be structured as either revocable or irrevocable. Similarly, in some cases it may be possible for you to set these up as either lifetime or testamentary trusts, and as either grantor or non-grantor trusts.

– Generation-Skipping Trust:
Designed to hold money that the grantor wishes to gift directly to grandchildren or younger generations, or an unrelated person at least 37.5 years younger than the grantor. By “skipping over” the grantor’s children, the trust avoids leaving them with an estate-tax liability. However, any amount transferred that exceeds the grantor’s lifetime gift- and estate-tax limit will be subject to the 40% generation-skipping transfer tax. A generation-skipping trust is primarily for donors with very substantial assets.

– Grantor-Retained Annuity Trust (GRAT):
A vehicle for transferring assets that can be set up as a single longer-term or shorter-term trust, or as a series of rolling short-term trusts. With a GRAT, the grantor receives a series of annuities whose total amount, when increased by the prevailing Section 7520 Rate (see page 7), is usually designed to equal the value of his or her original contribution. If that hurdle is cleared, any remaining appreciation in the trust goes to the beneficiaries with no gift- or estate-tax consequences to them or to the grantor. If the GRAT fails to clear the hurdle, no property is passed to the beneficiaries. Low interest rates increase the probability of a GRAT succeeding.
Who Do You Trust?: continued

- **Irrevocable Life Insurance Trust (ILIT):**
A trust holding the grantor's term or permanent life-insurance policy, taking the death benefit out of the grantor's estate and allowing it to pass to beneficiaries free of estate tax. The trust is subject to a three-year look-back, so if the grantor dies within those three years, the policy can revert to the grantor's estate, but strategies are available that avoid the reversion.

- **Marital Trust:**
A type of credit-shelter trust that splits the estate of a married couple into two parts, one of which is gifted to the surviving spouse after the first spouse dies, and the other of which is held in trust. The surviving spouse receives income from the trust, and may have access to a portion of its principal as well. The surviving spouse also has the power to appoint new beneficiaries of the fund. When the second spouse dies, the trust passes to its designated heirs. Although the portability of the estate-tax exemption has made marital trusts much less useful, they can still play a role in certain circumstances, including when one spouse is significantly wealthier in his or her own right than the other. See also “QTIP Trust” below.

- **Medicaid Trust:**
A trust structured to remove enough assets from the grantor's estate to assure that he or she will be able to receive Medicaid assistance if need be, especially for long-term health care. With Medicaid disqualification at very low levels of income and net worth, the cost of long-term care daunting, and the unreliability of housing assets with friends and family, Medicaid trusts are popular vehicles. If assets were transferred five years or less before establishing the trust (30 months in California), a time penalty will be imposed before the trust becomes valid.

- **Qualified Personal Residence Trust (QPRT):**
A trust designed to reduce the value of the grantor's personal or vacation residence for estate-tax purposes if he or she outlives the term of the trust. A QPRT allows the grantor to continue living in his or her home, but must pay the beneficiary rent after the trust expires. If the grantor dies while the trust is still in place, the home's fair market value will revert to his or her estate.

- **Qualified Terminable Interest Property Trust (QTIP):**
A type of credit-shelter trust similar to a marital trust (see above), but with more limitations placed on the second spouse to die. Used particularly in second (or later) marriages, these trusts are typically designed to protect the interests of both the surviving spouse and the beneficiary children of earlier marriages. The trust usually restricts the second spouse to die from naming new beneficiaries, but gives him or her the right to take income distributions (not an obligation, as in a marital trust). Like a marital trust, however, a QTIP targets the preservation of both spouses' estate-tax exemptions.

- **Special Needs Trust:**
An estate-planning tool useful, if not essential, for appropriate grantors of various income levels. These trusts, designed to protect a special-needs beneficiary, are structured to give disabled people access to funds that enrich their lives without jeopardizing their government benefits. The beneficiaries are often children of the grantors.
**Who Do You Trust?: continued**

- **Spendthrift Trust:**

  As their name implies, trusts in which the grantor gives the trustee latitude in withholding distributions to beneficiaries deemed unreliable by the grantor—but still worthy of his or her gift. These beneficiaries may include people with addictions, liens from creditors, disruptive behavior, and the like. The language of these trusts needs to reflect the particular circumstances of the beneficiary and his or her relationship with the grantor. These trusts are not valid in every state, and where they are, they may need to include certain restrictions.

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**A Team Sport**

From even this abbreviated discussion of estate planning it’s probably clear that estate planning is a process of exploration and identification: exploration of your goals (including some that may surprise you) and identification of the strategies best suited to meet those goals out of a panoply of alternatives.

Perhaps you’re looking upon estate planning as a task, which it is—and in some ways, an uncomfortable one. But it’s also an opportunity to define and establish the legacy you hope for. What it isn’t is a do-it-yourself enterprise. As important as estate planning is, it’s equally complex, and you don’t want to get lost in the weeds. Instead, work closely and cooperatively with experts who can help you pinpoint and address your objectives and guide you through the details.

*We at People’s United Advisors stand ready to meet with you and your other professionals as you move from thinking about estate planning to taking action and putting a plan in place.*

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