Financial Planning

Have Peace of Mind (and Reduce RMDs) with Qualified Longevity Annuity Contracts

Wouldn't retirement planning be easier if we all knew how long we were going to live? Individuals often underestimate how long they are going to live in retirement.

As a result, many retirees face the risk of exhausting their savings and burdening their families in retirement.

Longevity annuities, also known as deferred income annuities, are contracts that can provide income for life*, but defer the income start date for many years in the future. Similar to a pension, these contracts can give policyholders the peace of mind that regardless of how long they live, they will always have a lifetime income stream*, thus reducing their individual longevity risk.

In the past, purchasing longevity annuities in a traditional IRA or 401k was limited due to the requirement that individuals had to take income known as required minimum distributions (RMDs) by age 70½. That changed on July 2, 2014, as the Internal Revenue Service allowed deferred income annuities to be made available as Qualified Longevity Annuity Contracts (QLACs), which will be excluded from RMD calculations when certain conditions are met. This ruling now allows a person with a Traditional IRA to defer past the RMD age limitation of 70½ to a maximum age of 85 to plan for future income as well as lessen their RMD. As an example, if you have a $520,000 Traditional IRA, you could fund a $130,000 QLAC under the current rules. Your RMDs when you reach age 70 ½ would then only be calculated on $390,000, which could lower your income tax bill. Please note that there are contribution limits to QLACs that are mentioned below.

The contracts also have various options to be selected at issue that will affect the income payouts. The policy owner could add a spouse so the income could be paid over both lives. Also, depending on the carrier, a COLA (cost-of-living adjustment) could increase to the annual income stream. In addition, a return of premium could be added as a death benefit for beneficiaries if the full premium was not returned to the policy owner prior to death.

Due to their attractive payout rates, longevity annuities could be used as part of an effective retirement income laddering strategy with other income producing assets in a portfolio. In addition, you may feel that adding a QLAC policy to your portfolio shortens the time horizon on your other retirement investments due to the specific time horizon of the income stream. The QLAC may also balance out the volatility of any other investment type future income streams

Characteristics of QLACs

Common QLACs features include:

- The cumulative dollar amount invested into all QLACs across all retirement accounts may not exceed the lesser of $130,000 or 25%
- The limitations will apply separately for each spouse, if married
- Payouts must begin by age 85 (or earlier)
- The QLAC must provide fixed payouts, but a contract may have a cost-of-living adjustment (COLA)
- The QLAC cannot have a cash surrender value once purchased (i.e., it must be irrevocable and illiquid), but it can have a return-of-premium death benefit payable to heirs as a lump sum or a stream of income
- No growth component during deferral years
- Optional for 401k sponsors
- Not available with Roth IRAs, Defined Benefit Plans, and non-governmental 457 plans (Traditional Deferred Income Annuities can be purchased in non-qualified accounts)

If you are a retiree or pre-retiree who is concerned about outliving your assets, and own IRA or 401k assets, talk to you financial advisor about QLACs, to give you peace of mind that you will not run out of income — even if you run out of money. ■

*All guarantees subject to the claims paying ability of the issuing company.