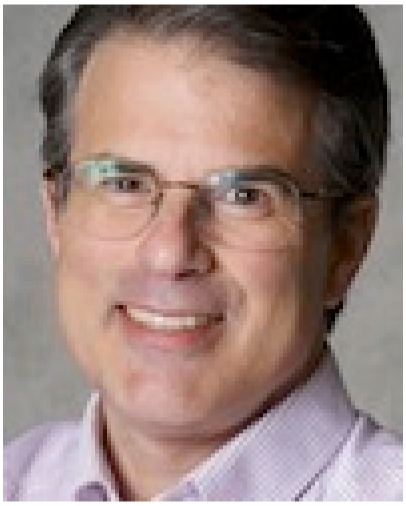
Did QLACs Get a Last-Minute Haircut?

By Kerry Pechter *Thu, May 6, 2021*

The Ways and Means Committee considered raising the limit on pre-tax contributions to a deferred income annuity to $200,000, but then, apparently for budget reasons, let the current limit of $135,000 stand.



Qualified Longevity Annuity Contracts, or QLACs, will get a modest boost if Congress passes the Secure 2.0 bill (H.R. 2954, or The Securing a Strong Retirement Act of 2021) for Americans) in its current form. The bill was approved yesterday by the House Ways & Means Committee by an unanimous bipartisan voice-vote.

QLACs are deferred income annuities (DIAs) that can be purchased with money in an IRA or 401(k) account. Secure 2.0 would repeal the 25% limit on the portion of those savings that can be applied to the purchase of a DIA but keep the dollar limit to $135,000, according to multiple sources. (*RIJ* was told the committee considered raising the dollar limit to $200,000, but backed away to conserve revenue.) The law also would facilitate the sales of QLACs with spousal survival rights and offer a free-look period of up to 90 days.

“There was discussion about lifting the threshold, which we favored,” said Dan Zielinski, communications chief at the Insured Retirement Institute, which lobbies for the retirement industry. “There’s speculation that cost was a factor in not raising it. We will continue to pursue the issue as the bill proceeds through the legislative process.”

An IRI public statement said, “Increasing the dollar limitation on premiums and authorizing QLACs to be offered through a diverse slate of indexed and variable annuity contracts with guaranteed benefits are critical elements of reforms needed to make QLACs more available to workers and retirees.”

QLACs need any help they can get. They haven’t not sold well over the past seven years. According to LIMRA Secure Retirement Institute, sales of all DIAs, including QLACs, totaled only $1.7 billion in 2020, down 32% from 2019. That was barely more than a quarter of the sales of immediate income annuities ($6.3 billion).

Would removing the 25% help QLAC sales, or help retirees? I thought the 25% QLAC limit supported a policy goal of getting middle-class people with mostly tax-deferred savings to carve out a small portion of their savings to mitigate longevity risk. It's hard to imagine the government choosing to encourage anyone to spend their entire IRA wealth on a QLAC.

Pre-2014 regulations prevented a QLACt from coming to market at all, because retirees typically begin receiving payouts from DIAs until well after age the age at which required minimum distributions (RMDs) must begin (formerly 70½, now 72 and headed up to 75 if Secure 2.0 passes).

The 2014 QLAC regs partially removed that legal obstacle. They allowed pre-retirees and retirees to apply up to 25% of their retirement account balances (to maximum of $125,000) for the purchase of QLACs. RMDs on that portion of savings could be delayed until the retiree began receiving payments from the QLAC—at the age of 80 or older.

"We created the QLAC in 2014 to help restore lifetime income to 401(k) and other DC plans and IRAs," said Mark Iwry, the deputy Treasury Secretary who shepherded the QLAC into existence, in an interview this week. "Our policy strategy was driven by the behavioral hypothesis that savers would be more likely to see benefit in partial, deeply deferred annuitization.

"The value proposition is to buy protection only from the longevity risk that is most worrisome—the tail risk of outliving average life expectancy— at the modest cost of giving up only 15% or 20% of their account balance," he said.

But financial advisers and their Boomer clients saw a glass half-empty, not half-full, and declined to drink very deeply from it. The tax break—from postponing a portion of RMDs for 10 years or so—was too small to excite tax hawks. And an annuity with a waiting period of 15 years had weak appeal, even though the delay made the annuity cheaper. (Treasury foresaw that issue and set no minimum age for starting income from a QLAC.)

"Among other useful provisions in the Neal-Brady SECURE 2.0 bill, I've supported repealing the QLAC 25% limit and raising the dollar limit," Iwry told *RIJ*. He said the tighter limits established in 2014 were dictated by the need to change the rules by changing a regulation, not a law.

"Because we created QLACs by regulation, we established those limits to help ensure that the RMD relief on which QLACs are based would be solidly within our regulatory authority consistent with the statutory RMD framework," he added. "Repealing the 25% limit will make it easier to buy QLACS in IRAs by rolling the premium amount to the IRA from a 401(k) plan.

"The repeal of the limit is mainly to allow the plan participant, for instance, to roll $125k of his $500k 401(k) account to an IRA and use all of the $125k to buy a QLAC, rather than have the limit apply again at the IRA level, thereby requiring him to roll over four times as much as he needs to buy the QLAC into the IRA," Iwry told *RIJ*.

While QLACs offer a modest tax break for the wealthy, their best application might be to help mass-affluent Boomers whose savings is largely in retirement accounts and who expect to live longer than average. The QLAC allows them to implement a simple two-bucket retirement income strategy that could greatly reduce their risk of outliving their savings.

For instance, at current annuity rates, a 65-year-old couple with $500,000 in their 401(k)s might use $100,000 of that money to buy a joint-and-survivor QLAC paying about $1,000 per month when they reach age 80 and guaranteed for as long as either of them lives. Such a contract could include either a cash refund feature or a minimum of 10 years of payments for the same price.

Between ages 65 and age 80, this hypothetical couple could live on the remaining $400,000, spending as much as $25,000 a year to supplement their combined Social Security benefits of $25,000. Academic research, such as a **paper** by Jason Scott and others in the mid-2000s, has demonstrated that such a strategy can maximize income in retirement while reducing risk of outliving savings.