Extend RMD Relief to Indexed Annuities

By David Littell *Thu, Jan 22, 2015*

A professor at The American College rebuts last week's RIJ critique of the National Association of Fixed Annuities' letter to the Treasury Dept. The letter asked that qualified indexed annuities, like qualified deferred income annuities, receive relief from required distributions at age 70 1/2.

Since deferred income annuities (DIAs) do not have account balances, the regulatory relief from required minimum distributions (RMDs) that the Treasury Department provided for these products in 2014 was necessary. It allowed DIA contracts with start dates after age 70½ to be used in a qualified environment. The justification for the relief, however, was not technical. Treasury granted the relief because it perceived the value of allowing Americans to gain longevity risk protection by using qualified assets to pre-purchase income that begins after age 70½.

So, if there are other products that can provide the same type of protection as well or better than DIAs can, shouldn’t they benefit from the same regulatory relief? Wouldn’t that allow consumers to choose the product that best fits their needs?

Today DIAs and FIAs with withdrawal benefit riders both are reasonable options for purchasing deferred income. In some cases, an FIA can provide as much or more guaranteed income than a DIA for the same premium payment. Some FIA income riders provide a specific roll-up rate and a payout percentage, so that the income amount for any age can be determined with certainty (allowing a clear comparison between the two product types). Other FIA products can provide an even higher guaranteed income floor, depending on the performance of the equity indices to which they are exposed.

There are other differences between these products, which may make one preferable to the other. While both will allow life and joint life payouts, DIAs are likely to have more payout options (life-with-period-certain, for example). DIAs can generally be built with inflation riders, while few FIA withdrawal benefit riders have an inflation option.

On the other hand, FIA withdrawal benefit riders have more flexibility in the choice of start date, because income can generally be turned on at any time. Such flexibility can be valuable to retirees who don’t know exactly when they will need to start the income.

Because FIAs do have an account balance, it is true that RMDs can be taken from a FIA, starting at age 70½. But doing so would reduce income payments when the withdrawal benefit rider is turned on. If the goal is to give consumers the option to buy delayed income that begins at age 80 or 85, requiring RMDs from the FIA only reduces the later income payments and defeats the objective of deferred income.

There don't appear to be any major obstacles to providing RMD relief to FIAs. The existing rules could be applied:

- Using the same premium limits that apply to DIAs (the lesser of $125,000 or 25% of qualified savings)
- Using the same age limit for the income start date (85)
- Allowing only the portion of qualified savings in the FIA to be exempt from the RMD requirements
- Requiring that the FIA income distributions not be aggregated with other required distributions

Other limits might be placed on the product design of qualifying FIAs. It may be appropriate to limit the relief to FIAs with withdrawal benefit riders. To deal with the trickiest aspect of relief—the possibility that a contract owner might take withdrawals without annuitizing or using the withdrawal benefit rider—the relief might need to include some schedule of required distributions or a penalty for this contingency.

I applaud the new Treasury regulations that provide RMD relief to DIAs. Deferred income annuities are an important retirement income planning tool. They mitigate longevity risk and can help ensure that retirees remain financially independent. The rules also recognize that, for many Americans, the assets needed to purchase these products will have to come from their 401(k)s, IRAs and other tax-advantaged plans. Extending this relief to similar products would provide a level playing field that encourages competition, better serves the public, and potentially expands the pool of consumers interested in these types of solutions.

David A. Littell, JD, ChFC, CFP, is professor of taxation, Boettner Chair in Research, The American College New York Life Center for Retirement Income.