Northwestern Mutual offers dividend-paying QLAC

By Editorial Staff *Wed, Jul 15, 2015*

Northwestern Mutual's actuaries have reproduced some of the attractive features of the variable-annuity-with-guaranteed-lifetime-withdrawal-benefit rider, but on a fixed income annuity chassis instead of a mutual fund chassis.

Northwestern Mutual has launched a QLAC (qualified version) of its deferred income annuity, which gives policyholders a chance of rising income in retirement through the accrual of dividends—the same steady dividend that the mutual insurer has been paying its life insurance policyholders since 1872.

The new product is the QLAC version of the insurer's Select Portfolio Deferred Income Annuity (Portfolio DIA). It works the same way the non-QLAC version works: In exchange for a lower guaranteed payout than a conventional DIA would offer, the policyholder benefits from Northwestern Mutual's dividend, which will be 5.6% in 2015. The dividend accrual is the key to this product.

The annuity owner gets a partial dividend at first, but it rises during the deferral period, eventually reaching the full amount. Each year, the owner can choose either to use the dividend to buy more income or he or she can take it in cash. The dividend is paid out every year, eventually diminishing in amount because income distributions gradually reduce the base on which the dividend payout is calculated.

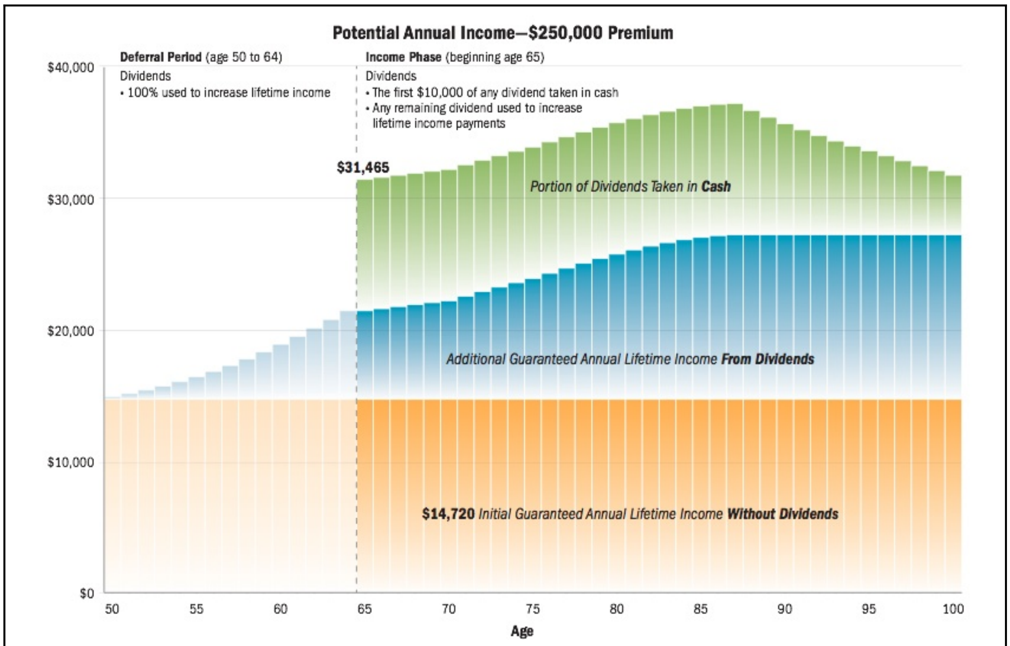
"You get prorated into the dividend," said Greg Jaeck, director of Annuity Product Development at Northwestern Mutual. We try to protect our existing policyholders. If we were to give new policyholders the full dividend from the start, the current policyholders would be subsidizing the new policyholders."

What you get, surprisingly, is a contract that reproduces some of the features—and a bit of the complexity—of the variable-annuity-with-guaranteed-lifetime-withdrawal-benefit rider that was so popular between 2006 and 2011, but one that uses a fixed income annuity chassis instead of a mutual fund chassis.

Instead of a roll-up in the benefit base and step-ups in the account value, the Select Portfolio DIA offers the dividend. Where the VAs, in some cases, allowed optional cash distributions (up to a point) that didn't necessarily affect the guaranteed minimum payout, the Select Portfolio allows the policyholder to spend or reinvest take any portion of the dividend. Policyholders who choose the deferral period death benefit option can also change the terms of their contract if they wish.

All this flexibility is great, but it makes it difficult to assess this product's value proposition without very close study. Essentially, it entails a bet that Northwestern Mutual will keep paying a healthy dividend, that the dividend will grow as prevailing interest rates rise, and that this product will produce more lifetime income, with more liquidity, than a straight fixed-payment DIA would.

Let's consider a hypothetical. Northwestern Mutual's product literature (see illustration below; click to enlarge) offers the example of a 50-year-old man who pays a $250,000 premium (the minimum is $10,000) for a life contract with a 10-year period certain and a return-of-principal death benefit during the deferral period. He plans to retire at age 65. [For a QLAC, maximum premium would be $125,000; assume that all the numbers in the example are halved.]



Hypothetical example (prepared May 2014) for Male, Age 50 • $250,000 premium (tax-qualified) • Single Life Income Plan with 10-year Period Certain • Deferral Period Death Benefit selected.

The illustrated dividends are based on the 2014 dividend scale. Illustrated dividends are not estimates or guarantees of a future result. Dividends actually paid may be larger or smaller than those shown.

In this hypothetical, the policyholder has a guaranteed minimum annual income at age 65 of $14,720. That's about half of the guaranteed rate he would receive if he bought a straight deferred income annuity with the same specs, according to the calculator at immediateannuities.com. Not so great, you might say.

But the picture looks better when you include the dividends. According to the illustration, the compounding of principal, interest and dividends over a 15-year deferral period would generate an estimated income of $31,465 at age 65. In this case, the policyholder has chosen to take $10,000 in cash and $21,465 as guaranteed income. Total income peaks between ages 85 and 90.

The liquidity of the product is quite unusual. “If the policyholders need access to some or all of the dividend, they can take 100% in cash, prior to cash date,” Jaeck told *RIJ* in a phone interview. He added that the dividend, which could be expected to grow if interest rates grow and the insurer’s profits rise, also provides protection from interest rate risk. “We often hear the question, ‘Do I have to lock in a rate?’ With this product, you’re not locking in a rate.”

Northwestern Mutual’s first DIA, issued in 2012, was only for qualified money, so a QLAC fits into its business plan. So far, about 75% of the company’s deferred income annuity sales were made with qualified money and 25% with non-qualified. “We have a 19% market share, and we’re second in DIA sales in the career channel,” Jaeck said. “According to LIMRA, we did $113 million in the first quarter of 2015 and $146 million in the fourth quarter of 2014. MassMutual did $53 million in the first quarter of this year and $95 million in fourth quarter of last year.”

QLACs were made possible by Treasury Department rulings in 2014 that resolved an obstacle to the use of tax-deferred money to purchase a deferred income annuity with an income start date after age 70½. The problem was that owners of qualified accounts have to start taking annual distributions from those accounts at that age.

But, a year ago, Mark Iwry, an assistant Treasury Secretary, announced that people could buy deferred income annuities with a start date after age 70½ and defer required distributions (and the taxes due on them) on the premium amount until they began receiving the money. They could wait to begin receiving the money until as late as age 85. Treasury restricted the purchase premium of a QLAC to the lesser of $125,000 or 25% of an individual’s tax-deferred savings.