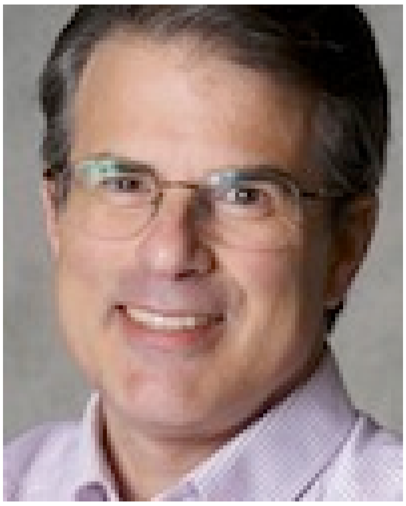
QLACs: The ‘Greek yogurt’ of Retirement Products?

By Kerry Pechter *Thu, Nov 20, 2014*

Longevity annuities were the topic of a two-hour discussion at the Brookings Institution two weeks ago and of a RIIA/New York Life webinar this week. Having read the transcript of the first one and attended the second, I offer these highlights.



Broccoli is just cabbage with a college education, Mark Twain said. And for those of you who believe that deferred income annuities (DIAs) are just fancy immediate annuities and that qualifying longevity annuity contracts are just fancy DIAs—and that they’re all boring—then you’ve probably ignored QLACs altogether.

That might be doubly true if you’d never sell or even recommend an insurance product to a Boomer. Or if you don’t work at one of the mutual insurance companies, where most of the slow but steady SPIA/DIA/QLAC sales action inevitably takes place.

But for income wonks—you know who you are—who love to combine investment and insurance products (for tranquility and more freedom to get frisky with the rest of the retirement portfolio) then you probably thrill to QLACs the way a health nut thrills to cruciferous vegetables like broccoli or kale.

A little exposition: QLACs—Qualifying Longevity Annuity Contracts—are average-size (up to $125,000) DIAs, by definition purchased with pre-tax savings, from which income doesn’t have to flow until age 85. That’s well past the usual age 70½ commencement date for taxable distributions from qualified accounts. Importantly, a QLAC has tax-reducing potential, because during the deferral period the premium can be excluded from the calculation of required minimum taxable distributions from qualified accounts.

The long-awaited Treasury announcements about QLACs in July and October have triggered some interesting new discussions about longevity annuities. The Brookings Institute hosted a **forum** on QLACs in Washington on November 6. This week, New York Life sponsored a QLAC webinar, hosted by the Retirement Income Industry Association.

Three sales opportunities

The beauty part of the RIIA/New York Life webinar came, I thought, when Scott Bredikis, director, Guaranteed Income Annuities, at New York Life, described QLAC business opportunities. New York Life, of course, owns about half the small but rapidly growing DIA market, with over $1 billion a year in sales. More than three-quarters of DIAs are purchased with qualified money, he said. Almost all are purchased with a cash or installment refund at death.

QLACs potentially create three types of sales opportunities to three types of pre-retirees or retirees, New York Life believes. One scenario involves a person who buys a QLAC as pure longevity insurance, paying up to $125,000 (or 25% of qualified savings, if less) at age 65 for income at age 85.

A second anticipated scenario involves a 60-year-old who anticipates working part-time for another ten or 15 years, and who wants to set up a guaranteed income stream of $18,508 (at current rates) that starts at age 75, while reducing some of his RMD. He makes an initial purchase premium of $60,000 at age 60, and then makes partial payments of $6,500 a year for 10 years.

In the third scenario, a person would use a QLAC to fund a personal defined benefit pension. He or she might start contributing $5,000 a year for 20 years starting at age 50, to create an income stream of $36,558 a year at age 80.

Asked which of the three scenarios is likely to generate the most sales, Bredikis picked the second one. That made sense. Give the public's resentment of RMDs, the QLACs' ability to put a small dent in them is expected to enhance their appeal. Also, current DIA sales patterns do not suggest a widespread desire to use longevity annuities as DIY pensions or as pure longevity insurance.

All of the New York Life scenarios involved a single purchaser. Ron Mizrachi, a New York Life tax attorney, said that the QLAC regulations don't, for instance, allow couples to pool their IRA savings to fund one joint-life QLAC. Either spouse could buy a joint-life QLAC, but the purchase premium would have to come from a single IRA.

QLACs as the next 'Greek yogurt'

At the well-attended discussion at the Brooking Institution, the prominent liberal think tank in Washington, D.C., it was suggested that QLACs might create a spike in demand for income annuities, just as Greek yogurt created a surprise spike in demand for yogurt.

That comment marked one of the lighter moments of the two-hour meeting. At one of the more serious moments, the discussion turned to the issue of whether variable annuities or fixed indexed annuities with living benefits will ever be considered as QLACs.

Under the new QLAC rules, deferred income annuities are the only types of annuities where the RMD rules are suspended during the deferral period. But manufacturers of other types of annuities would love to have the same market-expanding privilege. Kim O’Brien, president of the National Association for Fixed Annuities (NAFA), told *RIJ* recently that she’s leading a contingent to Washington in December to make a case for her products.

At the Brookings meeting, Don Fuerst, an actuary, argued in favor of including variable and indexed annuities as QLACs because their exposure to equities or equities indices offers protection against inflation risk in retirement, which he suggested is as big a danger as longevity risk.

“It’s not really a predictable source of income you need, it’s purchasing power that you need,” he said. “If you have a predictable source of income and inflation is two percent over 20 years, you’re going to lose a third of your purchasing power. And if it happens to be three percent you’re going to lose almost half your purchasing power.

“Now if you can invest in a diversified portfolio you have a potential for exceeding those fixed income rate and having the income be higher. So we think that providing that kind of flexibility in what we might call a variable income annuity or an investment indexed annuity would protect people against another risk, and that’s the inflation risk. It’s not a guarantee, but a guarantee is—I’d like to make the point—are very expensive.”

J. Mark Iwry, the Treasury official responsible for shaping the QLAC tax benefits from which VAs and FIAs are at least temporarily excluded, responded by saying that longevity annuities were the right place to start, given their simplicity. He also noted that inflation-adjusted longevity annuities are allowed by the new regulations. In addition, he said that the growth potential of the non-annuitized assets in their retirement accounts offers the upside potential that fixed-rate longevity annuities don’t provide.

But he didn’t rule out the use of VAs and FIAs as QLACs. “We did very much leave the door open to other approaches that could be permitted in the lifetime income longevity annuity space,” he said. “… This is a final reg, but this is not a final step in this whole process of regulation. In no way is this intended to suggest that variable products or indexed annuities don’t have a potentially important and very constructive place to play, nor to suggest that they would not be part of similar guidance that’s issued in the future.”

Certainly, some policy wonks [though not all; some think Social Security reform is a bigger priority] hope that if enough people talk long enough and loudly enough about longevity annuities, America will embrace both DIAs and QLACs. It was Ben Harris, co-director of Brookings’ Retirement Security Project, who compared QLACs to Greek yogurt.

“People’s attitudes can change,” he said. “Right while I was sitting here I was trying to think of an example of something that went from being unpopular to being very popular: Greek yogurt. Overnight we decided as a country that we loved Greek yogurt. The sales of Greek yogurt went up 2500% in five years.

“I can see a tipping point where once you’ve become more familiar with the product, and once your neighbors start buying longevity annuities, and once your employer sort of implicitly endorses it by offering them in their [retirement plan]… once you get all these sort of implicit endorsements, [you’ll ask,] Is it at least worth considering? You might see an uptake in the consumer behavior.”