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Annuities

Qualified Longevity Annuity Contract Rules Should Allow More Options, Commenters Say

A Treasury Department proposal to expand retirement income options is on the right track, but it requires some revisions to achieve the objectives outlined in the proposed regulation (REG-115809-11), a variety of interest groups said in public comment letters posted May 4.

The Committee of Annuity Insurers reflected the views of insurers in recommending that Treasury allow higher limits on premiums for longevity annuity contracts that qualify for favorable tax treatment under the proposed regulation. The group also recommended that Treasury impose fewer limitations on ''qualified longevity annuity contracts.'' QLACs, introduced in the proposed regulation, generally are no-frills contracts with no interest rate and inflation protections and no minimum guaranteed death benefits or cash surrender value.

In drafting a final regulation, Treasury should strike a better balance between keeping QLACs simple to maximize monthly income and offering features that would make them more attractive to more people, according to the Committee of Annuity Insurers, whose members represent large annuity issuers.

The proposed regulation would limit the amount that plan participants could pay to purchase a QLAC to 25 percent of a participant's aggregated account balances, or $100,000, whichever is less, according to the proposed regulation (22 PBD, 2/3/12; 39 BPR 218, 2/7/12).

Increase Limits. According to the Committee of Annuity Insurers, the median individual retirement account balance of about $54,000 in 2008 for individuals between the ages of 65 and 69 would support a maximum QLAC premium of about $13,500. Based on information provided in the preamble to the proposed regulation, the insurers said, a QLAC purchased at age 70 would produce about $290 in monthly joint and survivor annuity payments commencing at age 85.

''Assuming 3% annual inflation, the purchasing power of this monthly payment would be about $185 at age 85,'' an amount that may be insufficient to motivate individuals to purchase QLACs, the annuity insurers said.

The American Society of Pension Professionals and Actuaries recommended in its comments that the final regulation be written to allow a person to use as much as 35 percent to 40 percent of their aggregated balances in retirement savings accounts to purchase a QLAC. ASPPA also recommended that the proposed dollar limitation be increased from $100,000 to $150,000 or $200,000 ''to allow greater flexibility for participants.''

AARP, unlike ASPPA, endorsed the proposed $100,000 limit, citing two reasons. First, the account balances available for average participants to purchase longevity insurance are not substantial, AARP said in its comment letter. Second, the $100,000 cap ''protects the treasury in that it restricts substantial deferrals,'' it said.

Inflation, Interest-Rate Risk. The proposed regulation would require that annuity payments from QLACs comply with rules under Treasury Regulation § 1.401(a)(9)-6, which allow certain types of ''increasing annuity payments'' to insure against inflation- and interest-rate risk, the Committee of Annuity Insurers said. On that basis, the insurers commented, a QLAC could insure against inflation- and interest-rate risk after the date of the annuity payments.

However, the proposed regulation is unclear about whether a QLAC could provide similar protections before its annuity starting date, the insurers said. Without those protections, inflation- and interest-rate risks ''could significantly dilute the purchasing power'' of initial and subsequent annuity payments, even before the annuity starting date, the insurers said.

''QLACs should be permitted to include features that offer the potential for a higher level of annuity payments, provided that there is always a guaranteed floor of benefits payable,'' the insurers said in comments on the proposed regulation.

The insurers also recommended that the final regulation permit QLACs to provide an optional guaranteed minimum death benefit equivalent to the amount of premium payments that a participant makes to purchase the QLAC. Based on its own internal analysis, the insurers said, a QLAC with a guaranteed return-of-premium death benefit would provide lifetime annuity payments that are 12 percent to 13 percent lower than payments the contract would provide without a guaranteed minimum death benefit.

Revising the proposed regulation to also permit QLACs to have at least a limited amount of cash surrender value would provide enough liquidity to ''encourage more individuals to purchase longevity insurance and more plan sponsors to make QLACs available under their plans,'' the Committee of Annuity Insurers said.

Women's Issues. In a separate joint comment letter, the Pension Rights Center and various women's groups said that efforts by Treasury and the Internal Revenue Service to expand lifetime income options are best suited for employer-based plans because annuities of-

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fered through employer plans must be calculated without regard to gender.

When women purchase lifetime income products using funds from an IRA or other savings accounts, they receive less income for their purchase because those products are priced using gender-distinct mortality tables, the groups said. Those tables work to women's detriment because of women's longer life expectancy, the joint letter said.

''Moreover, if an annuity is purchased on the open market, federal law does not protect the interests of women as spouses by requiring spouses to consent if that annuity fails to provide a benefit to the surviving spouse,'' according to the letter, signed by the Pension Rights Center and eight women's groups, including the National Women's Law Center.

The joint letter recommended that Treasury and IRS make four modifications to the proposed regulation, which would make an exception to current rules on required minimum distributions by permitting qualified longevity annuity contracts to be excluded from account balances used to compute RMDs. The groups requested that the final regulation:

- require that premiums for QLACs purchased with IRA assets be priced on a gender-neutral basis for the exception to apply,
- specify that qualified joint and survivor annuity rules apply to QLACs offered by employer-sponsored qualified plans,
- encourage insurance companies to include spousal survivor protections in QLACs purchased with IRA assets, and
- adjust QLAC dollar and age limits for qualified joint and survivor annuities.

The Defined Contribution Institutional Investment Association commented that employers would be more likely to cooperate in providing lifetime income options if Treasury and IRS would provide fiduciary safe harbors. The regulators could do so, DCIIA said, by clarifying how retirement income products can qualify as qualified default investment alternatives (QDIAs) and by ''encouraging adoption of auto-enrollment into retirement income strategies.''

Separately, the National Association of Insurance and Financial Advisors commented that efforts to expand guaranteed retirement income could be undermined by a Department of Labor proposal to expand the definition of investment advice fiduciary.

''The commission-based compensation that is generally used in the annuity market would be prohibited under the revised fiduciary definition that the Department of Labor proposed in October 2010 [and subsequently withdrew for redrafting], unless appropriate exceptions or prohibited transaction exemptions (PTEs) are provided,'' NAIFA said in its comments.

By Florence Olsen

The comment letters are at: AARP, http://op.bna.com/pen.nsf/r?Open=foln-8u5uce; American Society of Pension Professionals and Actuaries, http://op.bna.com/pen.nsf/r?Open=foln-8u5udq; Committee of Annuity Insurers, http://op.bna.com/pen.nsf/r?Open=foln-8u5ue8; Defined Contribution Institutional Investment Association, http://op.bna.com/pen.nsf/r?Open=foln-8u5ueg; National Association of Insurance and Financial Advisors, http://op.bna.com/pen.nsf/r?Open=foln-8u5ugu; and Pension Rights Center, http://op.bna.com/pen.nsf/r?Open=foln-8u5uhe.

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