

Demystifying QLACs – What Every Financial Advisor Should Know

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Scott Witt, FSA, MAAA

Witt Actuarial Services

Fee-Only Insurance Advisor

Types of Annuities

- Deferred / Accumulation Annuities
- Immediate / Income Annuities
- Longevity / Deferred Income Annuities
 - Qualified Longevity Annuity Contract (QLAC)

Deferred / Accumulation Annuities

- Fixed, Indexed, or Variable
- Typical use case is for deferring taxation in non-qualified accounts
- Another use case is for generating income with a guaranteed income rider
- Another use case is for access to investment options that wouldn't otherwise be available
- Taxation
 - Taxed as ordinary income on a gain-first basis
- Oversold in my opinion

Immediate / Income Annuities

- Also referred to as SPIA (single premium immediate annuity)
- Fixed or Inflation-Adjusted
- Payment options range from certain period to life-only to life with certain period or refund
- Joint and survivor options available
 - e.g., 50%, 67%, 75%, 100%
- Taxation
 - Taxes spread out over life expectancy with exclusion ratio
- Undersold in my opinion

Longevity / Deferred Income Annuities

- Single premium or multiple premium payments
- Generates guaranteed income starting at a future date
- Primarily fixed
- Payment options range from certain period to life-only to life with certain period or refund
- Joint and survivor options available
 - e.g., 50%, 67%, 75%, 100%
- Taxation
 - Money grows tax-deferred during accumulation period
 - Taxes spread out over life expectancy with exclusion ratio during income period
- Undersold in my opinion but market is thin



QLAC

- QLACs are a specific type of longevity annuity
- Created in 2014
- Solved an RMD problem for those wishing to defer income past retirement age
- Allowed for income to be deferred as long as age 85 and to deem any money used to buy a QLAC as satisfying RMD rules



QLAC

- Purchased with a tax-free transfer from a qualified account
 - IRA – Traditional, SEP, SIMPLE (not Roth)
 - 401(k)
 - 403(b)
 - 457(b)
- Originally lesser of \$125,000 or 25% of qualified money
 - In 2023, the percentage limitation was eliminated and maximum increased to \$210,000 (inflation-adjusted) per person (SECURE 2.0 Act)



QLAC

- No cash value
- Can purchase with or without a refund feature
 - Life only (no refund) means that if death occurs before income begins, then no payments will be made on behalf of annuitant
 - This creates tremendous leverage as the payments of those who die early support payments of those who die late
 - Life with refund guarantees that at least the original purchase price (less payments already made) will be refunded at the time of premature death – lowers the income amount

QLAC Example

- 65-Year-Old Male
- \$210,000 purchase
- Lifetime income (no refund at death) with income starting at age:
 - 70 \$22,764
 - 75 \$35,304
 - 80 \$61,956
 - 85 \$110,820

QLAC Example (no refund)

- 65-Year-Old Male
- \$210,000 purchase
- Lifetime income (no refund at death) with income starting at age:
 - 70 \$22,764
 - 75 \$35,304
 - 80 \$61,956
 - 85 \$110,820

Pre-Tax IRRs at Various Ages of Death QLAC with No Refund at Death

	<u>Income Start Age</u>			
<u>Age at Death</u>	<u>Age 70</u>	<u>Age 75</u>	<u>Age 80</u>	<u>Age 85</u>
Age 75	-5.5%	-16.3%	-100.0%	-100.0%
Age 80	1.8%	0.1%	-7.8%	-100.0%
Age 85	4.7%	4.2%	3.3%	-3.1%
Age 90	6.1%	6.0%	6.2%	5.3%
Age 95	6.8%	6.9%	7.4%	7.4%
Age 100	7.3%	7.4%	8.0%	8.3%
Age 105	7.5%	7.7%	8.4%	8.8%

QLAC Example (with refund)

- 65-Year-Old Male
- \$210,000 purchase
- Lifetime income (refund at death) with income starting at age:
 - 70 \$20,832
 - 75 \$31,188
 - 80 \$51,324
 - 85 \$90,288

Pre-Tax IRRs at Various Ages of Death

QLAC with Refund at Death

	<u>Income Start Age</u>			
<u>Age at Death</u>	<u>Age 70</u>	<u>Age 75</u>	<u>Age 80</u>	<u>Age 85</u>
Age 75	0.0%	0.0%	0.0%	0.0%
Age 80	0.9%	0.0%	0.0%	0.0%
Age 85	3.9%	3.4%	2.2%	0.0%
Age 90	5.4%	5.2%	5.1%	4.3%
Age 95	6.2%	6.2%	6.4%	6.5%
Age 100	6.7%	6.7%	7.1%	7.5%
Age 105	7.1%	7.1%	7.5%	8.0%

QLAC Example
(joint 100% with no
refund)

- 65-Year-Old Male and 65-Year-Old Female
- \$210,000 purchase
- Lifetime income (no refund at death), payable until second death (100%), with income starting at age:
 - 70 \$18,588
 - 75 \$27,408
 - 80 \$43,272
 - 85 \$70,356

Pre-Tax IRRs at Various Ages of Death
QLAC Joint 100% with No Refund at Death

	<u>Income Start Age</u>			
<u>Age at 2nd Death</u>	<u>Age 70</u>	<u>Age 75</u>	<u>Age 80</u>	<u>Age 85</u>
Age 75	-8.0%	-18.4%	-100.0%	-100.0%
Age 80	-0.3%	-1.9%	-10.0%	-100.0%
Age 85	2.9%	2.5%	1.2%	-5.6%
Age 90	4.5%	4.4%	4.2%	4.1%
Age 95	5.3%	5.4%	5.6%	6.4%
Age 100	5.8%	6.0%	6.3%	7.4%
Age 105	6.2%	6.4%	6.7%	7.9%

When Are QLACs Appealing?

- Healthy individuals with high longevity expectations
- Individuals who wish to reduce/eliminate uncertainty in their planning horizon
 - Changes management strategy to having portfolio last to age 85 for instance
- Individuals with high RMD exposure looking to defer taxes
- Risk-averse individuals that want to eliminate long-term market risk

Other Joint Options Available

- Joint and 100% was illustrated here but other options exist
 - 75%
 - 66%
 - 50%
- Payments would be higher with reduced survivor percentages
- Must decide/elect at issue

What Are the Negatives Associated With QLACs?

- No liquidity – locked up for life
- Not appealing for individuals in poor health
- Subject to inflation risk due to fixed nature of payments
- It's true insurance – potential for getting nothing (and losing 100%)
 - Could be viewed as a positive with proper mindset

Why Aren't QLACs More Popular?

- Individuals don't appreciate the risk/reward trade-off of insurance against living too long
 - Reluctance to embrace possibility of -100% return
- Individuals underestimate longevity risk
 - Healthy 65-year-old male/female couple has a 25% chance of one of them reaching age 100!
- Agent compensation is minimal (or non-existent) compared to AUM

QLAC Compliance Concerns

- Cannot have cash value
- Cannot have variable or indexed component
- Payments must begin by first day of month following 85th birthday
- \$210,000 contribution limit indexed with inflation
- Insurance company reports annually to IRS and policyholder

Contact Info

- scottwitt@wittactuarialservices.com
- 414-525-8212
- www.wittactuarialservices.com
- Nationwide fee-only insurance advisor providing conflict-free advice on life insurance, annuities, and long-term care insurance
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