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New Regulations for Longevity Income Annuities

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The Treasury and the IRS have issued final rules on longevity income annuities (also known as a "deferred income annuity" or "longevity insurance"). A longevity income annuity is a contract between an individual and an insurance company. The insured deposits a sum of money with the insurance company in exchange for a stream of payments to begin at a designated future date that will last for the remainder of the individual's life.

The IRS, in conjunction with the Department of Labor, has been working to update regulations related to retirement income since 2010, when they issued a request for information on how 401(k) accounts could provide better lifetime income. The Treasury proposed the longevity income annuity rules back in February 2012 that have now been finalized.

A 401(k) is a feature of a qualified profit-sharing plan that allows employees to contribute a portion of their wages to individual accounts. With a 401(k), you can retire with a large account balance, but it may be difficult to determine how to spend it during your retirement. Turning part of that balance into a guaranteed income stream can mitigate the risk of outliving one's assets, or unnecessarily limiting spending in retirement.

Under the new rules, a 401(k) or IRA can permit participants to use up to 25% of their account balance (or $125,000, whichever is less) to buy a longevity income annuity without concerns about non-compliance with the age 70 ½ minimum distribution requirements, otherwise known as RMD's. The limitation will be adjusted for inflation in $10,000 increments.

In addition, the final regulations aim to protect individuals against accidental payment of longevity premiums exceeding the aforementioned limits. The final rules permit individuals who inadvertently exceed the 25% or $125,000 limits on premium payments to correct the excess without disqualifying the annuity purchase.

Complying with the RMD rules was hindering the effective utilization of longevity income annuities in retirement accounts. Before the new rule, an employee would have to include the value of the annuity contract as part of their account balance when calculating required minimum distributions from their retirement accounts.

Now under the new rule, the annuity contract is excluded from the account balance and the annuity payments will not have to begin at age 70 ½, as is the case with the other RMD's. However, payments must begin no later than the first day of the month following an individual's 85th birthday.

The final regulations also allow a "return of premium" death benefit. A longevity income annuity in a 401(k) or IRA can provide that, if a purchasing retiree dies before or after the age when the annuity begins, the premiums they paid but have not yet received as annuity payments will be returned to their accounts. This means that some or all of the initial investment can go to their heirs.

Finally, the final regulations offer more flexibility in issuing longevity annuities. The proposed regulations provided that a contract would not qualify as a qualified longevity annuity contract unless it clearly stated it was intended to be one when it was issued. However, the final rules permit the issuance of longevity annuities by allowing alternatives of including such statements in insurance certificates, riders, or endorsements relating to contracts.