QLACs: Your Retirement Accounts Can Act Like Pensions

These days, most people who work in the private sector don't have pensions, so they can only guess how long their retirement savings might need to last. Those who withdraw too much or live longer than expected could eventually run out of money; others may withdraw too little and live more frugally than might be necessary. A qualified longevity annuity contract (QLAC) is a special type of deferred income annuity purchased in an IRA or a qualified retirement account such as a 401(k). Lifelong income payments don't begin until the contract owner reaches an advanced age (up to age 85). The longer the payouts are deferred, the higher they will typically be. With a QLAC, retiring workers can use a portion of their tax-deferred savings to guarantee a certain income stream later in life — a time when they might have little or no ability to work and often face a greater risk of needing long-term care services.

Chances that a 65-year-old nonsmoker, with excellent health, will live to various ages

Age	Male	Female	One member of a couple
85	64%	73%	90%
90	43%	53%	73%
95	20%	29%	43%
100	6%	10%	15%

Source: Longevity Illustrator, Society of Actuaries, 2024

Better your odds

In 2019, the Employee Benefit Research Institute ran a simulation to determine whether using a portion of a 401(k) plan balance to fund a deferred income annuity at age 65 (with payments delayed until age 85) might help improve retirement savings outcomes. The results suggest that low-wage workers, who depend more on Social Security, may have little need for this type of longevity protection, but participants with incomes in the top 50% are more likely to benefit. For this group, the probability of running out of money decreases when an annuity is purchased with 5% to 25% of assets.[1] The SECURE 2.0 Act raised the amount taxpayers are allowed to invest in QLACs from $155,000 per person in 2022 to $200,000 per person in 2024 and $210,000 in 2025, as the limit is now indexed to future inflation. Plus, a previous rule that limited QLAC purchases to 25% of the taxpayer's total retirement account balances was eliminated. Despite new federal laws and regulations designed to promote wider adoption of QLACs, only about 4% of defined contribution plans offer them in 2024.[2] Consequently, retirement plan participants who are interested in QLACs might have to roll their funds into an IRA before they can purchase one.

How QLACs work

QLAC funds are exempt from the taxable required minimum distributions (RMDs) that must normally be taken from tax-deferred plans starting at age 73. So, for retirees who don't need RMD income to support their lifestyles, buying QLACs could help reduce their annual tax bills. Payments must begin no later than the first day of the month following the participant's 85th birthday. Like other distributions from tax-deferred retirement plans, payments from QLACs are taxable as ordinary income. (With nonqualified annuities purchased outside of a retirement plan, only the earnings portion is taxed.) Income payments can be continued throughout the lifetime of a designated beneficiary (usually a surviving spouse), and some annuities feature death benefits that return unused premiums to heirs. Of course, these options will either cost more up-front or reduce income payments later in life. Without the optional death benefit, insurers will generally keep the premiums paid if the annuity owner dies before (or after) the payout start date. Cash-out provisions are not allowed in QLACs. Investors should understand that the money invested in the annuity is no longer a liquid asset, and they may sacrifice the opportunity for higher investment returns that might be available in the financial markets. (Nonqualified annuities may offer a cash-out option that permits withdrawals during the deferral phase but surrender charges typically would apply.)

Annuities are insurance-based contracts that have exclusions, contract limitations, fees, expenses, termination provisions, and terms for keeping them in force. Any guarantees are contingent on the financial strength and claims-paying ability of the issuing insurance company.

1) Employee Benefit Research Institute, 2019

2) Plan Sponsor Council of America, 2024