ROBERTSON STEPHENS®

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Mitigating the risks of longevity and long-term care costs

One key goal that all our clients share, besides tax mitigation, is maintaining their lifestyle throughout their lifetime. In wealth planning, the risk of outliving one's assets is called longevity risk. During the planning process, we evaluate longevity risk by assuming a life expectancy of age 95 and in some cases, 100. Another important risk in long-term planning is rising healthcare costs, including long-term care. Healthcare costs are increasing at a higher rate than inflation. Since 1957, healthcare costs have increased four times faster than the price of all goods and services in the US.

There are many insurance products that guarantee income, and a new one became available in 2014 under the Obama administration. The Qualified Longevity Annuity Contract (QLAC) is a product designed to mitigate longevity risk. QLACs are a deferred income annuity that may be purchased within an IRA and 401(k) plan. The owner pays a single or a series of premiums. Payouts from the annuity are delayed until age 80 or 85. After these products are annuitized, they guarantee income throughout the annuitant's lifetime.

Here's what's interesting - QLACs have a special feature that delays required minimum distributions (RMD) until the owner reaches age 80 or 85, depending on the contract. This is much later than the current RMD age, which is 73. If the owner uses $100k of a $400k IRA to purchase a QLAC, their RMD amount at age 73 is reduced by 25%. The RMD from the 100k invested in the QLAC could start as late as age 85. New rules from the Secure 2.0 Act allow a total contribution of 200k to a QLAC in 2023. The limit will be indexed for inflation.

QLACs benefit clients concerned about depleting their assets toward the end of their expected lifespan. The product may be interesting to clients who are in or near retirement, risk-averse and prefer guaranteed income. For these types of clients, QLACs may provide income stability, inflation protection, and help mitigate longevity risk.

There are a few risks to be aware of. Early withdrawals may be subject to retirement taxes and penalties. For this reason, QLACs may not be a good solution for those who would like flexibility or may need to take withdrawals earlier than age 80. Annuity fees may decrease the asset's overall performance. Some contracts may also pay a lower interest rate than other investments or products. Essentially one is paying for the 'guaranteed' feature.

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