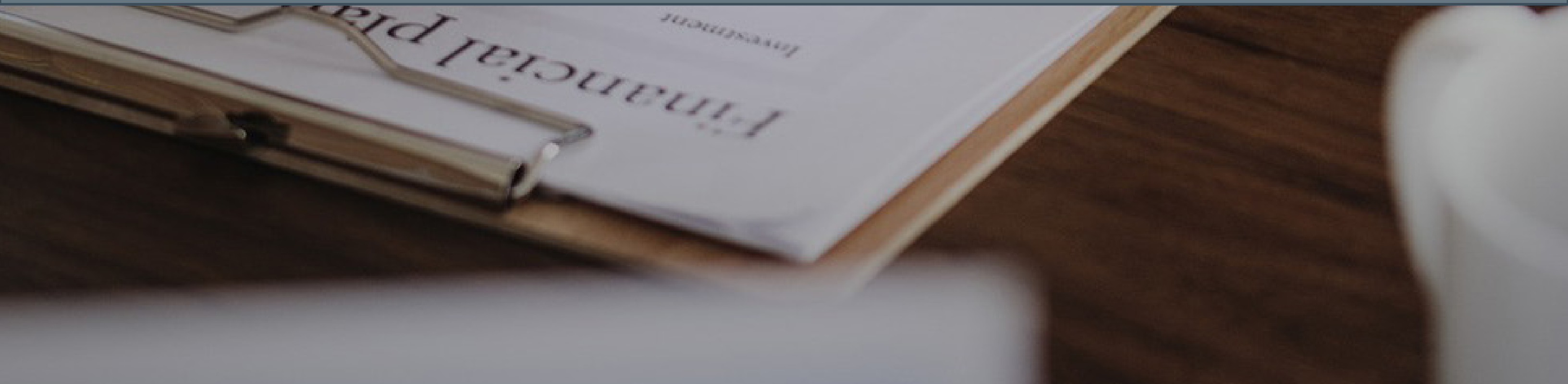
Qualified Longevity Annuity Contract:
Quick Reference Guide



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The IRA
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Qualified Longevity Annuity Contract: Quick Reference Guide

What is a QLAC?

A qualified longevity annuity contract (QLAC) is an annuity contract that is purchased from an insurance company, and is used to provide longevity income protection to the eligible retirement account owner and their eligible beneficiaries. A longevity annuity contract must meet certain specific requirements, in order to be 'qualified'. These include:

- Premium limitations on both dollar and percentage limits,
- Maximum annuity start date
- The QLAC value within the IRA, after age 70 ½, is excluded from Required Minimum Distribution (RMD) rules
- Unavailability of any commutation benefit, cash surrender right, or other similar feature
- Benefits after the death of the account owner are general Life Only with Return of Premium Death Benefit (ROP)
- Or via a life annuity payable to the surviving spouse where the periodic annuity payment is not in excess of 100 percent of the periodic annuity payment that was payable to the account owner
- When issued , the contract (or via rider or endorsement) must state that the contract is intended to be a QLAC
- Available only under allowed types of retirement accounts: ERISA 401k, 403(b), 457(b), or IRA
- Failure to follow the QLAC rules can result in disqualification of the QLAC

Deferred RMD on QLAC premiums and other RMD rules

- Generally, RMDs must begin for the year the account owner reached age 70 ½, and continue for every year after. Exceptions can apply to defined contribution plans, 403(b)'s and governmental 457(b) plans, allowing the employee to defer starting RMDs past age 70 ½ until retirement.
- For QLAC, distributions under the contract must begin no later than a specified annuity starting date that is no later than the first day of the month next following the 85th anniversary of the employee's birth
- Amounts used for QLAC premiums are not included in the fair market (FMV) used to calculate RMDs for the balance of the account. As a result, this lowers the RMD amounts for years before RMDs begin for QLACs.

Benefits of a QLAC

- QLAC premiums defer income and potentially reduce income taxes, from RMD's, depending on personal tax bracket
- Significant future income can be planned in advance
- Benefits to beneficiaries can be for a spouse or a non-spouse
- All fees for the QLAC income and payout options are contractually built into the income payout
- The contract is the guarantee – the quote is the quote
- Compliments Social Security by protecting against longevity risk
- Principal protection and contractual guarantees by insurance carriers with strong claims paying ability
- RMDs can be deferred until age 85
- No cash value but with return of premium improves mortality credit participation and encourages ownership
- For a 65 year old couple there is a 75% chance of an 80 (m) / 90(f) lifespan "2012 Table"
- No periodic distribution on the QLAC, within the IRA, is required /reported until the Annuity Start Date
- There is no "forced" QLAC RMD annuitization at age 70 ½. The QLAC income has an individualized "Start Date"
- The QLAC asset value excluded from the RMD calculation does not force an RMD asset draw on other IRA asset holdings
- The Fair market value of the QLAC is reported annually but not included in RMD calculation

QLAC Account Eligibility

A QLAC can only be held in eligible retirement accounts, for which the owner is subject to the required minimum distribution (RMD) rules. An exception applies to defined benefit plans which already provide benefits in the form of annuity payments.

Eligible Accounts	Ineligible Accounts
▪ Traditional IRAs, SEP IRAs and SIMPLE IRAs ▪ Defined contribution plans (example, 401(k) and profit sharing plans ▪ Governmental 457(b) plans and 403(b) plans	Roth IRAs Defined benefit plans

Premium Limitations

QLAC premiums are subject to both a percentage and a dollar limitation. Under these limitations, the premium for an individual cannot exceed 25% of the individual's account balance or $125,000, whichever is less.

25 Percentage limit	$125,000 Dollar limit
▪ Determined separately for each defined contribution plan ▪ Determined separately for each 403(b) plan ▪ Determined separately for each 457(b) plan ▪ All of an individual's traditional, SEP, and SIMPLE IRAs are aggregated (totaled and treated as one account) ▪ Reduced by any previous QLAC premiums paid: in the aggregate for all IRA's; and, applied separately to each employer plan	▪ Determined separately for each defined contribution plan, 403(b) plan , and each eligible governmental 457(b) plan ▪ All of an individual's traditional IRAs, SEP IRAs , SIMPLE IRAs and defined contribution plan accounts are aggregated (totaled and treated as one account) ▪ Indexed and adjusted for inflation in $10,000 increments ▪ Reduced by any previous QLAC premiums paid: in the aggregate for all IRA's; and, applied separately to each employer plan

- If an annuity contract fails to be a QLAC solely because a premium for the contract exceeds the above limits, then the contract is not a QLAC beginning on the date that premium payment and any excess premium is returned to the non-QLAC account portion
- If the contract fails to be a QLAC, then the value of the contract may not be disregarded for RMD calculation purposes as of the date on which the contract ceases to be a QLAC
- If the excess premium is returned to the non-QLAC portion of the account after the last valuation date for the calendar year in which the excess premium was originally paid, the account balance for that year must be increased to reflect that excess premium.

Death Benefits via Return of Premium or Survivor Annuity

A QLAC provides a death benefit, under Final Treasury Regulations, primarily in three forms(s).

- Life only no refund or death benefit
- Lie Only with Return of Premium Death Benefit (ROP)
- Life Only with 100% Survivor (typically the spouse)

1. A QLAC may provide a return of premium, instead of a life annuity payable to a designated beneficiary, in an amount equal to the excess of—
   (A) The premium payments made with respect to the QLAC over
   (B) The payments already made under the QLAC.
2. If a QLAC is providing a life annuity to a surviving spouse, it is also permitted to provide for a benefit paid to a beneficiary after the death of both the employee and the spouse in an amount equal to the excess of—
   (A) The premium payments made with respect to the QLAC over
   (B) The payments already made under the QLAC.

- If the employee's death is after the required beginning date, the return of premium payment is treated as an RMD for the year in which it is paid and is not eligible for rollover.
- If the return of premium payment is paid after the death of a surviving spouse who is receiving a life annuity, the return of premium payment must be made no later than the end of the calendar year following the calendar year in which the surviving spouse dies. If the surviving spouse's death is after the required beginning date for the surviving spouse, then the return of premium payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover.
- The final regulations allow return of premium (ROP) death benefits both before and after the annuity starting date (ASD), so long as such death benefits are distributed from the IRA or plan no later than the end of the calendar year following the calendar year in which the employee dies, or in which the surviving spouse dies, whichever is applicable. They also clarify that if the individual dies after his or her required beginning date, the ROP death benefit is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover. This means the ROP death benefit will be forced out and taxable to the beneficiary.
- Other than a lump sum ROP death benefit, the only type of death benefit permitted under a QLAC is in the form of a life-contingent survivor annuity. With respect to non-spouse beneficiaries, the final regulations retain that prohibition against QLACs providing a survivor annuity if the owner dies after the ASD unless the contract (1) provides no pre-ASD survivor benefit or (2) the non-spouse beneficiary was irrevocably elected before the owner's required beginning date., but clarify that the irrevocable election can be made until the *later* of the owner's required beginning date or the date the QLAC is purchased (rather than by the owner's required beginning date). This addresses a problem that could have arisen for QLACs purchased after the required beginning date.

Key QLAC Questions for Consumers

Consumers should consider the features and benefits of a QLAC, as well as the pros and cons, in order to determine suitability. Financial advisors should also take these factors in consideration. To that end, consumers, along with the assistance of their financial advisors, should ask the following questions:

- Do I want or need a single life or joint life based QLAC payment?
- How valuable is the QLAC return of premium feature?
- What impact will a COLA rider have on my QLAC income payment?
- What are my dollar and percentage QLAC limits given my retirement account balance?
- When should I begin ("start date") my QLAC lifetime income?
- Are there enough QLAC quotes available from competitive carriers?
- Reducing my RMD's will save me taxes -- but what if need the income?

QLAC Official Guidance and resources

Official Guidance and IRS Resources

- Internal Revenue Bulletin 2014-30 /TD 9673 July 21, 2014: www.irs.gov/irb/2014-30_IRB/ar07.html
- Final regulations Federal Register: http://www.gpo.gov/fdsys/pkg/FR-2014-07-02/pdf/2014-15524.pdf
- Treasury Press Release: http://www.treasury.gov/press-center/press-releases/Pages/jl2448.aspx
- QLAC TDF Press Release Guidance October 2014 http://www.dol.gov/ebsa/regs/ILs/il102314.html
- Lifetime Income Provided Through Target Date Funds in Section 401(k) Plans and Other Qualified Defined Contribution Plan http://www.irs.gov/pub/irs-drop/n-14-66.pdf
- IRS Form 1098-Q- Qualifying Longevity Annuity Contract: http://www.irs.gov/pub/irs-pdf/f1098q.pdf

Classics in Longevity Thinking

- Lifecycle, Individual Thrift, and the Wealth of Nations, Franco Modigliani (1986)
- Uncertain Lifetime, Life insurance and the Theory of the Consumer, Menachem Yaari (1965)
- The High Protection Annuity, James B Stephenson (1978)
- Making Retirement Income Last a Lifetime, J. Ameriks, R Veres, M.J. Warshawsky (2001)
- Merging Asset Allocation and Longevity Insurance, P. Chen and M.A. Milevsky (2003)
- Annuities and Individual Welfare, T. Davidoff, J.R. Brown and P.A. Diamond (2005)
- Efficient Annuitization with Delayed Payout Annuities, J.S. Scott, J.G. Watson and W.Y. Hu (2006)
- Evaluating the Advanced Life Deferred Annuity, G. Gong and A. Webb (2007)

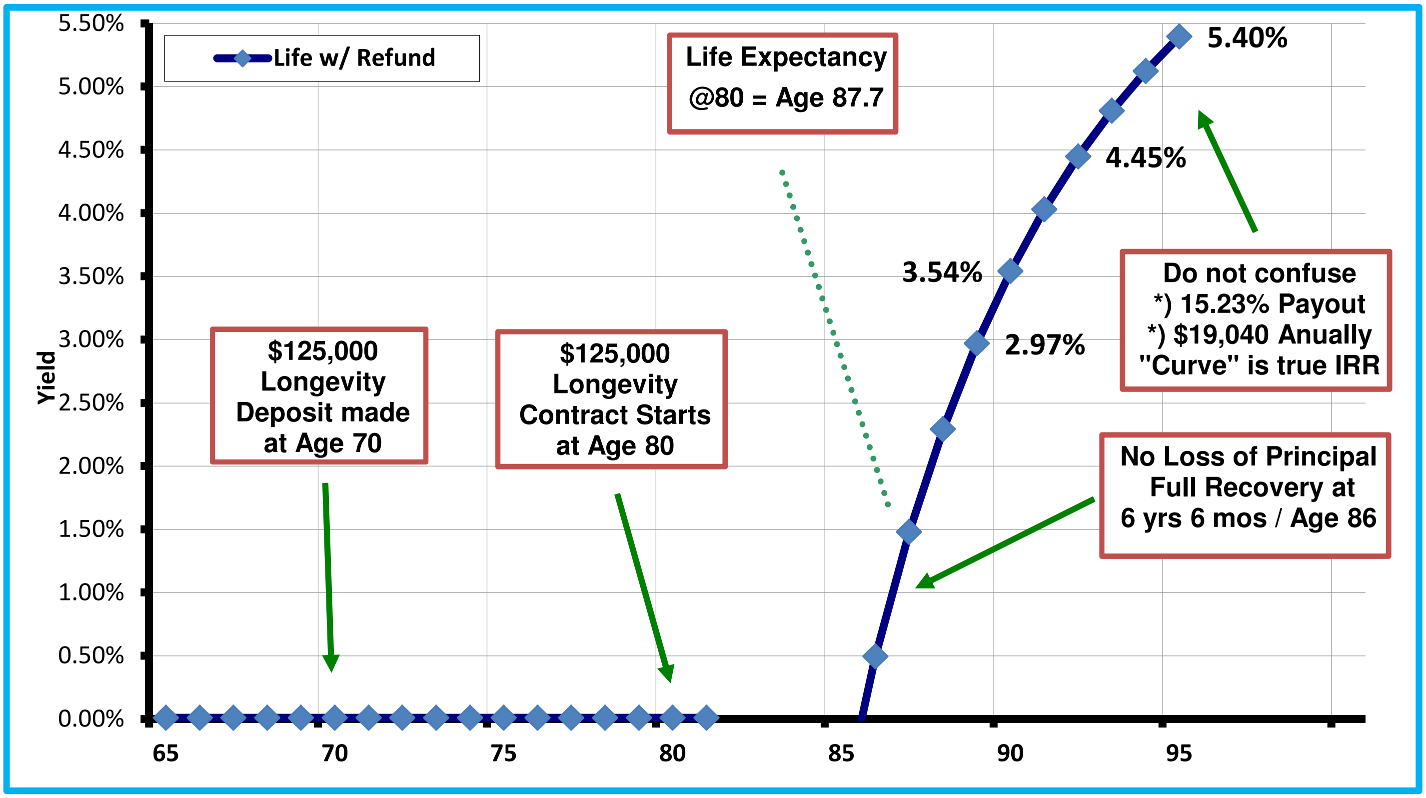
QLAC Optimal Purchase Strategies

- A QLAC provides an income stream that continues throughout an individual's life intended to begin after a deferral period
- The QLAC can be an effective solution for retirees who are willing to allocate a portion of their savings to protect against outliving their assets. (most notably protection from market risk, sequence of returns risk and longevity risk)
- If, for example, you owned a Target Date Fund in your IRA (or as a QDIA in your ERISA account) Investment managers base their glide-path strategy on "generally accepted investment theories". That is, a consistent investment strategy under which the asset mix is designed to change over time.
- There is sound financial and academic research to believe that consumers can take this one step further and apply this to TDF/QDIA and (QLAC) asset allocation! Such a model (asset mix) would take into account any projections or expectations of the non-QLAC investment portion (the TDF/ QDIA portion) and integrate this with QLAC payout rate portion of the IRA.
- The Annuity payout rate is subject to two opposing forces over the investment lifecycle. On the one hand, interest rates - and the term structure of interest rates—which underlie annuity payout yields. On the other hand, aging reduces the payout yield for QLAC's via the effect of the time value of money on mortality credits and discounting. The two forces of current low interest rates and loss of mortality credits, from waiting, act against each other, and create a financial economic tradeoff.
- This is why the Investment Account, over the lifecycle, requires an optimal glide path for both the Equity /Bond/ Cash mix of the non QLAC portion of the Investment account and an optimal time after age 70 ½ and prior to age 85 for the QLAC annuitization portion within the Investment account.
- You could purchase a QLAC with a *single payment* and with a single start date: A single purchase decision
- You could make QLAC deposits in one or multiple QLAC contracts over varying time frames:
    - via multiple annuity purchases over *several years*
        - Coordinate for a single start date or vary the start date(s)
        - Purchased potentially in a rising interest rate scenario but started at a single start date
        - Vary the income start date(s) and spread out the rising income
        - Purchased potentially in a rising interest rate scenario but started over several start dates

<u>The Chart(s) below are hypothetical illustations of a QLAC as a Risk Management tool and the QLAC impact on IRA RMDs.</u>

The top chart indicates that the QLAC was purchased at both the $125,000 and 25% limit in a $500,000 IRA account at age 65. Payments are deferred 10 years and begin at age 75. The Life exectancy at age 75 is 83.6 years and the payout from the QLAC premium is recovered,prior to projected life expectancy by age 82 and 10 mos under a "Life with Refund" Contract. While payment may be exressed as a "Payout Rate" a QLAC is a longevity risk management tool. However, behavioral finance economics indicates that consumers may still frame this as an "investment purchase". As such by age 87 the IRR% continues to grow incrementally as a function of the the "mortality credit" risk pooling effect. While capital market assets may have a 30 year time horizon the QLAC continues to pay through life expectancy.

- **<u>Graph One</u>**, = representative QLAC quote (90+ Comdex) from "CANNEX", as of **04/17/2017**, Male age 70, deferred 10 yrs.
- <u>Graph Two</u>, focuses separately, with a representative hypothetical example, on the QLAC impact on IRA RMD's that are reduced and taxes that are deferred, and is not in regard to any specific QLAC Purchase



*** The folllowing chart illustrates the amount of IRA RMD's that would be deferred between age 71 and 80 by transferring $125k from the IRA, at age 70, and placing those funds in a QLAC.**

Age	IRA RMD @ $500k *	IRA RMD @ $375k*	RMD Reduced	Taxes Deferred
71	$19,343	$14,507	$4,836	$1,209
72	$20,426	$15,320	$5,106	$1,277
73	$21,567	$16,175	$5,392	$1,348
73	$22,769	$17,077	$5,692	$1,423
75	$24,033	$18,025	$6,008	$1,502
76	$25,364	$19,023	$6,341	$1,585
77	$26,764	$20,073	$6,691	$1,673
78	$28,192	$21,077	$7,115	$1,779
79	$29,641	$22,321	$7,320	$1,830
80	$31,098	$23,323	$7,775	$1,944

*** The above example utilizes the Uniform Table, and assumes a level 6% CAGR.**
The QLAC is purchased at age 70. The income tax is a net combined effective rate of 25%

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