How Secure Act 2.0, Delayed RMD Age Would Boost Annuities

by Ben Mattlin

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What You Need to Know

- The bill would open the door to popular options such as cost-of-living increases and return-of-premium death benefits.
- Raising the RMD age makes purchasing an immediate or deferred annuity more cost-effective, Melissa Kahn of State Street says.
- The bill would also curb limits on QLACs.

In early May, the U.S. House of Representatives introduced the **Securing a Strong Retirement Act of 2021**. Known as **Secure Act 2.0**, since it builds on 2019′s Setting Every Community Up for Retirement Enhancement (Secure) Act, the bipartisan bill expands opportunities for retirement savers.

What's been largely overlooked, however, are the implications for annuities.

Boosting Annuity Appeal

"Many retirement plans today do not offer annuities due to perceived limitations in their flexibility and appeal," says Keith Namiot, chief operating officer for group retirement at Equitable in New York City. But the new act, he says, might change that.

One provision would remove a prohibition against non-level annuity payments in retirement plans — i.e., payments that start small and increase over time. This would open the door to popular options such as cost-of-living increases and return-of-premium death benefits.

Pushing the RMD Age

Another key provision would, over the next 10 years, incrementally increase from 72 to 75 the age at which retirees must take a required minimum distribution from tax-deferred retirement accounts. It would also reduce the penalty for those who fail to make the withdrawal and eliminate the RMD completely for those with less than $100,000 in retirement savings.

“Often, annuities are purchased as supplemental income opportunities [or] hedges against outliving other sources of income,” says Kim O’Brien, CEO of the Federation of Americans for Consumer Choice (formerly, Americans for Annuity Protection) in Phoenix, Arizona. Being able to keep funds invested longer could be “a strong planning tool,” she says.

Melissa Kahn, a managing director at State Street Global Advisors in Washington, D.C., says this change “makes the purchase of either an immediate or deferred annuity more cost-effective” because it allows retirees to “have more money in their accounts.” Raising the RMD age makes sense, since Americans are living longer and retiring later than they used to. But Philip Chao, chief investment offer and principal at Experiential Wealth in Cabin John, Md., observes that it also can mean bigger annuity payouts. “The longer one delays in starting to annuitize or draw income, the greater the amount of monthly income made available,” he says.

Some Doubters

Still, some doubt an extra three years will make much difference. Retirees and plan sponsors don’t typically “avoid annuities because of RMD rules,” says Matthew Eickman, national retirement practice leader at Qualified Plan Advisors in Overland Park, Kansas. Plan sponsors, he says, “avoid them for fiduciary reasons and other concerns, such as product availability, cost, and portability.”

In fact, he adds, it’s “unlikely to be nearly as significant” as the original Secure Act, which extended “safe harbor” protections to shield plan sponsors from liability if, say, the annuity carrier defaulted.

QLACs

The new act would also curb limits on qualified longevity annuity contracts (QLACs), which are deferred annuities that permit retirees to put off a portion of their RMD until age 85. (Back in 2014, QLACs became the first annuity approved for use in retirement accounts.) At present, no more than 25% of one’s retirement-account savings, or $135,000 — whichever is less — can be used to buy QLACs.

Secure Act 2.0 would eliminate the 25% cap. “The increase allows more flexibility [and] can lead to increasing the annual income that can be generated from the annuity,” says Dave Hanzlik, vice president of annuity and retirement solutions at CUNA Mutual Group in Madison, Wisconsin.

On the other hand, Wade Pfau, founder of Retirement Researcher and professor of retirement income at The American College of Financial Services in King of Prussia, Pennsylvania, points out that it would only matter for those with less than $540,000 in retirement accounts. “For those with more, the change does not have an impact,” he says.

One version of the bill, however, would also raise the maximum to $200,000 regardless of account balances. David Blanchett, head of retirement research at Morningstar Investment Management in Chicago, says that “could be important for some savers” but “doesn’t really do anything for folks that weren’t looking for a large QLAC allocation beforehand.”

ETFs in Variable Annuities

Finally, the new law would make it easier to offer exchange-traded funds (ETFs) in variable annuities (VAs). This “will likely make the total internal cost of variable annuities go down,” says Michael J. Zmistowski of Financial Planning Advisors in Tampa, Florida, “thus making them more attractive.”

It also affects how ETFs are taxed. “Gains on ETFs held in variable annuities, whether in qualified or nonqualified accounts, will be taxed at ordinary income rates when amounts are withdrawn, so capital gains tax will not apply,” says Frank O’Connor, vice president of research and outreach at the Insured Retirement Institute in Washington, D.C.

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