A new topic for Brits to argue about: Decumulation

By Editorial Staff *Thu, Jul 14, 2016*

Two UK small-plan providers, The People's Pension and Now Pensions, don't want NEST, the public DC option for small companies, to offer a retirement income strategy in competition with them.

In the U.K., private defined contribution plan providers are protesting the possibility that the National Employment Savings Trust (**NEST**), which is Britain's public workplace DC option, might introduce retirement income products and thereby "distort the decumulation market."

The UK "pensions industry warned against allowing NEST to compete with, or replace, private sector providers," IPE.com reported this week. Private companies like the People's Pension and Now Pensions are afraid that the NEST might crowd them out of the business of helping retirees spend down their savings.

The conflict is happening in the context of huge changes in the way Britons spend down their tax-deferred retirement savings. Until 2015, most of them were required to buy life annuities with their savings by age 75. The now-departed David Cameron government dismissed that long-standing policy—and decimated the individual annuity business in the UK—with the stroke of a pen.

Now the British people face a different rule: All workers must be auto-enrolled into a DC savings plan in 2017. NEST was created so that small companies not attractive to private DC providers would have a low-cost public plan option into which their employees could be auto-enrolled. It's a situation not unlike the efforts to create public-option DC plans for small companies in Connecticut and California.

But private companies don't want any more competition from NEST than they already have. Darren Philp, the director of policy for the **People's Pension**, the largest private DC plan (or "master trust" in Brit-speak), said that NEST shouldn't be allowed to compete with private drawdown providers while it continues to operate with the help of government loans.

"It is far from clear why we should be using a heavily subsidized government-backed scheme to provide services and products the market is well-equipped to provide in its own right," Philp reasoned.

NEST's entry into the decumulation market would "significantly distort competition in an already distorted market," agreed Morten Nilsson, CEO of the £192m master trust **Now Pensions**. "Its role was to be a provider of last resort with the intention that it should complement, not compete or replace, private sector providers."

NEST has more than 3.3m members and assets under management of £970m as of the beginning of June. While some of its costs are met through a 0.3% annual management charge, additional costs are met by drawing on a government loan.

Gregg McClymont, head of retirement savings at Aberdeen Asset Management, suggested however that private providers take a chill pill. NEST would only offer drawdown solutions to existing NEST members, not to Now Pensions or the People's Pension's participants.

Given the fact that NEST draws its participants from lower-income earners with marginal financial literacy, McClymont said, direct competition between NEST and private providers isn't likely.

"Given NEST's track record in the accumulation space, given the characteristics of the immature decumulation market, and given NEST's need to serve its target market more widely, a knee-jerk reaction is probably not the right way to proceed," he said.

In the wake of the "pensions freedom reforms," which lifted the annuitization requirement, NEST has been allowing those members wishing to access savings to take one or more lump-sum payments.

In 2015, NEST entertained the idea of offering its retirees a combination of investments and deferred annuities in retirement, thus balancing the need for liquidity and growth with the need for protection against longevity risk.

McClymont, previously the Labour party's opposition spokesman on pensions, praised NEST's work on drawdown products.

"This is a market crying out for some sort of innovation, and we're all trying to provide it," he said. "But, actually, it's difficult because usually you respond to consumer demand in the market – and it's unclear what the demand is."

Here's the decumulation strategy that NEST tentatively proposed a year ago:

- At retirement, the system will transfer 90% of a member's savings into the income drawdown fund, with the remaining 10% transferred into an accessible cash fund.

- The drawdown fund will invest in an income-generating portfolio, which would provide a monthly retirement income.
- The 10% cash fund is to run separately from the drawdown and will be invested in money market instruments to allow savers to take out lump sums without having to sell other assets. Members could access 10% of their savings without undermining the sustainability of the monthly income provided by the drawdown fund.
- After retirement, around 2% of the income drawdown fund will be used annually to finance an eventual annuity purchase. The deferred annuity will be bought after 10 years in retirement and kick-in after an additional 10 years—at about age 85. The UK deferred annuity market has not yet fully developed however.
- NEST had not ruled out a collective DC (CDC) system, whereby members pooled mortality risk, and annuities were provided from a central fund, but had reservations about it.