BlackRock’s Non-Insured Path to Predictable Income

By Kerry Pechter *Thu, Feb 20, 2014*

The five new CoRI Funds may appeal to near-retirees who currently have a lot of money in bond funds and are afraid that those funds will lose value as interest rates rise. The funds could, in theory, could protect them from sequence-of-returns risk.

Last year BlackRock launched a free new “razor” called the CoRI Retirement Index. Last week it introduced the “blades” for that razor: the CoRI Funds, a series of five actively managed target-dated mutual funds that invest primarily in investment-grade bonds.

The new funds, which are intended to attract the tax-deferred assets of Boomers ages 55 to 64, are managed (with the CoRI Index as a guide) to grow to a specific value in a specific number of years. The target value is the cost of an inflation-adjusted income annuity that (at age 65) delivers the level of income predicted at time of purchase. BlackRock has been talking about the CoRI Funds for months, and now they’re available.

This non-insured product appears to deliver some of the same benefits as deferred income annuities or deferred annuities with lifetime withdrawal benefits. But, while the future income stream of a DIA is guaranteed and the contract owner must annuitize at the end of the deferral period, CoRI Funds are not guaranteed to hit their target value, nor must the client annuitize.

The CoRI Funds could also serve as an alternative to bond index funds, offering a haven from interest rate risk for near-retirees who currently have a lot of money in bond funds but fret that those funds will fall in value as rates rise. In that scenario, the CoRI Funds could help protect them from sequence-of-returns risk while they pass through the so-called Retirement Red Zone.

Calculating your CoRI Index

What’s the CoRI Retirement Index? It’s a benchmark that tracks the current price of a dollar of future inflation-adjusted income. Using an online calculator, prospects can, by inputting their current age, discover their personal Index value, which is the cost today of a dollar of lifetime income at age 65. By dividing their investable assets by the Index value, they can find out about how much income their savings will deliver—assuming that they invest in an age-appropriate CoRI Fund now and convert the assets to an inflation-adjusted single premium immediate annuity at 65.

Here’s an example. You go to the CoRI website and input the datum that you’re 57 years old. The calculator will tell you that your CoRI Index is $14.53. Then you input the datum that you have $800,000 in savings. The calculator will tell you that, based on your CoRI Index of $14.53, your savings could buy an immediate inflation-adjusted annuity that will pay $55,058 a year starting when you reach age 65.

Since time is money, the older you are (up to age 64), the higher your CoRI Index will be and the more your future income will cost. A 60-year-old’s Index today would be $16.58 and he or she would have to invest $913,000 to get a $55,058 income at 65, not the $800,000 that a 57-year-old would pay.

The five initial CoRI Funds, which were filed with the SEC last July 30, are limited-term mutual funds. They're designed for Boomers who will reach retirement age in 2015, 2017, 2019, 2021, and 2023. They're actively managed to track the CoRI Index for each of those years. The managers will generally invest 80% of the assets in investment grade bonds and the rest in riskier assets, including derivatives.

Each fund has a current expense ratio of 0.83% (1.17% if and when fee waivers expire) and 0.34% for institutional class (0.58% if waivers expire). There's a front-end load that starts at 4% for initial investments below $25,000 but gradually declines to zero for investments of $1 million or more.

CoRI Funds aren't designed to be held indefinitely. It's up to the individual to decide if or when to sell the funds and whether to buy an annuity or tap the bonds for systematic withdrawals. But in the year the investor turns age 75, "the fund will be liquidated and your remaining investment returned to you," according to BlackRock.

While there's no guarantee that investments in a CoRI Fund will deliver the projected income on the projected date, BlackRock evidently will apply a lot of active, quantitative management toward meeting that goal. Instead of watching the NAV of their traditional bond funds fluctuate between now and retirement, 55-year-olds, for example, could rely on the presumed predictability of their CoRI 2023 Fund.

"Understanding what a lump sum savings provides in estimated retirement income is difficult," said Chip Castille, managing director and head of BlackRock's U.S. Retirement Group, in a release last week. "The CoRI Indexes enable pre-retirees to quickly estimate the annual lifetime income their current savings may generate once they turn 65."

In essence, these are target date funds whose managers try to track a benchmark that's based on the age of the investor, the prevailing interest rates, the anticipated future prices of income annuities and other variables. By all accounts, that's not an easy task.

As someone familiar with CoRI Funds explained at the Morningstar Ibbotson Conference in Phoenix today, it's one thing to create an inflation-adjusted annuity price index; It's quite another thing to successfully track that index, given all the variables involved. Others have noted the complexity of the CoRI concept. The mere fact that the CoRI Index and the client's future annual income are inversely related (the lower the Index, the more income per dollar invested) may be confusing to some investors.

"My sense is that the CoRI Index is a sophisticated process that may go over the head of the average investor," said one annuity industry participant. "It may be more for advisory use."

Alternative to an annuity

As noted above, investors could probably accomplish the same goal with a deferred income annuity (which would require annuitization) or with a fixed-rate deferred annuity (which permits but doesn't require annuitization). But investors who are averse to annuities might prefer BlackRock's non-insurance approach. Owners of tax-deferred accounts, who don't need another layer of tax-deferral over their investments, may also find the CoRI mutual fund approach less redundant than an annuity.

Indeed, the funds are intended for, but not limited to, tax-deferred accounts, according to the prospectus. It’s not hard to see how the CoRI Funds might appeal to 401(k) plan sponsors or IRA advisers who want to encourage participants or clients to adjust their mindsets from accumulation to decumulation without necessarily bringing the complexities of annuities into the picture.

The CoRI concept, not unlike Financial Engines’ Income Plus and Dimensional Fund Advisors’ Managed DC, seems able to help guide a participant’s portfolio toward the fulfillment of an income goal while remaining agnostic on the purchase of an annuity. This is one direction in which the retirement industry seems to be moving.

Plan sponsors today arguably feel more pressure to reduce fees than to provide income solutions, however, and CoRI Funds cost much more than bond index funds. If the contract’s temporary fee waivers ever expire—they’re good at least until March 1, 2015, according to BlackRock—and the expense ratios jump to 1.17% (for individual accounts) and to 0.58% (for institutional accounts), plan sponsor advisers may have a harder time justifying the higher cost.

But individual investors and their advisers might like the CoRI Funds’ combination of semi-certainty and full liquidity. An investor can always decide to sell his or her CoRI Fund and put the money somewhere else. That scenario wouldn’t necessarily be bad for BlackRock. The CoRI concept might still have served as a hook for attracting, at least temporarily, many millions of dollars in 401(k) and IRA money from near-retirees.