Retirement Income
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Danish DC Model Draws a Crowd in Britain

By Vanessa Drucker *Wed, Jul 9, 2014*

Through a subsidiary called "Now: Pensions," Denmark's national defined contribution plan provider (ATP) is making hay of the UK's requirement that all British employers auto-enroll their workers into a DC plan by 2017.

In 1016, Denmark's King Canute conquered England, uniting the Anglo-Saxon and Scandinavian kingdoms. Just shy of a thousand years later, in 2012, Denmark invaded the U.K. again, this time bringing a new kind of employer-based defined contribution savings plan.

The plan is called Now: Pensions. It's a low-cost, single-investment-option, portable, multi-employer retirement savings fund designed for the small- and mid-sized UK company market. A new market for such plans flared open in 2012, when the UK required all employers to auto-enroll every worker into a retirement savings plan by 2017.

Though new to Britain, Now: Pensions isn't a start-up. It's a subsidiary of ATP, Denmark's $113 billion national employer-based pension fund, a DC/DB hybrid. When Now: Pensions participants in the UK make payroll deferrals, their money goes into an absolute-return fund that's run separately but almost identically to ATP's fund in Denmark.

NOW: Pensions' 90 employees in London work out of two floors in an office building opposite Liverpool Street Station. Each one is a Now: Pensions participant, explains Morten Nilsson, president and CEO (right), who welcomes me to a glass-encased conference room, next to an open floorplan of sales and marketing employees.

Nilsson reports directly to ATP's CEO, but he and his staff have established their own entrepreneurial culture in the UK. "ATP provides us with money and the brand to leverage, and gives us autonomy. We can make fast decisions. People who join us enjoy the startup atmosphere," he told me. Now: Pensions is marketed to UK companies through financial advisers and through payroll management firms.

The formula is working. After only two years, Now: Pensions serves over 2,500 employers and hundreds of thousands of participants. It ranks among the top three multi-employer DC plans in the UK, along with NEST [the government-supported National Employment Savings Trust] and the People's Pension. (Big UK employers, like Tesco or Sainsbury's, tend to build their own in-house pension platforms.) NOW: Pensions, unlike NEST, also coordinates with payroll companies to provide back office functions.

Not exactly the Danish model

Although Now: Pensions copies ATP's absolute-return, even-keeled approach to investing, it departs from ATP during the income stage. ATP pays its participants a monthly income when they retire—an income that can fluctuate with the performance of the permanent underlying fund. But when Now: Pensions' participants retire, they, like typical DC participants in the U.S., take a lump sum based on the value of their own shares at the time they retire.

"There's no way around that, for a mutual system, with no shareholders or capital, where the assets remain inaccessible, legally separated accounts under a custodian," says David Blake, professor of Pension Economics at Cass Business School.

"From our point of view, all we can do is hold their hands until retirement, and see they end up with a decent-sized pot," says Nigel Waterson (below left), chairman of the board of Now: Pensions, and former Conservative Minister of Pensions. (Other board members are Jocelyn Blackwell of Dunnett Shaw, former government actuary Christopher Daykin, John Monks of the House of Lords, and Win Robbins, former head of fixed income at Barclays Global Investors.)

Income solutions are on Now: Pensions' to-do list, however. As people live longer, and many choose to continue working part-time after retirement, retirees will need more than a straightforward annuity. The cost of retail annuities in the UK is expected to go up because a recent law made the purchase of an annuity with tax-deferred savings voluntary instead of semi-mandatory. In a voluntary annuity market, only the healthiest people tend to buy annuities, and manufacturers adjust by raising prices and reducing payout rates.

Even if Now: Pensions develops less expensive, in-plan annuity options for its participants, it will still be offered on a voluntary basis, Waterson said. "Internally we are looking at all new options that might be available to make sure members have all the information they need," he told me. "We might develop our own products that they might want to look at. But they themselves must make the choices."

Early last month, after a UK government official said he would propose a change in UK pension laws to accommodate an ATP-style DC/DB hybrid, Now: Pensions CEO Nilsson immediately issued a press release saying that DC/DB hybrids are premature for the UK, which is still adjusting to a DC environment after a long tradition of DB.

"Whilst innovations such as collective DC schemes have been successful in Denmark and the Netherlands, both of these markets are highly unionized and have had mandatory or quasi-mandatory pension saving for many years.

"The populations are relatively homogenous and the collective DC schemes operate on an occupational basis with people from similar professions sharing risk with one another—a much fairer approach than manual workers sharing risk with white collar workers. The UK is a much more fragmented market and while changing legislation to allow these schemes could have merit, in many ways it feels as though we are running before we can walk."

Keeping it simple—and cheap

NOW: Pensions brings two attractive features to the U.K. retirement market: low costs and a one-option investment lineup. Most competitors in the new auto-enrolled DC space offered at least five or six investment options, but ATP's research showed that, in practice, participants don't like to be presented with too many decisions. They tend to make one choice and then forget about it.

So the firm decided to offer each age cohort a single target date fund with three actively managed components: a diversified growth fund, retirement protection fund and cash protection fund. The assumption was that participants would be less baffled by multiple choices and more able to engage meaningfully with the plan. "Most welcome packs are huge, but ours consists of only two pages," Nilsson said. But taking on the full investment responsibility also puts pressure on the company's ability to deliver.

Blake and his researchers have looked at the research for that proposition, and agrees that, "evidence shows you can't buy better performance from hiring more expensive investment managers. The single fund keeps costs down, with economies of scale and low expenses."

The cost structure is the other attraction. It consists of a flat 0.3% of fund per annum plus £1.50 (about $2.50) per month per member. "We're a bit proud of that, and think it's fairer," Nilsson says. Compare those costs with the charges for the publicly mandated system NEST, which also comprise 0.3% of asset under management, but charge 1.8% of individual contributions.

Under NEST's expense ratio fee structure, higher-income participants pay more. The fixed fee from NOW: Pensions, on the other hand, means that everyone bears the same cost. The firm doesn't believe that different groups of workers should cross-subsidize each other. "Moreover, we can take any members, because they cover their own administrative costs," says Nilsson. "We don't mind having low earners or dealing with churn."

Waterson also takes professional pride in the distinctive characteristics of the NOW: Pension model. In his prior political role, he spoke for his Conservative party on all major pension legislation, including the establishment of NEST and provisions for auto-enrollment.

In 2010, he left Parliament after national elections, but he can continue to see his legislative efforts bear fruit. When he joined the board of NOW: Pensions, he explains that he "leaped at the chance to see those ideas work in practice, which is what we're doing."