England Swings (Away from Annuities)

By Kerry Pechter *Thu, May 14, 2015*

Until April 6, most Britons bought annuities with their DC savings. Now they can do as they wish with those 'pension pots.' BlackRock and AllianceBernstein see opportunity.

You think you know England, don't you? Well, you don't know Union Jack. There's more to the merry olde UK than lurid tabloids, Downton Abbey, heavy food, the ForEx market and royal babies. At the moment, its £3.9 trillion ($6.16 trillion) retirement market is in a state of disruption.

As of April 6, defined contribution participants in the U.K. are no longer under any pressure to buy life annuities at retirement or any other time. Because of that, McKinsey & Co. expects the percentage of DC savings going into life annuities to drop from 75% to between 30% and 40%. An estimated £10 billion leaves DC plans each year.

The impact: an opportunity for global asset managers to step in and offer non-annuity alternatives that provide volatility control and systematic payouts. So far, Barclays and AllianceBernstein have responded. A spokesperson for indexing giant Vanguard, which is currently an investment-only DC provider in the UK, said her company is watching the situation but not responding yet.

McKinsey, the consulting firm, has been tracking the evolution of the U.K. retirement market, which "is undergoing profound change across all dimensions: regulations, technology, competitive dynamics and customer preferences," according to a report the firm released in April, ***In the Eye of the Storm: Transformation in the UK Retirement Market***.

"The result is an opportunity for capturing market share that is unique in the broader European asset management landscape, and which has prompted an unprecedented level of strategic debate among the asset managers, insurers, pension providers, platforms and distributors that operate in the sector," the report said.

But McKinsey also noted that "the time window for action is limited – strategic initiatives launched in the next six to twelve months will likely set the course for years to come.

Last fall, AllianceBernstein, which manages about $1.6 billion in target date funds for DC plan participants in the UK, introduced a new non-annuity, non-guaranteed lifetime income product for retirees called "**Retirement Bridge**." Designed to create a seamless transition for retirees from DC plans, it measures out a monthly income from a TDF.

The income amount matches the payout the retiree would have received from a single-premium immediate annuity, drawing on principal if necessary. At age 75, the retiree can buy a life annuity or stay in the TDF. Income from the TDF from that point onward would consist only of earnings, while preserving principal.

The cost of Retirement Bridge would "depend on the administration provider," said Sebastian Kadritzke, an AllianceBernstein spokesperson, in an interview. One provider currently offers it for a combined annual investment and administration fee of 85 basis points.

BlackRock, the $4.8 trillion asset manager that administers DC plans in the UK, has just begun offering its 300,000 British participants in 195 workplace plans a systematic withdrawal plan. While SWPs are offered by about half of U.S. 401(k) plans, according to PlanSponsor magazine, they're relatively new to England.

On April 27, the BlackRock Retirement Income Account was announced. The firm characterized it as an "income alternative to annuities" that "aims to provide a low-cost and straightforward option for retirees… following new pensions freedoms introduced on 6 April.

"We have seen a raft of new fund launches within the industry to cater to new pensions freedoms, but we believe this innovation provides our members with a simple, flexible and cost-effective way of moving from the accumulation phase of workplace pension saving to decumulation," said Paul Bucksey, head of UK Defined Contribution at BlackRock, in a press release.

According to the release, "Account holders will be able to access a multi-asset core fund, LifePath Flexi, but can also create their own personal portfolio from a range of around 100 investment funds from BlackRock and other leading managers… The annual management charge to use the core fund, LifePath Flexi, is 0.41% of funds under management." The all-in cost is 50 basis points a year, a BlackRock spokesperson told RIJ.

In 2013, BlackRock introduced a new retirement income concept in the U.S. called the CoRI Index, a benchmark based on current prices for single-premium immediate annuities that shows pre-retirees the estimated cost of a dollar of lifetime income starting at age 65.

By investing in corresponding BlackRock CoRI long-term bond funds that are based on the CoRI Index, a near-retiree can build predictable retirement income but not guaranteed, lifetime or mortality-pooled income. The CoRI funds have an annual expense ratio of 2.04%, compared to 0.12% for Admiral shares of the Vanguard Long-Term Government Bond Index Fund.

The end of compulsory annuitization in the UK, effected by the Cameron administration, has been a disaster for UK annuity issuers. The old law gave many Britons, especially those not at risk of running out of money in retirement, some flexibility in spending their tax-deferred savings.

Annual withdrawals were subject to a cap, but annuitization could be postponed until age 75 and they could take out up to 25% of their savings tax-free. Most middle-class workers bought single-premium immediate annuities with their DC savings when they retired, to avoid the significant tax costs of doing otherwise.

Those days are over. This week, Just Retirement, a British private-equity-backed annuity issuer, reported a 59% drop in sales of "medically underwritten annuities," which are sold to people with medical problems and priced lower than typical life annuities, and a 22% drop in overall sales in the nine months after June 30, 2014. But the company has seen a big increase in its purchases of pension liabilities from corporations.

Total retirement assets in the UK are estimated at £3.9 trillion, according to McKinsey, compared with about $24.7 trillion in the U.S., which is the latest estimate from the Investment Company Institute.

"Annual assets in motion [in the UK are] about £155 billion currently, including contributions to workplace and personal pensions, and assets moving from pensions into decumulation products," McKinsey's report said. "Given the various market changes (e.g., auto-enrolment, pension freedom, shifts in customer preferences), this value is expected to grow to about £180 billion by 2020."

Most British pre-retirees don't realize exactly what has happened in the retirement space or what it will mean to them, surveys show. But sooner or later they'll need systematic ways to draw down their money in retirement, either direct from their DC plan or from Self-Invested Personal Pensions (SIPPs), which are similar to traditional IRAs, as well as for financial advice (including "robo") that meets recently-established UK standards for low cost and transparency.