UBS Looks at Longevity and Annuities

By Kerry Pechter *Wed, Feb 25, 2015*

For years, wealth managers have paid little attention to longevity risk or annuities. But times are changing, and even wirehouses like UBS are at least talking the longevity talk.

At the Investment Management Consultants Association's annual conference, held in midtown Manhattan on a wet, windy day in early February, a UBS executive gave a presentation titled "Planning for Longevity ~~Risk~~ Certainty." (The strikethrough was his, and it was intentional.)

Michael W. Crook's slides weren't exactly what you expect to see in that type of venue. The wealthy clients of IMCA members usually don't run out of money in retirement, unless they're reckless. And wealth managers at wirehouses like UBS aren't known for their interest in things like longevity risk or annuities.

Crook, the head of portfolio and planning research at UBS Financial Services, never did mention annuities in his IMCA presentation. But the fact that he addressed longevity risk at all, and that IMCA asked him to speak to its members about it, hints at a growing interest in lifetime income where it once hardly existed.

"Clients and prospects have been asking about it," Crook told a few hundred investment managers, mostly men in business-casual. He spoke in a hotel ballroom just north of Times Square, where TV screens the size of tennis courts poured sensational images, colors and ad slogans down on phone-wielding tourists from Asia and Europe, like hot oil on barbarian invaders.

Times are changing. In addition to tax minimization and estate planning, high-net-worth clients, especially those without pensions, recognize a need for guaranteed lifetime income. And even the wirehouses—UBS, BoA Merrill Lynch, Morgan Stanley Smith Barney and Wells Fargo—have begun talking the longevity talk.

The wealthy have more longevity risk

The wealthy *in particular* should worry about longevity risk because they tend to live the longest, Crook pointed out. As couples, they live even longer. His father, a smoker, died in his 60s, he said, but his mother, a retired teacher, is still alive in her 90s. (The wealthiest 55-year-old Americans can expect to live about 10 years longer on average than the poorest, according to the Brookings Institute.)

Major risks to Wealth in Retirement (Weighted, by %)	
Longevity risk	31
Interest rate risk	14
Inflation risk	14
Equity market volatility	13
Equity returns	10
Interest rate volatility	10
Withdrawal rate	7
Correlation risk	1
Source: UBS.	

“Keep in mind that the people you’re working with aren’t average,” Crook said.

People who live the longest, no matter how much rich or poor they are, can eventually face frailty and isolation. Recognizing this, Crook said, UBS urges its advisors to ask clients three simple non-financial questions: Who will change your light bulbs? Where will you get an ice cream cone? Who will you have lunch with?

These questions help clients focus on three major challenges in retirement: coping with physical limitations, relocating to a more convenient residence, and maintaining an adequate social network. While the questions don’t directly address finance, they all involve needs—home maintenance, transportation, and recreation—that could entail financial decisions.

Like other retirement experts, Crook talked about the threat of sequence of returns risk for retirees. This is the risk that a retiree will be forced to sell depressed assets in order to generate income, especially in the 10-year “red zone” that’s centered on the retirement date. One way to protect yourself from this type of volatility or market risk, he said, would be to “manage both sides” of the household balance sheet and to live on borrowed money if the market drops while you’re in the red zone.

In fact, UBS has created a “securities-based lending program” to facilitate such a strategy. Using creditworthy clients’ investments at UBS as collateral, the bank offers credit lines of $55,000 or more to clients at a maximum interest rate of LIBOR plus 5.5%. It would serve as an alternative to holding enough cash to cover a year or two worth of living expenses, or to securing a source of income, perhaps from an annuity, that’s immune to market volatility.

Besides helping clients avoid losses during downturns, leverage can help increase returns during upturns, Crook said at the IMCA conference. “You can get a one percent larger return on your assets with the appropriate amount of leverage,” he said. “The prudent use of leverage is not that risky. There’s a clear tactical opportunity between the costs of the debt and the return on assets. It’s a simple way to take advantage of both sides of the balance sheet.”

Bucket list

“Bucketing” is a popular if somewhat controversial approach to investment management in retirement, and one of Crook’s slides showed his version of it. The slide referred to a conservative “liquidity” bucket “dedicated to preserving lifestyle over the next 3-5 years,” a balanced/growth “longevity” bucket “dedicated to achieving lifetime consumption goals,” and a growth or speculative “legacy” bucket with “excess assets not necessary for lifetime consumption.”

Crook (left) used “longevity” as the label for an income-generating bucket during retirement, as opposed to the label for a bucket whose assets are a hedge against longevity risk. He showed a rough schematic of each bucket’s content at three different ages: 35, 65 and 85.

During the working years (age 35), the liquidity bucket would be tiny, the longevity bucket growing, and the legacy bucket empty. At age 65, the longevity bucket would be the largest of the three buckets. At age 85, the liquidity bucket would be the same size it was at age 65, the longevity bucket would have shrunken to roughly the size of the liquidity bucket, and the legacy bucket would dwarf the other two.

Asked after the conference where annuities might fit into this scheme, Crook said, “The annuity question is a tough one. There’s pretty conclusive evidence that they have a role to play for some households, and that people like annuitized income when it is endowed to them (pensions, etc). However, it’s a hurdle for many investors to purchase something with a negative expected value (like all insurance).”

But there are signs that UBS interest in individual retail annuities may be growing. Last fall, UBS advertised on LinkedIn for someone to fill a vacancy for an Annuity and Insurance Specialist to support financial advisors and promote the UBS Retirement Platform to financial advisors. Also last fall, the company's CIO Wealth Management Research division dedicated the quarterly issue of its magazine, "Your Wealth & Life," to "**Navigating Longevity**."

An annuity executive at UBS confirmed to *RIJ* that his company is encouraging its advisors to become more familiar with indexed annuities—an insurance product whose strong sales in the insurance channel many broker-dealers and wirehouses are no longer able to ignore.

"They recognize that, on the whole, there's value in that type of product," Steven Saltzman, of Saltzman Associates, which conducts roundtable discussions where distributors from many different companies can talk frankly about product trends.

"They see indexed annuities as effective vehicles for income riders, and they see a need to educate and inform their advisors about them. Only a few years ago, these advisors were selling against indexed annuities. Now that there are better product choices available, they feel that it's incumbent on them to provide education."

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In an email to *RIJ*, Crook expressed interest in CDAs, or contingent deferred annuities. These products are a lifetime income rider, sold by an insurance company, which registered investment advisors can wrap around portfolios of mutual funds. If the value of the portfolio goes to zero as a result of withdrawals or market depreciation, the insurer pays a monthly income for life. In essence, the product (sometimes known as stand-alone living benefit or SALB) is a variable annuity guaranteed withdrawal benefit that's unbundled from the variable annuity.

But the product, championed by Prudential as a way for insurers to sell a product to the annuity-resistant RIA channel but descried by MetLife as a source of uncontrollable risk, has been slow in coming to market. (See **ARIA Retirement Solutions**, as an exception.) The

National Association of Insurance Commissioners has been studying the product to determine whether it is or isn’t an insurance product, and how it should be regulated.