TONTINES

Back to the future

Tontines were wildly popular in the 18th and 19th centuries but their status suffered at the hands of fraudulent life insurers. Natalie Tuck **explores whether tontines have a place within a modern European pensions system**

WRITTEN BY NATALIE TUCK

As a retirement product, tontines are a rare sight in the 21st century but references to their existence remain in many a mid-20th century murder novel.

The likes of Agatha Christie, P.G Wodehouse, Robert Louis Stevenson and even *The Simpsons* have all made use of the tontine in the name of entertainment. Such references are caricature-like, based on a bygone era, but the age-old product is about to make a comeback.

The concept of a retirement tontine is simple; a group of people pool their assets together and receive a sum of money paid to them for the rest of their lives. Whenever someone in that group dies, the remaining members benefit from a share of the deceased member's assets.

"Tontines had their heyday in the late 19th century and gradually became mired in scandal and corruption," Irwin Mitchell pensions partner, Penny Cogher, notes. "There is a Russian roulette aspect to the pure tontine concept – that the final survivor of the tontine is the winner who collects all," which explains their popularity with crime novelists.

A report by CFA Institute Research Foundation's Richard Fullmer, published in 2019, *Tontines: A Practitioner's Guide to Mortality-Pooled Investments*, notes that their previous success did not last long because, "the products fell victim to misappropriation and fraud on the part of tontine issuers".

After this their popularity faded, but they never completely disappeared. As the report states, tontines still exist in France as a niche product, and Fullmer highlights the Swedish pension system as being "explicitly tontine-like".

"Moreover, a slow trend toward acceptance of such longevity pooling arrangements has arisen over the past few decades. European Union member states now allow tontine offerings under the Second European Life Insurance Directive of 1990," the report notes.

A role to play

Set against a diminishing number of defined benefit (DB) schemes in Europe, tontines are being "seriously re-examined to see if they could have a role to play as a new retirement product", Cogher says.

Expanding on this, Heriot-Watt University associate professor and director of the Risk Insight Lab, Catherine Donnelly, highlights the main choices facing UK savers in defined contribution (DC) schemes currently – income drawdown or a life annuity.

"I definitely think people should be buying life annuities, but they're not buying them for various reasons. With income drawdown, you are taking a huge risk as you could run out of money very easily. If you invest in a tontine or a pooled annuity fund, then you are pooling mortality risk, which is the same principle underpinning a life annuity. This allows you to significantly reduce your risk of running out of money in retirement compared to income drawdown," she states.

University of Leeds professor, Iain Clacher, says that a tontine-type structure is something that "could be part of the mix" of products alongside existing retirement solutions, but he does not believe that it's going to be the only product that emerges.

"A tontine may well be suitable for a portion of the population, but other products will be more suitable for others. It's about trying to have that mix in the marketplace so there's a greater diversity of products and so people are given more choice, and hopefully this leads to people getting the right product they need for their retirement," he says.

In terms of other products, tontines are very similar to collective defined contribution (CDC) schemes – some would even argue they are two of the same kind. These schemes are currently seen in the Netherlands, and the UK is in the process of legislating for CDC.

Compared with the current 'income for life' options in the market, research puts CDC on top. Cogher references a report published by Willis Towers Watson in October for the UK, which found that with a typical CDC, the pension provided would be 70 per cent higher than an individual DC insured annuity and 40 per cent higher than the average pension from a DB scheme.

One of the backers of risk-sharing products is TontineTrust CEO, Dean McClelland, who believes these products, such as CDC schemes and tontines, will "take over the whole industry" because the current DC option is "just a savings account".

"It's not a pension, it's not deserving of the name. Our traditional understanding of what a pension is, is that it pays you an income for life in retirement, and that's what people want," he adds.

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The concept

In regards to the way a tontine works, Donnelly says, it should look very much like a life annuity, in that it is providing people with a stable income, but you are pooling mortality risk rather than having it transferred to an insurer. She says it is cheaper than buying a life annuity because it does not provide any guarantees, such as investment and longevity risk, which is why a premium is paid for an annuity.

"A pure pooled annuity fund doesn't guarantee you those things so it's less expensive but it should still give you the main benefit of a life annuity, which is this pooling of mortality risk, and you can add guarantees to it if you like," Donnelly notes.

"There are many ways of constructing these tontines but the method of withdrawing income from a tontine looks like income drawdown. However, you would adjust what you're paying people in line with experienced mortality in the tontine pool, as well as with investment returns." She adds that because of the pooled aspect of the investment, the tontine should be able to have a very low risk investment strategy and still have a very good chance of paying a stable, lifelong income.

A gap in the market

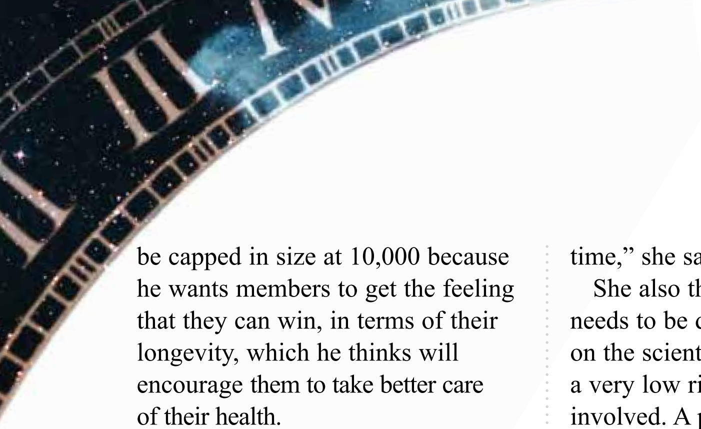
Tontines are offered as a niche product in France, but with the introduction of legislation for Pan-European Personal Pension Products (PEPPs) imminent, other players are using it as an opportunity to bring tontines back into the foreground.

McClelland's TontineTrust is hoping to launch its product in the next few months, before applying for PEPP accreditation next year. His firm recently partnered with Dutch consultants Westerbrink to help fulfil that ambition. In contrast with traditional CDC schemes, which see all members of different ages and genders in one scheme, TontineTrust will segregate men and women into separate groups and will split people into similar age groups.

"It is very similar [*to a CDC scheme*] except that we don't mix age groups…in a tontine you are in separate pool, your money is kept with all the other people in your age group," McClelland states.

He is patent pending the product around the world and has trademarked tontine pension products in Europe. Initially, Europeans will be mixed with people from other countries but the company is creating an algorithm that will switch people to the most appropriate pool, as they grow in size.

McClelland adds that pools will also



be capped in size at 10,000 because he wants members to get the feeling that they can win, in terms of their longevity, which he thinks will encourage them to take better care of their health.

Another entrepreneur, Nobuntu CEO, Tyron Fouche, has launched a tontine in South Africa, which has recently been through a fintech regulatory sandbox to receive regulatory certainty. However, he has also formed a new venture called Nuova Longevita with a group of global tontine research experts, including Richard Fullmer and Pascal Winter, which is specifically targeting the European market.

“Our approach is business to business to consumer (B2B2C), so we will help existing asset managers and insurers launch tontine products to their customer base. These are clients who want to offer their customers higher yield through an alternative investment,” he says.

Like McClelland, he sees the opportunity that tontines have in solving “many of the limitations of traditional life annuities”. He also plans to structure the product within the PEPP and Solvency II legislation.

“Because as a team we have written papers on the topic of tontines and have successfully implemented them, we *[Nobuntu]* are optimistic that we have a good value proposition to asset managers and insurers in Europe.”

Fine-tuning

Like most retirement products, there are pros and cons, and a tontine is not without its drawbacks.

Not least, Donnelly has reservations about the name tontine, and prefers pooled annuity fund, as she says people think that tontines are illegal and the last survivor gets everything. “Yes, there were tontines like that in the past but this is not what is being proposed at the current time,” she says.

She also thinks that more research needs to be done within academia on the scientific basis of having a very low risk fund for the people involved. A paper Donnelly recently published with a co-author, Thomas Bernhardt, proved mathematically that when the pool is left with just a small number of participants, there is a lot of volatility in payments.

“This is because when someone dies in a tontine you share out the funds with everyone else, and you want to do this is an actuarially fair way. When people age, they are highly likely to die... This makes the income withdrawn from the tontine very volatile as the membership becomes very old.”

“IN MY VIEW, THE TONTINE SHOULD BE PAYING AN INCOME IN RETIREMENT UNTIL YOU DIE”

On the flip side, Donnelly believes more work needs to be done on systematic longevity risk – the chance of people living longer than expected. There is academic research ongoing on these issues currently; Donnelly will start an Actuarial Research Centre project in January, funded by the Institute and Faculty of Actuaries, looking at systematic longevity risk and other risks, such as investment risks.

Communication will also be a challenge when it comes to launching a tontine, something the experts agree on. “As with all new pensions products, your challenge is going to be making sure people know what they’re buying and making sure that products, all of them not just tontines, start to do something around providing people with adequate retirement incomes, which is clearly quite a challenge,” Clacher says.

For McClelland, he says the biggest part will be explaining that payments can vary depending on investment performance, and that “tontines are for life, not just for Christmas”, the idea that once you invest in a tontine, that’s it. “Those are the main things that we have to get people to understand, if you’re in, you’re in it for life.”

Room for guarantees?

One of the factors that makes tontines cheaper than a life annuity is the lack of guarantees. A tontine in its purest form cannot guarantee that income will always rise, or indeed stay stable. Neither do they pay out any bequests as a result of a member dying, or a spouse’s pension.

McClelland does not see this an issue, as he believes the industry has this idea wrong: “I think they perceive that what everybody wants is for the parent to live frugally in retirement and pass away at 90 and pass on some money to their kids.

“With a tontine you can immediately go and purchase the lifetime income that you want now for a fraction of the cost than if you bought an annuity, which means you have cash leftover. You can give that cash to the kids now, which means they can go buy a house, start a business, they don’t need to sit there waiting for you to kick the bucket [*to die*].”

And if people join a tontine and subsequently receive news of a terminal illness? “They are only going to put in the amount of money that they deem necessary to take care of them for the rest of their lives,” he says, “if they join, and subsequently get bad news, then they don’t need the money and they’ve already taken care of the kids. That’s the quid pro quo, that’s what keeps it fair.”

A 21st century tontine, however, is in its infancy and Donnelly is

working on how tontines could have more choices built within them, such as spouse's pensions or bequests. She has already published a paper with her co-author, Thomas Bernhardt, on how to include a bequest in a tontine.

A member could have two accounts with one of them linked to the tontine and another in a separate account. Every time someone else dies in the fund, a fair share of the deceased's money is paid to each survivor's tontine account and nothing to the non-tontine accounts. However, these accounts are instantly re-balanced to some pre-determined proportion. When the member dies, the non-tontine account is paid to their estate and the tontine account goes back into the pool to be shared out by the remaining members. Of course, both of these options, the bequest and the spouse's pension, would result in a lower pension paid to the member, she notes.

Accumulation aspirations?

On the face of it, a tontine is purely a decumulation product, but McClelland has aspirations to use behavioural science to get young people saving into a tontine. Initially, he says, the TontineTrust will be about "solving decumulation" in order to get assets under management but in the long term he wants to get everybody saving.

"Everybody is trying to figure out how to get younger people saving, their problem is young people think they're invincible and they are not worried about retirement. If we give them a pension, which is essentially in a large financial game of *The Hunger Games,* that invincibility works in their favour," he says.

"You know if you put the money in and take good care of your health, you're going to collect all the money of the people who don't do as good a job as you of taking care of your health in retirement. You hold the winning lottery ticket, you are the winning lottery ticket. My belief is that we can move the needle in terms of getting younger people to start saving by turning the whole feeling of the pension upside down."

Others, however, are not so convinced that the tontine concept can work for the accumulation phase. "When you are young you are highly unlikely to die, so I don't think it's a very attractive proposition for somebody young to have a chance, however small, of losing all of their retirement savings to a tontine pool in exchange for what would be a minuscule stream of longevity credits *[money paid to the tontine survivors due to deaths in the tontine*] while they were alive," Donnelly says.

"A TONTINE MAY BE BETTER VALUE NOW, BUT NOBODY KNOWS WHAT WILL HAPPEN TO THE ECONOMY OVER THE NEXT 40-50 YEARS"

"The longevity credits are proportional to your chance of dying – the more unlikely you are to die, the smaller they will be," she adds.

"In my view, the tontine should be paying an income in retirement until you die, that's what it's for. You could have a situation where you have people saving for retirement in a DC plan and then you have a tontine or pooled annuity for their retirement, so you're not just being kicked out of the pension scheme upon retirement."

Clacher also raises the issue of the long-term nature of saving for retirement. A tontine may be better value now, but nobody knows what will happen to the economy over the next 40-50 years. A period with higher interest rates would push up the value of annuities making them relatively more attractive, he says.

"The point about any new product is yes you can compare things, and say in this environment it is potentially better, but the trick is to be able to provide an adequate income in retirement. This can't be irrespective of economic circumstances because that's impossible without costly guarantees, but optimising around trying to make sure that you deliver good retirement benefits and you give people a product that is suitable for their situation is the innovation that the market needs." ■