‘The most discredited financial instrument in history’ makes comeback in Canada. Will it solve a problem with retirement savings?

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A forgotten financial relic pulled from the pre-Industrial Age has been resurrected to help Canadians saving for retirement.

This past week, Guardian Capital [introduced a line of mutual funds](https://www.theglobeandmail.com/investing/globe-advisor/advisor-funds/article-guardian-modern-tontine-mutual-funds-retirement/) that riff off the concept of the tontine – a financial instrument that more or less vanished a century ago.

The tontine is an investment fund with a dark twist – all participants benefit when one among them dies. In the most extreme version, shareholders commit their money for life, with the entire sum of capital going to the last survivor, making tontines a classic plot device in Agatha Christie novels, murder mystery dinner theatre, and even an episode of The Simpsons.

It was a gentler form of the tontine that gained immense popularity in Europe starting in the 17th century as an annuity that pays a growing dividend as investors die off. About 200 years later, a type of tontine administered by U.S. life insurers flourished, before an embezzlement scandal brought on a regulatory crackdown.

That effectively killed the tontine, at least in North America, bringing an ignominious end to what British financial historian Edward Chancellor once called “perhaps the most discredited financial instrument in history.”

Moshe Milevsky, a York University finance professor, has been arguing for years that tontines deserve a reboot to help fill a gap in the collective retirement security of Canadians. A June poll by Angus Reid found that more than six in 10 Canadians aged 55 and older have delayed or plan to delay their retirements because of a lack of savings.

The average Canadian is retiring at 64 years old, leaving at least two decades’ worth of living expenses to plan for. This has made for a growing longevity problem. As people live longer, it raises the risk of outliving one’s savings.

One existing solution is an annuity. You hand over your money to an insurance company in exchange for a guaranteed income stream for life. But it’s irreversible, and the insurer takes a big cut for taking on that longevity risk.

With tontines, that risk is shared among the participants. When someone dies, some or all of that money goes back into the pool, what is known in financial jargon as “harvesting mortality credits.” This way, the dead effectively subsidize the living, Mr. Milevsky said.

“My objective was to give investors mortality credits without having to go to an insurance company,” Mr. Milevsky said. “That was the guiding mantra.”

In Guardian Capital, he found a company willing to go along with him.

“I came across tontines, and lo and behold, the foremost expert in the world is right here in Toronto,” said Barry Gordon, Guardian’s head of Canadian retail asset management. Over the next couple of years, he and Mr. Milevsky worked on bringing tontines into the 21st century.

The result was the GuardPath Modern Tontine 2042 Trust Fund. Here is how it works: People born between 1957 and 1961 are eligible to park their money in the fund for a period of 20 years. By the time the fund matures, roughly half of the unitholders should have died, leaving the other half to divide up the fund’s assets. Early redemptions are hit with a penalty that increases over time.

As with any mutual fund, there are risks, specifically that the fund’s investments underperform, or fewer people die than expected. Guardian says it is modelling about 7 per cent returns, compounded annually.

According to Mr. Milevsky, taking lessons from the tontine’s checkered past was key to creating a version that works for modern investors.

In the earliest popularized form of the tontine, investors of all ages were allowed to take part. People eventually figured out that they could game the system by nominating a young child as beneficiary. If that child happened to die, it wasn’t too difficult to fudge the identity of another child to keep the payments flowing.

For the segment of the population participating in tontines, mortality rates magically seemed to plummet. In a letter to the editor of the London Gazette in the early 1700s, an investor complained about the dwindling payouts from his tontine. “Don’t Britons die any more?” he wrote.

As the tontine caught on around the world, it became a foundational tool for a variety of financial applications. European governments used them to finance wars. They were created to raise capital to build meeting halls, hotels, and bridges. A tontine formed in 1792 in Manhattan financed the building of the Tontine Coffee House, which became a trading hub that eventually evolved into the New York Stock Exchange.

American insurance companies put their own twist on the tontine, which divided premiums between life insurance and a deferred dividend scheme that paid out after 20 years. The product took off. By the early 1900s, nearly half of Americans were invested in tontine insurance. But having such vast pools of money locked away for so long invited abuse, and insurance companies took to using the surplus cash however they wished. In 1906, tontine insurance was banned in New York State, which proved to be a fatal blow for the scheme.

“Besides the accounting flaws, the tontine aspect was again painted as an unsavory form of gambling on the lives of others,” Kent McKeever, director of the library at Columbia Law School, wrote in a history of tontines. Its reputation in tatters, the tontine was subjected to grim portrayals in pop culture, as members tried to kill one another off to claim the reward.

Hostility to the morbid essence of the tontine is one of the big reasons it has been abandoned for decades, Mr. Milevsky said. “But it’s odd, because the entire insurance industry is based on other people’s misfortune. The tontine is just a more blatant trade in misfortune.”

Retirement experts and academics have been increasingly lobbying for a reconsideration of the tontine. But there has been little movement from the financial industry until recently. Last year, Purpose Investments introduced a mutual fund that pools longevity risk without actually calling it a tontine.

Guardian’s Mr. Gordon said he wanted to lean into the tontine’s rich history. “We decided that we were going to call it what it is, and actually embrace the opportunity to educate investors and advisers about tontines.”

But the format required some modernizing. Gone is the last-person-standing arrangement. Unitholders won’t know each other’s identities, so they won’t have to scour the obituaries or go around plotting each other’s murders. And restricting the fund to a narrow age range makes it more fair, by pooling together people with comparable chances of surviving until the fund pays out.

Not everyone within that cohort would be a good candidate. “People need to do a very candid self-assessment, and ask themselves if they expect to be alive 20 years from now. If not, this is not for you,” Mr. Gordon said.

People focused on leaving money behind when they die will also find little appeal in a tontine. “There is resistance to this idea that what I’ve worked to build up over a period of 30 years is going to go to a complete stranger,” Mr. Milevsky said.

The common ideal of spending little in retirement and leaving a sizable estate to children or charity is being increasingly questioned. Books such as Die With Zero are extolling the virtues of making the most of your money while you are alive. Tontines mesh well with that idea, while reducing the risk of your savings running out before you die.

There will be a learning curve with a product like this, said Dan Hallett, vice-president of research and principal at Highview Financial Group. Investors and advisers will need to figure out how tontines might fit into a broader retirement plan.

But at a time when many are inadequately prepared for retirement, tontines may prove to be an important tool in helping people torque their savings plans, Mr. Hallett said. “The majority of people will need every penny of their assets to generate the cash flow they’ll need in retirement.”