Moshe Milevsky on Tontines

By Jonathan Forman *Wed, May 6, 2015*

Moshe Milevsky's latest book, King William's Tontine, is reviewed here by University of Oklahoma law professor Jonathan B. Forman, himself a tontine expert. Milevsky and Forman think that tontines, an archaic, now-illegal type of annuity, are ripe for a comeback.

Tontines are investment vehicles that combine features of an annuity and a lottery. In a simple tontine, a group of investors pool their money together to buy a portfolio of investments, and, as investors die, their shares are forfeited, with the entire fund going to the last surviving investor. For example, in an episode of the popular television series M*A*S*H, Colonel Sherman T. Potter, as the last survivor of his World War I unit, was entitled to open the bottle of cognac (and share it with Hawkeye Pierce et al) that he and his fellow doughboys brought back from France.

Similarly, imagine that you and nine friends each throw $1,000 into a pot, and the last one to die gets to keep all $10,000. That’s a type of tontine; and so long as you and your friends all have similar life expectancies and none of you has murderous intentions, it’s what we call a “fair bet.”

In a fascinating new book, *King William’s Tontine: Why the Retirement Annuity of the Future Should Resemble Its Past*, York University Professor Moshe A. Milevsky takes us through the grand history of tontines and explains how tontines can be used to design a wide variety of financial products today—from investment funds to annuities and pensions.

The story, like Col. Potter’s, begins in France. Back in the 1600s, the French and the British couldn’t get enough of fighting with each other. But wars are expensive, and the divine kings of the time needed to raise money to pay for them. Along came Italian financier Lorenzo de Tonti (1602-1684), who proposed the idea of a tontine to King Louis XIV—and for whom tontines are named.

Here’s the basic idea: Instead of selling bonds that pay 6% interest to the lenders, a government sells subscriptions in a tontine fund that entitles all *surviving* investors to receive, say, a 10% dividend each year while they are alive, but nothing at all after they die. When the last investor dies, the debt is gone—*finito*—in effect, amortized over the lives of the investors. You can see the benefit to the government. But is it a fair bet for the investors?

To answer that question, Professor Milevsky's book focuses on King William's tontine, the first of its kind. King William (of Orange) persuaded the English Parliament to enact the Million Act of 1693. The Act invited 10,000 Englishmen to contribute £100 each to a tontine scheme so that King William could have £1,000,000 to finance his war with France. In exchange for each £100 share, the government promised to pay a high dividend on the tontine until the last investor died (10% a year for the first seven years and then 7% a year until the last investor died).

Unlike bondholders, however, deceased investors could not bequeath their shares to their children or friends. Instead, the dividends on their shares would be forfeited to the investors who were still alive. When the last investor died, however, King William's tontine would end, and the government would keep the £1,000,000 principal.

Milevsky's book entertains us with stories about King William, about the tontine, about the lives (and deaths) of the investors who bought into that first government tontine, and even about Edmond Halley—the astronomer-mathematician who advised investors about the tontine.

From there, the book also offers a witty and pleasurable romp through the history of tontines, from the 1600s to the present. Along the way, Alexander Hamilton, our first Secretary of the Treasury, contemplated issuing tontines— rather than bonds—to pay off the United States' Revolutionary War debt. But other Founding Fathers apparently hated the idea, and it was never enacted. That should not surprise us. Can you imagine our politicians agreeing to pay off our $13 trillion public debt over the next 30 years (much as homeowners routinely do when signing 30-year mortgages)?

Professor Milevsky is an engaging author, and the past 350 years of tontine and government-finance history come alive in his book. Of equal importance, however, is his discussion about how the tontine principle could be used to improve today's annuities and pensions.

The trick is to use the tontine principle—the idea that the share of each investor, at death, will be enjoyed by the survivors—to design tontines so that they benefit *multiple* survivors, not just the *last* survivor. Remember those ten friends who each threw $1,000 into a pot? Instead of waiting until nine die to pay the $10,000 to the last survivor, a tontine fund could be designed to make distributions each time a friend dies. For example, when the first friend dies, the other nine should each get $111.11 ($111.11 = $1000/9); and so on. Better still, if you could recruit new investors to replace those who die, a tontine fund could be perpetual.

Tontine funds could even be run by low-fee discount brokers, not life insurance companies. After all, the investors just need a custodian to hold (and invest) the contributions and to divide the contributions of those who die among those who survive.

Nothing is guaranteed in a tontine fund, so there is no need for insurance. The custodian bears no risk. No money would need to be set aside for insurance company reserves, risk-taking or profits. That means that tontine funds could provide significantly higher benefits to investors than commercial annuities and other commercial insurance products. And that's why, as Milevsky demonstrates so well, the retirement annuities of the future should resemble the tontines of the past

__Jonathan Barry Forman__ is the Alfred P. Murrah Professor of Law at the University of Oklahoma in Norman, Oklahoma. He is the author of **Tontine Pensions***, 163(3) University of Pennsylvania Law Review 755-831 (2015) (with Michael J. Sabin).*