
Survivor Funds: Not for the Faint of Heart

By Jonathan B. Forman and Michael J. Sabin *Wed, Mar 29, 2017*

“Survivor funds,” which offer mortality credits but aren’t annuities, could provide investors with enhanced returns, these authors claim. But, for some, loss of principal would be certain. (Painting of New York’s Tontine Coffee House by Streeter Blair, 1953)



In the reality television show *Survivor*, contestants are stranded in a remote location, and the sole “survivor” of a series of tasks wins a million-dollar prize. With what we call “survivor funds,” retirees could enjoy significantly higher returns—but no more investment risk—than they can get on today’s 10-year Treasury bonds.

Of course, there’s a catch. But it’s a catch that most retirees could “live” with: You need to be alive at the end of the term of the survivor fund, or you get nothing. That is, with a survivor fund, you will get a bonus if you live until the end of a relatively short investment period. If you die before then, you will get nothing.

But who cares? Although you’d receive zero on that particular investment, your need for income would be over.

Here is a simple example that shows how a survivor fund works, relative to an ordinary investment fund:

First, imagine a fund where ten 65-year-old men each invests \$8,000 in a pool that buys 10-year Treasuries. At the current Treasury interest rate of 2.3% a year, that \$80,000 investment would grow to \$100,000 in 10 years, and each man—or his heirs—would get \$10,000, reflecting that pitiful 2.3% yield.

But what if we created a pool that divided the \$100,000 only among the men who survived ten years to age 75? According to the Social Security Administration, the typical 65-year-old man has an 80% chance of living to age 75. So, probably, just eight of our ten men will live

to 75.



With a survivor fund, those eight survivors will divide the \$100,000, and the two men who died will get nothing. In short, each of the eight survivors will get \$12,500 on his \$8,000 investment, and that works out to be a 4.6% yield. That's double the 2.3% yield on the underlying Treasuries. (We chose "men" for our example only because a single-gender group has a more definable life expectancy than a group of men and women.)

In a recent law review [article](#), we show how a new class of hypothetical savings products, called Survivor Funds, would use the survivor principle to benefit multiple investors. Each time an investor died, his account balance would be divided among the survivors. Survivor funds would be attractive investments because the survivors would get a greater return on their investments, while the decedents, because they no longer have longevity risk, would not care. (At right: Jonathan Forman)

In our example, instead of earning a measly 2.3% interest on a 10-year Treasury, our 75-year-old survivors get 4.6% (2.3 percentage points more). The bump from a survivor fund is not always that large, but as long as some investors in a survivor fund die, the rest will always get a higher return than they could get from the underlying investment. And even if no other investors die, the survivors will never get less than the return on the underlying investment.

Returns should be even higher if a survivor fund invests in stocks instead of bonds. For example, if our hypothetical survivor fund had instead invested in a Standard & Poor's 500 Index fund that earned say 7%, the survivors would get 9.4%. If that S&P500 Index fund

earned 10%, the survivors would get 12.5%.



Historically, such last-survivor-takes-all games were called “tontines”—after the 17th century Italian banker Lorenzo de Tonti who came up with the survivor principle—that the share of each, at death, is enjoyed by the survivors. (At right: Michael Sabin)

In a simple tontine, investors contribute equally to buy a portfolio of investments that is awarded entirely to the last surviving investor; and it can make for some great fiction. For the erudite, there is Robert Louis Stevenson’s 1889 book *The Wrong Box*. For the rest of us, there is the 1966 movie of the same name, starring Michael Caine.

There was also a 1980 episode of the popular television series *M*A*S*H*, in which Colonel Sherman T. Potter, as the last survivor of his World War I unit, got to open the bottle of cognac that he and his fellow doughboys brought back from France (and share it with his Korean War buddies). Even the Simpsons had an episode that involved a survivor-take-all tontine (in 1996).

But the survivor principle—that the share of each, at death, is enjoyed by the survivors—can be used to design financial products that benefit multiple survivors, not just the last survivor. For example, in the 17th and 18th centuries, European governments sometimes used variations on the simple tontine to raise money. And in our earlier research, we have shown how the survivor principle could be used to create “tontine annuities” and “tontine pensions” that would benefit lots of retirees.

Admittedly, there are no survivor funds out there today. After all, our survivor-fund idea is brand new. But there should be survivor funds soon. Lots of retirees want higher returns on

their investments, and we think that investment companies could create survivor funds fairly easily.

Squaring such products with existing regulations would require time and effort, as one of the authors acknowledged in a recent [*New York Times*](#) article. State insurance laws and gambling laws might be obstacles, and issuers of the funds would probably want more certainty about the federal tax laws as well. But the problems aren't insurmountable.

Our law review article focused on how to create those survivor funds—and how they should be regulated. As we envision it, survivor funds could easily accommodate thousands of investors of varying ages and investment levels. Administrative fees would be quite low, and the returns for survivors would be high; and that is exactly what today's retirees want.

The origins of Wall Street investing date back to around 1793 when the Tontine Coffee House was established there as a meeting place for stockbrokers. We think survivor funds will also find a new home on Wall Street—with today's investment companies and mutual-fund houses.

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