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Vanguard consolidates three managed payout funds into one

By Kerry Pechter *Thu, Nov 7, 2013*

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The same low interest rate environment that has forced annuity issuers to reduce their payout rates has also affected the world of payout mutual funds, as evidenced by Vanguard's recent decision to consolidate its original three payout mutual funds into one fund that pays out at a target annual rate of just 4% of the account value, down from its previous 5%.

The $804 million Vanguard Managed Payout Distribution Focus Fund and the $110 million Vanguard Managed Payout Growth Focus Fund will merge with the $531 million Vanguard Managed Payout Growth and Distribution Fund to create the $1.45 billion Vanguard Managed Payout Fund. The merger is expected to be complete by January 2014. Investors in the phased-out funds will become investors in the consolidated fund.

The new fund-of-funds will allocate its assets across Vanguard funds that invest in stocks, REITs, bonds, cash, inflation-linked investments, and selected other exposures, such as commodities and market-neutral investments.

"Vanguard research indicates that a 4% payout offers a higher probability of providing a stable income stream that can be sustained over the 20-30 year retirement period of the typical retiree," the company said in a release. The payouts consist of earnings and, if earnings fall short, they will be topped up with a return of principal. The funds aren't guaranteed against loss of principal or against the risk that the owner might outlive the payments.

Vanguard originally launched the three funds to offer Vanguard investors a way to supplement their retirement income that was more structured than pure systematic withdrawal but not insurance-based. Each fund featured specific payout and principal objectives. Promoting payout funds makes sense for Vanguard, which has a much bigger stake in mutual funds than in annuities. Although Vanguard distributes white-label annuities that are issued by life insurance partners, it doesn't own an insurance company. Vanguard competitor Fidelity Investments also offers managed payout funds.

Since the 2008 launch of the first managed payout funds, market conditions have not favored the concept. "The funds have faced challenges in meeting their objectives, given a financial market environment marked by a prolonged period of historically low bond yields," said the release. "The funds also encountered difficulties gaining investor acceptance and understanding, given that the managed payout concept is relatively new, coupled with the complexity of the funds' strategies and payout formulas."