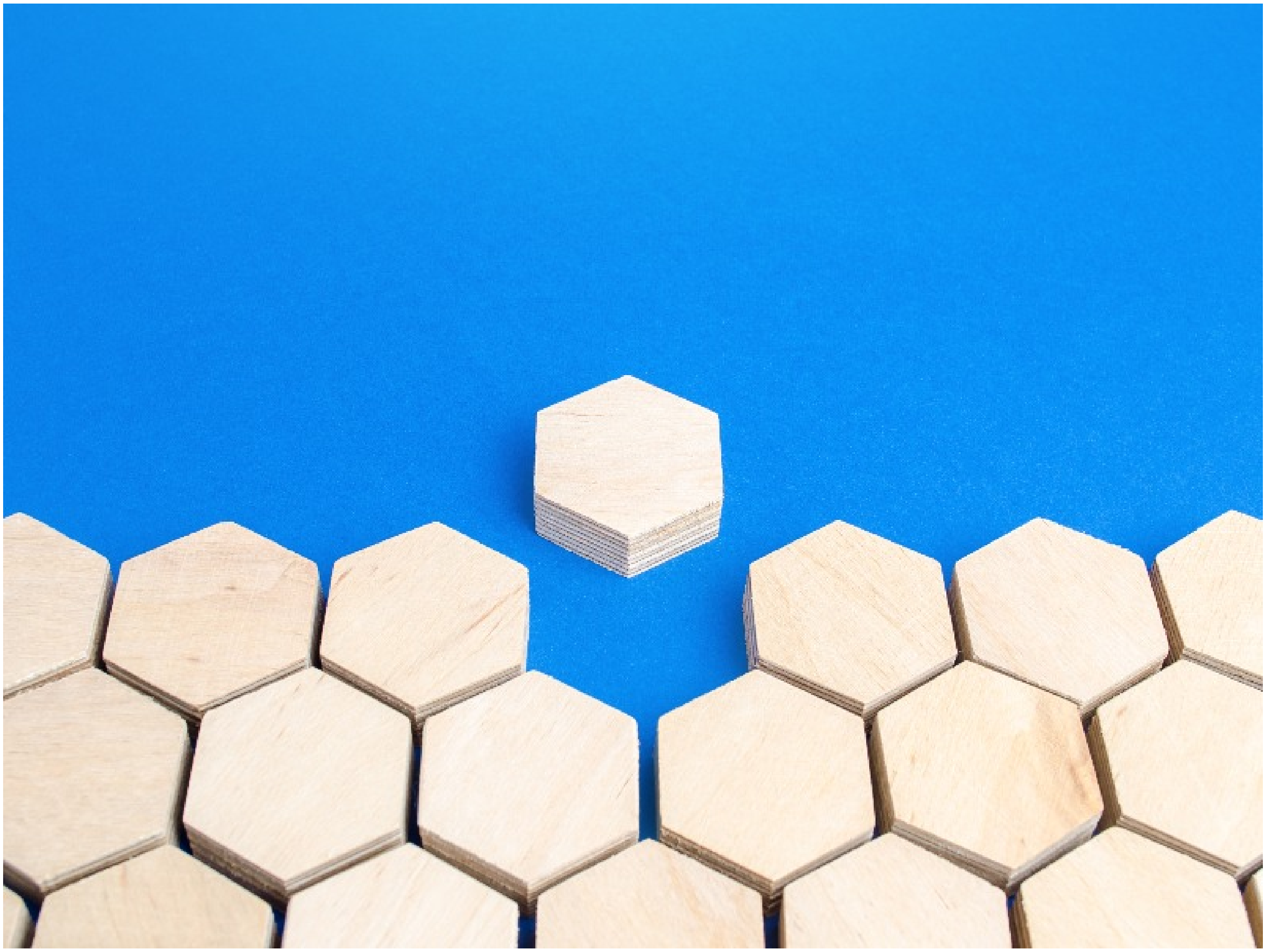
New longevity pension fund offers decumulation option for plan sponsors

By: Blake WolfeJune 7, 202109:00



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Purpose Investments Inc. is introducing a new longevity pension fund, which invests 50 per cent in equities and 50 per cent in fixed income.

It can be incorporated into a defined contribution plan to provide plan members with an in-plan decumulation option, says Pat Leo, vice-president of retirement solutions at Purpose Investments, noting investors can redeem or invest more at any time.

"It's a mutual fund but it incorporates longevity-risk pooling like an annuity. But it's not a mutual fund designed to pay you based on the investments — you're not looking at the risk tolerance of the fund, you're looking at how much money you'll need in retirement for this fund to generate."

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Plan members join the fund based on age cohort and accumulate savings until age 65, at which point they switch tax-free to the decumulation phase and begin receiving monthly payments, says Leo. While payment distribution rates begin at 6.15 per cent, the plan is designed to gradually increase these rates and generate larger distributions over time.

"By the time the cohort reaches 85 years old, we believe we can increase that 6.15 per cent by three per cent per year. Because there's fewer people remaining in the cohort, the idea is that there's fewer people to divide the pot with and the distributions go up. The longer you live, the more financially beneficial it is."

Decumulation from DC plans is a continuing challenge for members as the increase in life expectancies impacts financial planning, says Joe Nunes, co-founder and executive chairman at Actuarial Solutions Inc.

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"People aren't good at predicting the future and there's a big risk of underestimating how long you'll live and running out of money. But there's also a risk of the opposite, of overestimating how long you'll live and hanging onto a significant portion of your retirement nest egg to leave for others, when you might be able to live a more comfortable life if you just spent your own savings."

Investment management also becomes more difficult for aging plan members, as they face fewer years to recover from financial hurdles while dealing with cognitive challenges, he notes. "It gets more dangerous to take investment risk, because if there's a big setback in investment performance, you might only have a few more years to draw down your pension. There's a lot of people in their 80s decumulating assets and managing investments and their cognitive skills are diminishing in those later years. It can be a real challenge to know what to do and you can become reliant on an advisor to make good choices."