

ACGA Board Approves Reduction in Gift Annuity Rates Effective July 1, 2003 to June 30, 2004

At its regular spring meeting on May 12, 2003, the Board of the American Council on Gift Annuities approved a reduction in the recommended maximum gift annuity rates, effective July 1, 2003. The reduction varies from .2% to .3%, depending on the age of the annuitants.

The new schedule of rates and an explanation of the assumptions underlying those rates will appear on the ACGA website (www.acga-web.org) within the next few days.

The Gift Annuity Rates Committee conducts an annual review of gift annuity rates each spring and makes its recommendations to the ACGA Board. Any adjustment in the rates approved by the Board becomes effective on July 1.

The Board took the unusual action of making an interim adjustment in the rates effective January 1 of this year. Except for some reductions at some very young ages, the gift annuity rates had not changed for eighteen months prior to that date. The Board is well aware that rate changes are inconvenient for charities and vendors so its preference is always for stable rates. However, it takes very seriously its responsibility to provide a schedule of rates that will result in a significant residuum for charitable purposes and minimize risk to charities.

Reasons for Reduction in Rates

The decision to reduce the rates resulted from the following considerations.

1. A year ago the Rates Committee, pursuant to consultation with nine major financial institutions, refined its methodology for calculating the assumed total return on gift annuity reserves. The total return assumption underlying the current rates is 6.25%. Following the same methodology, the assumed total return as of May, 2003 would be 6.0%. Reducing the return assumption by 25 basis points causes the rates to drop by .2% to .3%. (Note: Since annual expenses for investment of reserves and administration are assumed to be 1.0%, the assumed *net* total return for the new gift annuity rates will be 5.0%.)
2. During the past twelve months, commercial, fixed-annuity rates have decreased by approximately 10%. The new gift annuity rates will likewise be about 10% lower than the ACGA rates in effect a year ago, except that at the oldest ages the decrease in the ACGA rates will be less than 10%.
3. As the CMFR has dipped below 4.0%, the charitable deduction resulting from use of the current ACGA rates for immediate gift annuities at certain younger ages, and from the use of current ACGA rates for deferred gift annuities at certain ages and deferral periods, will not be more than 10% as required by IRC Sec. 514(c)(5). The reduction in rates will cause most gift annuities that are based on those rates to pass the 10% test.
4. In general, charities have become increasingly concerned about the risk of a gift annuity program, and some are taking steps to reduce that risk. By developing and adhering to a conservative methodology for rate determination, the ACGA provides reassurance to charities that issue gift annuities and do not exceed the recommended maximum rates.

Given interest rates in the marketplace, gift annuities, even with the rate reduction, should continue to be quite attractive to philanthropically-inclined individuals.

Observations

The assumed total return underlying the rates in effect through June 30, 2003 is based on a portfolio consisting of (1) 35% equities using the average annual return over the past 100 years (10%), (2) 60% 10-year Treasury Notes using the average yield for 2002 (4.5%), and (3) 5% cash using the average 90-day Treasury Bill rate for 2002. The weighted average return on such a portfolio is 6.25% (5.25% net of expenses, which are assumed to be 100 basis points.)

The assumed total return underlying the rates that become effective on July 1, 2003 is 6.0% (5.0% net of expenses). The reduction results from using 3.9% as the yield on 10-year Treasury Notes. This was the approximate average yield during the first four months of 2003. No change was made in the assumed return on equities, and the somewhat lower return on the 90-day Treasury has a minimal effect.

For ages 51 - 86, the rates for single-life, immediate annuities follow from the stated assumptions. For ages above 86 and below 51, they are lower than the rates that would follow from these assumptions. Rates for ages above 86 are lower because the rates are graded up to the cap, which, in the case of the rates that become effective July 1, 2003, is 11.3%. The rates for two-life annuities where the younger annuitant is under age 59 are likewise lower than the rates that would follow from these assumptions.

Rates for younger ages, in the case of both one-life and two-life immediate annuities, are lower than the rates that would follow from the stated assumptions in order to result in a charitable deduction of more than 10%, even when the CMFR is quite low.

The following table shows when the 10% test will be met.

	<u>3.6% CMFR</u>	<u>3.8% CMFR</u>	<u>4.0%+ CMFR</u>
Single-life annuity	Age 52+	Age 48+	All ages
Two-life annuity	Younger annuitant age 61+	Younger annuitant age 55+	All ages

It is impractical to provide such a table for deferred gift annuities, for there are too many age-deferral-period combinations. While deferred gift annuities will be more likely to pass the 10% test when based on the post-June 30 ACGA rates, there will still be some instances when they may not. In those cases, gift planners will need to offer a rate lower than the ACGA rate.

The Importance of an Actuarially-Sound Industry Standard

It is essential that charities operate their gift annuity programs so that they can fulfill commitments to annuitants and preserve a meaningful residuum for their charitable work. They are more likely to meet both objectives and minimize their risk if their gift annuity rates do not exceed the maximum rates suggested by the ACGA. It is also in the best interest of the charitable community if donors are encouraged to make decisions based on the charities they want to support rather than on which charities offer the highest rates.