

American Council on Gift Annuities

Gift Annuity Best Practices

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Introduction

In 2004, The American Council on Gift Annuities (ACGA) conducted its third survey of charitable gift annuities and received responses from approximately 829 charities across the country.¹ Other information gathered during the survey indicates that over 4,000 organizations are offering gift annuities.² Clearly there are many more organizations offering charitable gift annuities than responded to the survey, so the gift annuity remains an immensely popular way of making a gift to charity while retaining an income stream.

The vast majority of organizations offering charitable gift annuities is doing so in a responsible manner and to the great benefit of its donors and organizations, but gift annuities and the charities that offer them have faced a number of challenges in recent years. Between 2004 and 1999, which was when the last survey was conducted, the country experienced one of the worst bear markets in history.³ This substantially decreased the value of many charities' gift annuity reserves and caused charities to focus on the financial risk they incur when issuing gift annuities. Not only was there risk in the financial markets, but a lawsuit in Texas that threatened to destroy the issuance of charitable gift annuities focused attention on the legal risks to institutions offering gift annuities.⁴

State regulators have increased their scrutiny of gift annuities and the organizations that issue them because of concerns over scams targeted at senior citizens by issuers more interested in financial gain than the charitable giving opportunity that gift annuities present. In 2002, The North American Securities Administrators Association (NASAA) issued a press release including charitable gift annuities as one of its "Top Ten Scams, Schemes, & Scandals" of the year.⁵ The ACGA responded and it appears that NASAA has backed off from that assertion.⁶ The Arizona Commission Corporation's Security Division identified gift annuities as one of its top ten scams.⁷ Much of this regulatory activity in Arizona was a result of the conduct by Mid America Foundation, which amounted essentially to a \$54 million Ponzi Scheme in which the principal used the donated funds to buy homes, to pay child support, and to support a lavish lifestyle.⁸

In 2003, The Securities Administrator in Maine issued a cease and desist order against a Maine insurance agent and the Tennessee based "New Life Corporation" for representing gift annuities as "guaranteed, no risk investments."⁹ The insurance agents selling these gift annuities also received a 6% commission.¹⁰ The Administrator's action prevented the sale of one annuity valued at over one \$1 million.¹¹ In the summer of 2003, Arizona State regulators secured judgments totaling \$4.3 million against an Arizona company and two insurance agents for fraudulently selling gift annuities, again representing them as secure investments.¹²

Finally, gift annuities have come under increased scrutiny by The Internal Revenue Service. Early in 2007, the IRS issued a proposed rule making that would make changes to the private annuity rules that would remove the ratable reporting of gain in the asset used to establish the private annuity, and while doing so requested comments as to

whether the rules governing gift annuities should be similarly changed.¹³ NCPG and ACGA have filed comments opposing this few point. The results remain to be seen.

Gift annuities remain a well respected and excellent way for many people to make gifts because the vast majority of organizations are acting responsibly and donors are satisfied with their gifts and the income they receive. The responses to challenges and pro-active activity by ACGA, by NCPG, and by many charitable organizations have met the regulatory challenges head-on and for the most part have been successful in preserving gift annuities as a viable gift option. To continue being successful and standing up under State and Federal scrutiny, ACGA must continue to promote its mission:

The American Council on Gift Annuities actively promotes responsible philanthropy through actuarially sound gift annuity rate recommendations, quality training opportunities, and the advocacy of appropriate consumer protections.

In furtherance of those efforts and ACGA's mission, ACGA recommends the following best practices and encourages charitable organizations to utilize as many of them as possible.

Gift Annuity Best Practices

ESTABLISH THE PROGRAM PROPERLY

1. Meet State Regulations
State regulatory requirements
State of Incorporation
Multi-State Expectations
Disclosure requirements
Annual reporting requirements
2. Develop a gift policy that specifies what assets will be accepted
Cash, appreciated securities
Other assets – real estate, tangible personal property, intangible property
Process for making exceptions
3. Establish minimum ages for immediate and deferred annuities
The most common minimum age is between 60 and 65 years old; approximately 30% of institutions issuing gift annuities have a 55 age minimum; the average age is 78. The younger the donor, the smaller the benefit to the donor of the arrangement because of the effects of inflation on the annuity distributions and the smaller the benefit to the charity because of the work required over a longer period of time to maintain and steward the gift

4. Establish minimum amounts for a gift annuity
\$10,000 is the most common in Higher Education; \$5,000 in religious and environmental – this ensures the charity will realize a minimum in exchange for the effort in setting up the gift and its stewardship
5. Follow the ACGA Rates
Risk is minimized
Larger residuum (assuming the alternative is rates higher than ACGA rates)
Don't need own actuarial work
The focus is on the gift
6. Establish Gift Allocation Policies
Ensure the donor designation is honored
Ensure that all organizational units understand and appreciate the value they will receive.

PROSPECT RELATIONS, DISCLOSURE AND CLOSING THE GIFT

7. Make sure the donor understands the gift
Proposal modeling
It's irrevocable and not guaranteed
Disclosure statement (required by law)
Explain the contract in detail
Meet with the donor in person if possible
8. Invest the entire face amount of the annuity
Assumption built into the ACGA rates, if it's not done the investment return needed to reach the 50% residuum goes up
Self insures against the liability, protects the institution
9. Have the donor sign the contract
Helps to insure donor understands the agreement
Protects the institution
Required by law in some states
Reduces risk
Increases donor confidence

INVESTING, REPORTING AND AFTERCARE

10. Invest the assets appropriately given the fact that the gift annuity assets back the issuing charity's obligation to make annuity payments

Reserve assets should generally be invested more conservatively than general endowment and should remain more liquid than the general endowment
It may be appropriate for institutions with larger endowments to invest more aggressively
ACGA assumed returns are based on a conservative and relatively low risk portfolio
Monitor the investment performance on a quarterly basis
Formally rebalance annually, informally as you raise cash to make distributions

11. For purposes of the distribution to the charity from the annuity at the end of the income beneficiary's lifetime, establish a method for determining the balance of each gift annuity
Will ensure that the donor's purpose is realized if specified in the contract
Will enable your institution to determine which annuities are in the red and the extent of the risk of each annuity to the entire pool
Commercially available software will track the value of each contract based on the annuity payments and the value of the pool
For those institutions that do not use such software or another method of fund accounting, determine a method to track the value of each annuity contract.
12. Develop a good working relationship with your finance and administrative staff
Will ensure the program is administered in the best interests of the donor and the institution
Will help the gift process go more smoothly
When issues arise with payments or tax work, they will be easier to resolve
Exceptions when you need them will be easier to obtain
13. Communicate regularly with your gift annuity income beneficiaries
14. Educate your colleagues about the benefits and liabilities of gift annuities

Endnotes

¹ The "Report and Comments on the American Council on Gift Annuities 2004 Survey of Charitable gift Annuities" is available at www.acga-web.org/orderform.pdf

² *Supra*, See the ACGA 2004 Report's Introduction

³ *Supra*

⁴ *Supra*, and Ozee, et al. v. The American Council on Gift Annuities, Inc., et al., www.pgdc.com/usa/item/?itemID=30453

⁵ See Charitable Gift Annuities Make Regulator's Top 10 Scam List, Planned Giving Design Center, September 19, 2002, www.pgdc.com/usa/item/?itemID=54550.

⁶ See comments by the ACGA at www.acga-web.org/scams.html

⁷ See Commission News, www.azcc.gov/divisions/securities/news_releases/2002/Apr01c-02.pdf

⁸ See Tax Analyst Summary on the Planned Giving Design Center's website at www.pgdc.com/usa/item/?itemID=54550

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- ⁹ See Testimony of Christine A. Bruenn, NASAA President and Maine Securities Administrator, U.S. Senate Committee on Banking, Housing and Urban Affairs, May 7, 2003, http://www.nasaa.org/Issues___Answers/Legislative_Activity/Testimony/555.cfm
- ¹⁰ *Supra*
- ¹¹ *Supra*
- ¹² See, the press release by the North American Securities Administrators Association, September 4, 2003, “State Securities Cops: Senior Investors Facing a Perfect Storm for Investment Fraud” http://www.nasaa.org/NASAA_Newsroom/News_Release_Archive/1552.cfm
- ¹³ See www.ncpg.org/gov_relations/Annuity_letterncpgadd.asp, and www.acga-web.org/IRShearingletterJan07.pdf
- ¹³ The “Report and Comments on the American Council on Gift Annuities 2004 Survey of Charitable gift Annuities” is available at www.acga-web.org/orderform.pdf
- ¹³ *Supra*, See the ACGA 2004 Report’s Introduction
- ¹³ *Supra*
- ¹³ *Supra*, and Ozee, et al. v. The American Council on Gift Annuities, Inc., et al., www.pgdc.com/usa/item/?itemID=30453
- ¹³ See Charitable Gift Annuities Make Regulator’s Top 10 Scam List, Planned Giving Design Center, September 19, 2002, www.pgdc.com/usa/item/?itemID=54550.
- ¹³ See comments by the ACGA at www.acga-web.org/scams.html
- ¹³ See Commission News, www.azcc.gov/divisions/securities/news_releases/2002/Apr01c-02.pdf
- ¹³ See Tax Analyst Summary on the Planned Giving Design Center’s website at www.pgdc.com/usa/item/?itemID=54550
- ¹³ See Testimony of Christine A. Bruenn, NASAA President and Maine Securities Administrator, U.S. Senate Committee on Banking, Housing and Urban Affairs, May 7, 2003, http://www.nasaa.org/Issues___Answers/Legislative_Activity/Testimony/555.cfm
- ¹³ *Supra*
- ¹³ *Supra*
- ¹³ See, the press release by the North American Securities Administrators Association, September 4, 2003, “State Securities Cops: Senior Investors Facing a Perfect Storm for Investment Fraud” http://www.nasaa.org/NASAA_Newsroom/News_Release_Archive/1552.cfm
- ¹³ See www.ncpg.org/gov_relations/Annuity_letterncpgadd.asp, and www.acga-web.org/IRShearingletterJan07.pdf