Gift Annuity Risk – Keeping On Your Toes

PG Calc Featured Article, January 2016

By Edie Matulka, Senior Consultant, PG Calc

During the downturn in the stock market in late 2008, many charities monitored their gift annuity reserve fund balances on a weekly or even daily basis, concerned that there were sufficient reserves to meet the requirements of states with a calendar year reporting period. But the uncertainty brought by the financial turmoil of the "great recession" had at least one positive effect, prompting charities to take a more detailed look at their gift annuity programs, either through an internal review or by hiring an outside consultant. For some, this was the first time a thorough review of the program had been done.

During the downturn, investment allocations and returns were the biggest issue influencing the condition of reserve funds. However, other factors – including age and contribution minimums, or accessing funds before annuities terminated –also affected the overall health of gift annuity programs. The negative impact of such policies, usually having been in place for years, was masked by strong investment returns during this period that resulted in high market values. Because the program seemed to be doing well, no one thought to see if there were adjustments that might be made to have it perform even better.

One Main Risk, Several Contributing Factors

The ultimate risk a charity faces in offering gift annuities is that the amount contributed for a particular annuity will be exhausted before the payment obligation ends. Even the most successful gift annuity programs experience this problem from time to time. A related risk is that the amount remaining for the charity when an annuity terminates, even when positive, will be significantly lower than expected. While not every gift annuity can be expected to be left with at least 50 percent, the target that underlies the suggested annuity rates of the American Council on Gift Annuities (ACGA), a charity should be concerned if its program as a whole is realizing substantially less than half of the amount contributed.

Whether your organization follows the ACGA suggested rates, as most do, or has created its own rate schedule, it is important to understand the assumptions that have been made in establishing the schedule. (For more information on the ACGA's rate assumptions, see the American Council on Gift Annuities.) These assumptions help you understand your program, allowing you to compare actual results with the assumptions. For example, poor performance might be traced back to differences from the assumptions in any of the following areas:

- higher expenses
- lower investment returns
- longer lived annuitants
- spending some of the contribution upfront
- offering of a higher rate than set forth in the ACGA schedule

Assessing The Risk

Much of the analysis a charity might perform can be conducted in-house or with the assistance of the financial institution the charity uses to manage its gift annuity assets, especially when annuities are tracked using software such as PG Calc's GiftWrap. A quick sense of how current gift annuities are doing as a group can be found simply by comparing the total amount contributed for those annuities with the amount that now remains. If the balance for individual annuities is tracked, a more detailed review can project – based on various assumptions – what will remain at some future point, typically upon the death of the annuitants.

In reviewing the results, look for patterns and trends. For instance, if annuities established during a particular time period or for annuitants of certain ages are doing particularly poorly, consider raising the minimum age, adjusting the list of who receives targeted gift annuity mailings, or discussing the investment allocation with your asset manager. A charity might approach the annuitants of contracts that have gone into the red (or likely will) about reassigning their annuity interests to the charity, terminating the gift annuity early and saving the charity the cost of future payments.

What Next?

The main takeaway should be that review of your gift annuity program shouldn't just be in times of crisis. Even now, as the recession begins to fade from people's immediate memory, it is easy to be lulled by positive returns and increased reserve fund values. However, knowing whether your program is profitable, and how to make it more productive, should be an ongoing goal.

In all of these things, PG Calc brings considerable expertise. We frequently perform risk analyses of gift annuity programs, tailoring the scope of each project to the needs of the client. We also can conduct a more extensive program audit that considers not only the numbers but also policies and procedures, outreach to potential donors, and state regulatory compliance. For more information, see PG Calc consulting services.