Taking The Temperature of Your Gift Annuity Program (And What To Do If It Is Unwell!)

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Fundraisers consider a well-functioning gift annuity program the cornerstone of a robust planned gift fundraising effort. Although bequests and beneficiary designations typically produce most of the realized planned gift revenue, offering gift annuities is usually the mark of a mature planned giving program. Nonetheless, among those charities that have offered gift annuities, many frequently worry about the continued viability of offering them.

Is Your Gift Annuity Program In Trouble?
Charities often find themselves in one or more predicaments with their gift annuity programs: a small number of contracts, some gift annuities that are significantly larger when compared to the rest of the pool, multiple gifts from a few annuitants, or a combination of all three. Any of these scenarios creates concentration risk. With a small number of annuitants and contracts, the success of the program is more dependent on each individual annuity performing in accord with the longevity and economic returns underlying the ACGA mortality and investment assumptions. The challenge for such a program is that the ACGA assumptions derive from the experience of large numbers of people over long periods; while any one annuity may perform quite differently, the larger the pool the more likely the performance "averages out."

Some examples of how these scenarios develop:

1. At one point, there was a champion for planned giving and gift annuities (it might have been a board member or fundraiser) but that person has moved on. These programs may have closed a handful of annuities years ago, but the program has been moribund since. No new contracts have been closed because of insufficient staff and marketing resources.

2. The prospective gift annuity donor base has not expanded. A trickle of new annuities, often one or two from existing annuitants, continue to come in each year. Over the years, these charities may have a respectable number of annuity contracts, but the majority of these contracts are in the hands of a tiny group of annuitants.

3. There has been inconsistent or intermittent issuance of gift annuities, resulting in more exposure to market swings and other external events. For example, contracts established in the late 1990s were issued with annuity rates that were, in hindsight, unsustainably high. Annuities issued on the cusp of significant market drops such as the burst of the tech bubble or the great recession also are at greater risk for exhausting the donors' original gifts. Organizations that stop issuing annuities after such events can end up "locking in" the losses and miss the opportunity for healthier annuities.

What Does a Healthy Gift Annuity Program Look Like?
A gift annuity program functions as a shared risk pool. The vitality of that pool depends on a steady influx of new gifts, at varying amounts, with annuitants of various ages, during diverse economic market conditions. The larger and more diverse the pool, the lower the investment risk and the lower the risk of unusual longevity.

A charity that offers gift annuities in regulated states that require a segregated reserve fund will be required to hold sufficient assets to cover payments for annuities that have exhausted their original principal. Most commonly this is done by retaining some annuities that ended with a positive balance in the reserve assets. Even if a program does not issue gift annuities in a state that requires a reserve fund, a healthy annuity pool will establish one and retain sufficient reserves to cover future annuity obligations. A well-funded reserve account will not require closing new annuities to cover the payments for older contracts.

Like some of the troubled programs described above, a healthy pool could also have contracts from the 1990s with annuity rates that contributed to a dramatically reduced, if not exhausted, value. But these programs also have been closing new annuities since 2012, when the current ACGA rates went into effect that are among the lowest in the history of the ACGA's rate setting. A healthy annuity program also issued contracts just as the tech bubble burst and just as the recession decimated financial markets. Instead of pulling back, these programs continued issuing contracts. Consequently, some annuities were issued at the end of the recession just before stocks rebounded with one of the longest sustained bull markets in history.

The distinguishing feature of a successful program? It issues annuities in good times and bad, to annuitants of a variety of ages, when annuity rates are high and when they are low. Marketing and promoting annuities is ongoing and sustained. The successful program doesn't dabble.

Options for Problem Annuities
Gift annuities are a guaranteed contractual obligation to make payments to annuitants so long as they live. Until the last annuitant dies or the last contract is surrendered, you need to have professional administration so that donors are paid, state regulatory requirements are met, and correct compliance reports, such as 1099-Rs, are sent. Nevertheless, if gift annuity reserves are limited or even exhausted, annuities can seem like an endless liability with no way out. If a decision has been made not to reinvigorate the gift annuity program, there are ways to manage the liability of an underperforming program.

While a gift annuity is an irrevocable gift plan, the parties to the annuity can agree to solutions that will take the liability off the charity's books:

- Surrendering an Annuity

  The most attractive option for charity is for the annuitant to surrender his right to future payments. Since charity already owns the charitable residua, when an annuitant gives up the right to payment the charitable and non-charitable interests merge. The charity is relieved of the payment liability for future payments. As an additional incentive, the annuitant (even if she is not the original donor) may be entitled to an additional income tax charitable deduction upon surrender of the right to future payments.

- Cashing Out an Annuity

  Another solution, less attractive to charity, is for the annuitant to exchange or commute their right to lifetime payments for a lump sum cash out. The lump sum payment would be set to be equal to the present value of the future stream of payments. While this option requires the charity to make a payment from their annuity reserves, it gets rid of the liability for future payments. The lump sum payment to the annuitant will be taxed in a manner that reflects how the future annual payments would have been taxed.

Committing to Gift Annuity Success

A commitment to a successful gift annuity program requires staff and marketing resources, as well as support from leadership. At least one person in the development function must have primary responsibility for oversight of gift annuities, including marketing, donor identification, and closing of new gifts.

A successful gift annuity program will continuously market annuities to a targeted donor base with a simple, cohesive message. Gift annuities are most appealing to the oldest donors, as annuitants are attracted to the safety, predictability, tax and income benefits of a gift annuity.

With 75 million baby boomers on the verge of retirement, for the next twenty years, an average of 10,000 people each day will reach age 65. The obvious takeaway is that there is a demographic trend providing more and more prospective annuitants every day.

Conditions are favorable to reinvigorate a gift annuity program that has grown stale. While annuity rates are at historic lows, current rates compare favorably to low risk fixed income investments such as certificates of deposits, bond yields and dividends. Make sure marketing to the target gift annuity demographic includes references to gift annuities. Use testimonials from satisfied annuitants to highlight the attractiveness of this gift option. Operate development offices with a point person responsible for responding to inquiries, actively reaching out to gift annuity prospects, creating proposals and following up to close new annuity contracts.