The Benefits of Reinsuring Charitable Gift Annuities

By David DeGeorge, Vice President, Life & Income Funding Solutions

Charitable gift annuities (CGAs) are an important element of many charitable organizations’ planned giving programs. With a CGA, a donor gives the charity a lump sum of money, securities, or real estate and, in return, the charity offers a way for the donor to receive a stream of income. It does so by promising to pay the donor a fixed monthly (or periodic) payment (i.e., an annuity) for the rest of the beneficiary’s life. The charity keeps the remaining portion of the contribution – known as a residuum – when the contract ends and the donor (or their survivor in the case of a joint and survivor annuity) dies. In effect, the non-profit is offering the same guarantee as an insurance company would with a commercial annuity.

CGAs enable donors to support causes they care about, while gaining the security of lifetime income. A donor can typically begin to receive income right away, or at a predetermined date in the future, the latter of which can be attractive for younger donors. CGAs, which are tax-advantaged, are particularly well-suited for “philanthropic, often high-net-worth retirees to meet their need for lifetime income and their desire to donate money to charity in a single contract.” The American Council on Gift Annuities (ACGA), which provides standardized CGA payout rates, suggests a payout rate of 4.7% for a single 65-year old, although payout rates do vary from charity to charity. In comparison, a commercial annuity would likely offer a 7% rate. ACGA rates are calculated so that with average life expectancy, a significant portion of the original gift will be available to the non-profit at donor’s death. The donor also is entitled to a tax deduction for a portion of their gift annuity purchase.

CHARGABLE GIFT ANNUITIES: THE RISK OF SELF-INSURING

Historically, most philanthropic organizations have been willing to act like an insurance company by self-insuring the longevity, investment and other risks associated with their gift annuities - risks that are backed only by the assets of the charity. Self-insuring the risks associated with a CGA can have a significant negative impact on the financial viability of the charity if a significant market event was to occur and the charity was unable to meet donor obligations. This can be a very risky proposition for the charity since a CGA’s guarantee is based on the claims-paying ability of the charity. In fact, according to a Retirement Income Journal article, “During the [2008-9] financial crisis, many small or shallow-pocketed charitable funds were said to be ‘underwater,’ and a few actually went bankrupt.” With the unpredictability of volatile markets, self-insuring can result in mismatches with the charity’s risk tolerance and unexpected contributions may be needed to shore up the charity’s obligations.

In addition to the risks associated with self-insuring CGAs, charities need to be aware of the requirements that govern CGAs, which differ by state. Most states require that a separate annuity reserve fund be created by the CGA, but the specific requirements, including the amount required to be kept in reserve and the annual reporting requirements, vary. According to John Hook, Esq., an attorney with the law firm of Stradley Ronon Stevens & Young, LLP, “Some states provide minimal regulation and oversight (e.g., Pennsylvania, where the charity self-regulates) and other states provide a much higher level of regulations (e.g., New Jersey, which requires the charity to file an extensive application, obtain a permit to issue gift annuities and file annual reports).” These complexities can be a distraction to the mission of the non-profit.

WHAT IS CGA “REINSURANCE”?

How can charities minimize or transfer the risks associated with their CGAs? One way is to “reinsure” their CGA with a commercial insurance carrier. The term itself is actually a bit of a misnomer because reinsurance usually describes an arrangement where one insurance company cedes excess risk to another insurance company for a premium. In contrast, CGA reinsurance is “simply a financing technique whereby a charity chooses to purchase a commercial single premium immediate...
years, the average residuum – the net
In the ACGA’s 2013 Gift Annuity Survey
charities that have time-sensitive objectives.
the remaining value of the gift and the cost of
purchase of CGA reinsurance. They obtain
Immediate use of CGA donations:
annuity as an asset to back its contractual
life-income liability owed to the donor. This
eliminates investment, longevity, mortality and
concentration risks for the charity, and
relieves the administrative burdens and costs
associated with managing a CGA program.
An article in Planned Giving Today
provides a practical example of how CGA
reinsurance works: ’Some charities, acting
at their own discretion, use a portion of the
amount contributed for a gift annuity to
purchase a commercial annuity from a life
insurance company that will make payments
equal to the amount stipulated in the gift
annuity agreement. For example, a woman
age 70 contributes $100,000 for a gift annuity, and
the charity agrees to pay her $5,100 per year for life. The charity then covers its
obligation by purchasing from an insurance
company at a cost of $73,368 a single-
premum immediate annuity that will pay
$5,100 per year. Assuming the reinsurance
relieves the charity of reserve requirements, which will be true in most states, the charity
can either spend the remaining $26,632 or
invest the money in its endowment until the
death of the annuitant.’

KEY BENEFITS OF CGA REINSURANCE INCLUDE:

Immediate use of CGA donations: When a non-profit organization reinsures a
gift, funds are immediately released after
the purchase of CGA reinsurance. They obtain
the immediate use of the difference between
the remaining value of the gift and the cost of
the annuity, without having to worry about
providing a payment stream to the donor. Faced with declining residua,# the ability
to use donors’ funds immediately rather than
later may be attractive, particularly for those
charities that have time-sensitive objectives.
In the ACGA’s 2013 Gift Annuity Survey
Report,# the fifth edition of the survey, for
annuities that terminated in the last five
years, the average residuum – the net
amount remaining for the charity after
the donor’s passing – was 65%. This is the
lowest average residual reported in the last fifteen years since the high of
98% in 1999. It is unclear from the survey
findings but some possible reasons for the
decline in average residuals among survey
respondents may include:
• a decline in the average donor age (a younger donor means more years
of income the charity has to pay to them);
• donors living longer than assumed (meaning more years of income
to be paid out than assumed) or
both; and,
• actual interest rates earned on the
reserves the charity is supposed to establish are lower than assumed,
meaning that more of the principal is
used in making the annuity income
payments.

Security and certainty: CGA reinsurance reduces investment, longevity and
concentration risk, eliminating the need to draw on other revenues or
unrestricted dollars in order to meet donor
obligations. CGA reinsurance can be used
to back reserve funds, and may also be
considered an alternative fixed income
asset. It helps ensure that the charity
will not default on annuity payments by
reducing or eliminating the possibility of
depleting CGA reserves if (a) the donor
lives past estimated life expectancy or (b)
assets underperform.

Reassurance about the security of
time-lapse payments: If desired, the
insurance company providing the CGA
reinsurance can make annuity payments
directly to the donor. Employing an
insurance company funding mechanism
can make donors more comfortable with
the amount of their donation or increase
the possibility of additional donations.

“Risk capacity” for accepting more
CGA gifts: The transfer of risks may free
up capital and enable the organization to
issue additional CGAs.

Renewed focus on the charity’s
primary mission: According to the ACGA,
gift annuity administration requires the
’structure and resources to invest reserve funds, manage accounts, make annuitant payments and meet state and federal
reporting requirements.’v The transfer of
risk to the insurance company requires
fewer of an organization’s resources to
maintain the program, which allows an
organization to focus more time on its
primary mission.

SELECTING A SUITABLE ANNUITY PROVIDER

When selecting an insurer to reinsure
CGAs, there are several criteria that a
charity should consider. First, it is important
for a charity to select an insurer with CGA
reinsurance as a core competency to ensure
that the charity is working with a provider
who truly understands the need to balance
the charity’s ability to promote its mission
by freeing up its capital, and protecting
the income stream that has been promised
to valued donors in exchange for their
genosity. It is also extremely important
to select an insurance carrier with strong
financial strength ratings to be certain
the insurer is able to meet all of its
payment obligations.

INTEREST IN CGA REINSURANCE PROJECTED TO GROW

The 303 charities responding to the
ACGA’s 2013 Gift Annuity Survey Report
who reported issuing one or more gift
annuities in 2013 were asked whether
they purchased commercial annuities to
‘reinsure’ the gift annuities they issue. Nine
in ten charities (91%) reported they do not
purchase commercial annuities at all, while
7% purchase some commercial annuities, and
2% reported that all gift annuities they
issue involve the purchase of commercial
annuities, compared to 6% and 1%,
respectively, in the 2009 survey. This means
that the percentage of charities reinsuring
their annuities is up slightly since the wake
of the 2008-2009 U.S. financial crisis, which,
as noted above, saw several charities go
bankrupt and be left unable not only to
re-pay their donors, but also to promote
their missions.

The increase in the percentage of
charities reinsuring their CGAs indicates
that awareness of the extensive benefits
that CGA reinsurance can offer to
charitable organizations is expanding. The
percentage is likely to grow even further as
more charitable organizations realize that
working with an insurance company whose
expertise lies in mortality and longevity risk
management and asset-liability matching
can mitigate the risks associated with
managing CGAs, relieving some of the
burdens that come with administering a
CGA program and allowing the organization
to focus on its core philanthropic purpose.

For more information, please visit
www.metlife.com/cga.

---

3 Hook, John, Stanley Ronon Sevens & Young, LLP, “Ten Things You Need to Know About Planned Charitable Giving,” Metropolitan Corporate Counsel, October 21, 2015.
6 The ACGA’s 2013 Gift Annuity Survey was conducted online among 378 charities with gift annuity programs in October and November 2013. The survey was sponsored by Bank of New York Mellon. The survey has been conducted in five year intervals since 1999.

MetLife Life Insurance Company
200 Park Avenue, New York, NY 10166
www.metlife.com

© 2015 METLIFE, INC.