CHARITABLE LIFE INSURANCE EVALUATION GUIDELINES

A Tool For Charitable Gift Planners

NATIONAL ASSOCIATION of Charitable Gift Planners

CHARITABLE LIFE INSURANCE EVALUATION GUIDELINES

A TOOL FOR CHARITABLE GIFT PLANNERS

Printed in the United States of America by the National Association of Charitable Gift Planners
200 S. Meridian Street, Suite 510 • Indianapolis, IN 46225
Phone: 317-269-6274 • Fax: 317-269-6268 • E-mail: info@charitablegiftplanners.org
Web Site: www.charitablegiftplanners.org

Preface

Alchemy was a medieval practice that relied on elixirs, mysterious incantations and strange rituals to cure ills, prolong life, and, most famously, transform base metals into gold. Life insurance is sometimes promoted as a modern alchemist's tool because of its ability to provide significant cash payments and to allow the accumulation of wealth. So too, in some instances, has planned giving been touted as an alchemy of sorts, giving the appearance of generating substantial benefits for the donor, beyond the mere retention of an income interest while fulfilling a charitable goal.

Perhaps it is inevitable, then, that life insurance and planned giving should regularly find common intersections.

Sometimes these intersections have been beneficial. Generous outright contributions of life insurance policies have provided significant financial support for charitable causes. And life insurance has frequently provided the wealth replacement component that made a gift plan possible for the donor and his or her family. On other occasions, the results have been less positive, as was the case with certain split dollar plans promoted in the 1990s.

Charitable gift planners owe it to their donors, clients, and charitable institutions to understand the workings of charitable gift plans and to be willing to objectively explore new and innovative proposals. However, considerable time, effort, and resources would be wasted pursing each and every possibility.

The successful gift planner will rely on the *Model Standards of Practice for the Charitable Gift Planner* as the foundation for any review and evaluation of a gift proposal, including those involving novel applications of life insurance. The Model Standards are reproduced in Appendix 5. Three of the standards (I, III, and X) are key when considering charitable life insurance proposals:

Philanthropic Motivation – The principal basis for making a charitable gift should be a desire on the part of the donor to support the work of charitable institutions.

Disclosure – The role and relationships of all parties involved should be fully disclosed to the donor and no party should act or purport to act as a representative of any charity without the express knowledge and approval of the charity.

Public Trust – Gift Planners shall act with fairness, honesty, integrity and openness and, except for compensation for services which has been disclosed to the donor, shall have no vested interest that could result in personal gain.

These *Charitable Life Insurance Evaluation Guidelines* are provided as a guide to the charitable gift planner. Recognizing the wide array of circumstances and conditions under which life insurance may be applied to charitable giving, no attempt is made to unconditionally affirm—or condemn—life insurance in charitable giving. Even answering all of the questions posed by these Charitable Life Insurance Evaluation Guidelines will not produce a simple yes or no answer.

Ultimately, each proposal for an application of life insurance to charitable giving will have to be judged on its own merits to determine, first and foremost, whether or not the proposal will produce value for the charity and assist the donor in the achievement of his or her charitable objectives. If a proposal or program fails to meet these two criteria, then it fails to qualify as a charitable gift plan.

Acknowledgements

PPP would like to acknowledge the time and effort invested by members of the Insurance Gifts Guidelines Task Force, and by many charitable gift planners, donor advisors and representatives of the insurance industry who reviewed and refined the guidelines throughout the drafting process.

Task Force Members:
Craig Wruck, Chair
Charles Gordy
Robert Lew
Reine Shiffman
Tanya Howe Johnson, Ex-Officio

Of Counsel:
Jane Peebles

Editor: Barbara Yeager

Contents

Introduction

Life insurance is a valuable tool in many financial and estate planning applications. In addition, many programs have been developed over the years to apply life insurance to charitable giving. Some, such as the charitable reverse split dollar programs promoted in the 1990s, have been discredited and subject to significant regulation while others, such as the outright contribution of existing policies or the combination of wealth replacement insurance with a contribution to a charitable remainder trust, have stood the test of time and have proven to be a significant source of value for charitable organizations.

Charitable gift planners are frequently approached with offers of creative applications of life insurance in regard to charitable gift planning. Some of these proposals involve new or innovative uses of life insurance products while others are merely novel marketing approaches for traditional applications. In general, charitable life insurance programs are aggressively marketed, often with sales promotions that are aimed at board members and other high level officials within the charitable organization.

Some of these proposals provide real economic value for the charitable beneficiary and advantages for the donor, while others seem to be designed primarily to enrich the promoters involved. Frequently, these marketing approaches are accompanied by voluminous, but not necessarily illuminating, financial illustrations which can make it difficult to compare alternatives and to evaluate the potential value to the charitable organization.

Charitable gift planners and donor advisors struggle to analyze these offerings and to navigate through the many and sometimes conflicting claims in order to advise charities, donors and clients. The Partnership for Philanthropic Planning (PPP) has issued these *Charitable Life Insurance Evaluation Guidelines* as a tool to assist charitable gift planners in the analysis and evaluation of charitable life insurance proposals.

These guidelines do not purport to judge any specific proposal or type of program; rather, they are designed as an analytical tool that will:

- be useful in the analysis of charitable life insurance proposals;
- provide a methodology to reveal the overall value of such plans for the charitable organization;
- suggest a framework to analyze the projected economic value created for the charitable beneficiary;
- assist charities and donor advisors in evaluating the legal and ethical ramifications of charitable life insurance plans that might place a charitable organization or donor in jeopardy.

Approach

Unfortunately, a common sentiment toward discussions regarding life insurance is summarized by the following observation:

> *Ignorance, complexity, and apathy are the three words that best characterize the market for individual life insurance. In this kind of atmosphere, opportunities for the exploitation of consumers abound."*[1]

Gift planners can be tempted to spurn all life insurance proposals without devoting the time and effort to examine each proposal to determine what value it might bring to the charitable organization.

When choosing an insurance policy to protect your own personal financial well-being, you would, of course, resist being pressured to make a decision. Instead, you would carefully weigh your personal needs compared to the program being offered, considering your priorities and your financial goals and whether this is the most efficient way to achieve them. You would conduct due diligence to ensure that the promoter was reliable, that the product being touted was legitimate, and that any risks did not outweigh the potential benefits.

You should apply that same level of analysis, and caution, before entering into a life insurance program on behalf of your charitable organization. The sections that follow suggest a stepped analysis that leads to progressively deeper review of charitable life insurance program proposals. Seldom will there be one question or one measure that disqualifies—or qualifies—a specific program. However, in the aggregate, the answers to these questions will, like a mosaic, create a picture that will help determine whether or not a specific charitable life insurance program is likely to create real value for your organization, or if you would be better off devoting your efforts elsewhere.

Methodology

Responsible gift planners should conduct a careful analysis before engaging in any charitable life insurance program. Since a complete analysis can represent a significant investment of time and effort, these *Charitable Life Insurance Evaluation Guidelines* propose a stepped analysis, leading from broad and qualitative inquiries through progressively more specific and quantitative analysis, in order to allow the gift planner to effectively triage his or her efforts. If a proposal cannot meet the broad requirements, there may be no need to engage in the more exacting and time-consuming steps in the analysis.

The guidelines are divided into the following sections:

Guiding Principles – an outline of principles to guide the analysis of a proposed charitable gift plan

Threshold Questions – a set of key considerations that should be examined before beginning the step-by-step analysis of a proposed charitable life insurance program

Meeting Organizational Priorities – a subjective examination of how closely the proposal fits the needs of the charitable organization

Economic Analysis – an estimate of the actual value of the proposed program to the charitable organization

Financial Analysis – identifying and understanding how the values flow within the program

Structural and Risk Analysis – analyzing the specific components and structure of the program and the soundness of the providers

---

[1] Joseph Belth, *Life Insurance, A Consumer's Handbook*, Bloomington: Indiana University Press, 1985.

Definitions

At the outset, it is important to establish the roles and functions of the entities involved in charitable life insurance programs. In some cases, these definitions differ from those used in ordinary non-charitable applications. Although Appendix 1 contains a more complete glossary, the following terms and definitions are key, and will be used consistently throughout these *Charitable Life Insurance Evaluation Guidelines*:

Insured – the individual upon whose life a policy or annuity is issued.

Insurer – the insurance company that issues the policy or annuity.

Owner – the individual or entity that owns the policy.

Policy – a contract issued by an insurer that promises to pay a death benefit to the beneficiary upon the death of the insured.

Annuity – a contract issued by an insurer that promises to periodically pay an amount to a beneficiary (the amount of the annuity can be fixed or variable and continue for the lifetime or last for a shorter period according to the terms of the contract).

Death benefit – the amount paid upon the death of the insured (the amount of the death benefit can be guaranteed and fixed at the time the policy is issued or it can vary according to the terms of the contract; the net amount available may be reduced by loans or withdrawals made before the death of the insured).

Beneficiary – the individual or entity to whom the death benefit or periodic annuity is to be paid.

Premium – the amount paid to the insurer in exchange for the contractual promises (insurance policies usually require periodic payment of premiums during the lifetime of the insured; annuities usually require a single premium payment paid when the contract is issued).

Many charitable life insurance programs are variations on one of two basic concepts:

Premium Financed Plans – These programs are typically presented as a package consisting of a pre-arranged loan (or other debt facility) that provides the charity with funds to purchase a number of life insurance policies on the lives of a group of donors or other constituents. Such programs rely upon the assumption that a sufficient number of the insured will die as expected based upon an actuarial prediction, in order to ensure that the death benefits collected will be enough to retire the debt and continue to provide future premium payments. After all of the insureds have died, the charity is projected to be left with a significant amount of money or economic benefit despite having invested little, or sometimes no, cash over the course of the program.

Premium Arbitrage Plans – These programs are often promoted as a sophisticated investment option rather than as a charitable contribution program. The plans involve either an expenditure of the charitable organization's own funds or the use of borrowed or other funds provided by outside investors to purchase both an annuity contract and a life insurance policy on the same individual, usually from different insurers. Often the individual to be insured must meet certain specified health and age criteria in order to secure favorable premium pricing.

The promoters maintain that under these conditions they can obtain an annuity that pays enough to cover the premium amount for the life insurance and the interest on the loan (if any) and still provide a current return to either the investors or the charitable organization for as long as the insured lives. When the insured dies, the death benefit of the life insurance provides a guaranteed return of principal to the investors or is used by the charity to repay either the loan or its endowment for the amount that was spent for the annuity contract. (In cases where an outside investor must first be repaid, the charity receives only what is left after this obligation is satisfied.)

Guiding Principles

The following key principles are the philosophical underpinning for these *Charitable Life Insurance Evaluation Guidelines,* and are useful in the analysis of any charitable gift proposal, especially a proposed charitable life insurance program.

Complete Analysis – Careful analysis of both the subjective and objective factors is key. Some aspects of charitable life insurance programs lend themselves to quantitative analysis, while other aspects are more qualitative in nature. A worthwhile charitable life insurance program will meet both subjective and objective criteria.

Value and Values – The analysis should guard both the value and the values of the charitable organization today and in the future. Even though a charitable life insurance program may be financially viable, it may present unwarranted risk to reputation and/or consume unreasonable amounts of valuable staff time and resources.

Time to Decide – The charitable organization should not be pressured into a decision, no matter how appealing the proposal. Charitable life insurance programs typically run for many years, sometimes multiple lifetimes. Charitable organizations should devote sufficient time and effort to ensure that the charitable life insurance program will provide real value to the charitable organization and is supported by its leadership and its constituents.

Nothing is Free – Nothing of value comes without a price. All of the costs of the charitable life insurance program, including the costs of insurance, borrowing, commissions, and on-going administration, must be paid by someone at some point. The charity should have a clear understanding of all costs and the sources of the funds to pay these expenses, as well as the ultimate source of the value the charitable organization expects to receive.

Charitable Interest – The charitable life insurance program must respect and serve the charitable interests of the donor.

Obligations and Commitments – Charitable organizations should fully understand the costs involved in a proposed charitable life insurance program and the impact on those costs should the program not unfold as planned. Interest rates, mortality assumptions, and the cost of insurance are all variables that may increase or decrease the charity's out-of-pocket expenses over time.

Threshold Questions

Before beginning a careful analysis of the details of a charitable life insurance program, first consider a number of threshold questions. These tend to be subjective in nature and the answers may be qualitative or "gut reactions." The questions will not likely provide a clear go or no-go decision. However, they may suggest caution, or perhaps additional inquiries that should be made before significant time and effort is devoted to analyzing the financial and technical details of the proposed charitable life insurance program.

What was your initial reaction? – If you found yourself feeling that the program sounds too good to be true or may not be legal or ethical, you may be right. Before your brain got involved, did your gut tell you that something may be wrong? Don't get caught up in the initial sales pitch.

Do you feel that the program will work? – Don't check the numbers or research the Internal Revenue Code yet. Just ask yourself whether or not the program seems viable and makes sense. Do you believe that this program, if all goes as planned, will work?

How does the value flow through the program? Is it logical? – "Follow the money," is still good advice. It should flow from point to point, much like water flowing down a river. It should never move upstream unless there is a reason—which might prove to be a submerged rock creating an eddy! If a donor intends to flow money to his or her favorite charity, it shouldn't flow backwards without a good reason.

How do you feel regulators and other government officials will react? – How will the IRS react to a deduction that might be taken? How will your State Attorney General view this activity and the decision of your board of directors–as a charitable contribution or as a form of business relationship with the donor? How will your State Insurance Commissioner react to your charity insuring the life of a donor?

Does the program make economic sense for the donor? – Will the donor receive a benefit from the program and is that benefit what the donor expects?

Does the program make economic sense for your charitable organization? – Will your organization receive a value that will exceed your time and effort? Will the long term economic gain exceed the potential long term cost?

Does the program cultivate true "donors" or simply individuals willing to be insured? – Is the program likely to generate new prospective donors? What will the impact be on your current donors?

Organizational Considerations

Does the proposed program fit the needs and priorities of the charitable organization? When purchasing life insurance for your own personal needs, you would approach the decision thoughtfully and cautiously, and you might wonder who would benefit most from your purchase of the policy. Before going very far at all, you would make certain that you actually *need* the protection and value provided by the insurance product. You would look to the facts for answers, but you would also rely on your knowledge and intuition about your own circumstances and needs.

Many charities have welcomed and promoted contributions of life insurance. The proceeds from life insurance policies have helped charitable organizations carry out their charitable purposes, often in ways that would otherwise not have been possible. Outright contributions of existing or new policies, and the use of life insurance as a wealth replacement strategy in planned giving are commonly used.

These traditional uses of life insurance in charitable giving require little additional effort or commitment from the charitable organization. However, the decision to promote a charitable life insurance program as a source of contributions must be carefully scrutinized. The need to identify, cultivate and solicit participants, and then steward those relationships for many years, as well as manage and monitor the program, all require a long term commitment of staff and program resources.

Supporting Organizational Priorities

Consider three different charitable organizations with different needs that might be met by a charitable life insurance program designed to benefit the charity:

Organization A – was recently notified that its Service Center has been condemned as a result of a termite infestation. It must quickly secure funds to build a new facility.

Organization B – has just launched an endowment campaign with the goal of securing $18 million for its endowment within the next five years.

Organization C – is a financially sound charity that hopes to preserve its ability to serve the community for many years to come.

Although it may be tempted by the potential for long term benefit, Organization A should carefully weigh its need to secure funds for immediate use against the risk of diverting staff attention for the potential of a future benefit. The decision to participate in a charitable life insurance program should be guided by its pressing need for current, rather than deferred, funding.

Similarly, Organization B hopes to have an endowment of $18 million in five years. It too needs to concentrate on those activities that will provide more immediate revenue than the charitable life insurance program.

However, Organization C may determine that the charitable life insurance program is in line with its priorities. Still, Organization C will need to explore other factors that may influence its decision to participate.

Efficient Use of Resources

Although a traditional program simply promoting contributions of life insurance policies is reasonably easy to administer, a charitable organization must recognize that a more complex charitable life insurance program can require considerable staff energy, resources, and attention. Consequently, it needs to decide whether the assignment of staff to the proposed charitable life insurance program is the most cost-efficient way to meet its funding priorities or whether participation in the charitable life insurance program will divert effort and resources from fundraising activities that are more conducive to the organization's objectives.

Donor Diversion

Some charitable life insurance programs tout the ability to provide donors with the opportunity to support the organization without making a monetary contribution. While this may be an alluring option, prior to soliciting a pool of potential prospects, you should carefully consider whether there are those in the prospect pool who may conclude that this is their "contribution" and reduce other gifts as a result of their involvement in the charitable life insurance program. Staff time may be better used to identify and cultivate prospects for immediate and more substantial contributions.

Non-disclosure Agreements

A non-disclosure agreement, as its name implies, is usually a legal contract in which the signer agrees not to disclose certain information, except under terms as described in the agreement. Common in the scientific industry, non-disclosure agreements are becoming widely used in the financial services field by those who hope to maintain a competitive advantage by claiming a proprietary interest in certain features of a particular charitable life insurance program.

Sometimes these agreements can seriously handicap the charitable organization, and can prevent you from sharing the details of the charitable life insurance program with your trusted advisors. Furthermore, by agreeing to preserve secrecy about a proposed charitable life insurance plan, you may open your organization to legal liability even if you choose not to participate in the plan. For example, if you sign a confidentiality agreement and then decide not to participate with that particular promoter but later choose a proposal from a competing promoter, the first promoter might accuse you of violating the initial non-disclosure agreement.[1]

Your best protection is to secure the advice of your own counsel prior to signing any confidentiality or non-disclosure agreement, especially in light of the fact that state laws vary widely regarding the validity and enforceability of non-disclosure agreements.

Debt Financing

The question is not whether the charitable organization has the *right* to borrow funds, but whether it *should* it borrow money for this particular purpose. There are many good reasons for a charitable organization to borrow funds. For example, loans are often used to allow organizations to alleviate cash flow problems, meet capital projects, or purchase equipment. However, a responsible charitable organization should carefully consider the decision to go into debt for the purpose of purchasing insurance.

Several factors should be weighed in the decision to borrow to pay insurance premiums:

- Will the new debt limit or preclude the charitable organization from borrowing funds in an emergency situation? Will it limit or preclude the organization from borrowing funds to support projects requiring immediate financing?
- As a result of the new debt, what constraints will the organization face? When will cash begin flowing and how will debt service be covered in the meantime?
- What is the probability that the anticipated proceeds from the insurance death benefit(s) will not be received when expected?
- Although investment earnings are tax-exempt for a charitable organization, borrowing funds to generate interest can lead to Unrelated Business Taxable Income (UBTI). Thus, the charitable organization could also subject itself to taxable income on some of the proceeds from the charitable life insurance program.
- There may be securities ramifications. The Securities and Exchange Commission (SEC) regulates investment transactions that involve larger numbers of individuals. This is particularly relevant if the charitable life insurance program involves borrowing funds. If a large number of individual lenders becomes involved, it is possible that the SEC may review the process.[2]

Some charitable organizations will be guided by their investment policies. Does board policy permit indebtedness? If so, are there restrictions that would limit your organization's consideration of a loan for the purpose of paying insurance premiums?

Full Disclosure

If you were approached on the street by a stranger who offered to sell you shares of stock in an undisclosed company, you would never consent to the investment without first demanding more details. Similarly, you have a duty to obtain the facts prior to entering into any agreement on behalf of your organization.

It is your right and obligation to know the relationships of the parties involved in the charitable life insurance program and to understand how, under what circumstances, and how much each is compensated and the value each adds to the program in return for his or her compensation. Appendix III provides a checklist with questions that may be useful as you try to understand these relationships. These questions are meant to serve as a guide; your advisors may recommend additional areas of inquiry.

Nonprofit Status

As a matter of public policy, charitable organizations are afforded tax-exempt status when the Internal Revenue Service (IRS) determines that the organization exists primarily to serve charitable purposes. In his article *Charities and Insurance, The Next Big Thing*, Larry Bell reminds readers that the IRS did not intend that charitable organizations be used to fill the pockets of for-profit professionals, and that if the IRS believes the organization is more intent on generating commissions or fees to the promoters rather than meeting its exempt purposes, the organization could jeopardize its 501(c)(3) status.[3] While this is certainly a worst case scenario, nonetheless it is one that must be seriously considered, especially in light of the recently increased interest of Congress in the activities of charitable organizations.

Ethical Concerns

Many charitable life insurance plans are built on the assumption that the charitable organization will procure large pools of participants willing to be insured. Usually, but not always, the charity is encouraged to seek participants from those who have an existing relationship with the charity. When considering the solicitation of individuals, both those already affiliated with the organization and new participants, legal and ethical ramifications can arise.

In addition to the issues raised by state insurable interest statutes (see page 21), ethical considerations may affect both the organization and the individual to be insured. The organization, especially the governing board, should fully discuss and evaluate the potential consequences of involving unknown individuals in the purchase of life insurance on your constituents before proceeding. Consider:

- Marketing expert Regis McKenna reminds us that it's not so much what you say about your organization, it's what your donors and prospects say about you.[4] Perhaps the best test is the age-old "headline" analogy. Ask yourself: What will your constituents say if they read an article describing your involvement in the program? Boston University was the subject of public outrage in 1989 after the Boston Globe reported that the University planned to raise money by taking out insurance policies on BU students.[5]
- A secondary market is developing for charitable life insurance programs, which allows the original lenders or investors to sell their stakes in the program. Will your constituents, whom you invited to participate, be aware of the involvement of new parties and their interest in your constituents' lives? If not, should they be advised of this situation? And when they become aware of it, will they be comfortable with unknown individuals having a financial stake in their life expectancy? (NOTE: As this report goes to press, Federal legislation has been proposed which would significantly diminish the appeal of charitable life insurance programs as an investment.)
- The promoters will have gained access to financial and contact information on those constituents who choose to participate and often on those who do not choose to participate. Is this appropriate?
- As discussed more completely later in this document, there is a limit to the amount of life insurance that insurers will issue on any given life. Is it ethical to ask a donor to participate in a plan that might restrict or prevent him or her from acquiring additional insurance coverage for personal or other planning needs in the future?

Experience of Others

Finally, before deciding to participate in a charitable life insurance program, be sure to obtain recommendations directly from other participants. How many other charities are working with the promoter? Call some of them and inquire about their successes, any problems they have encountered, ease of communication, and whether the program is working as they had expected. Do background checks. What do you know about the company, the agents, and other involved parties? Consult with colleagues through PPP's e-mail discussion group, GIFT-PL, or other national forums, the Better Business Bureau and, certainly, the national insurance associations.

---

[1] IPWatchdog.com, copyright 2003-2004

[2] Steve Leimberg, *Estate Planning Newsletter* #671. An excellent examination of the risks and ramifications of this particular area. Steve Leimberg's *Estate Planning Newsletter* can be accessed at www.leimbergservices.com

[3] Steve Leimberg, op. cit.

[4] Regis McKenna, *Relationship Marketing,* Addison-Wesley Publishing, 1991.

[5] *Boston Globe*, April 20,1989.

Economic Analysis

Ultimately, how much value will this program bring to your organization?

A charitable organization should consider a number of economic factors before obtaining an insurance policy on the life of an individual. Key among them is a careful analysis and projection of the ultimate economic benefit to the charitable organization, and how much charitable work that economic benefit will allow the organization to accomplish. Analysis of the economic benefit raises several questions:

- What is the present value of the projected future death benefit payment to the charitable organization?
- How is the present value determined?
- Are assumptions used in the projections reasonable?
- What is the probability of receiving the death benefit payment when it is projected?
- What is the present value of the required expenditures during the projected lifetime of the charitable life insurance program?
- Are there circumstances that might require additional payments or contributions to achieve the projected economic value?
- What will be the impact if the insured lives longer than expected?
- What are the economic risks involved (e.g., If interest rates change, how will the value to the charity be affected?)

Investor versus Charity Funded

There are two basic funding models for charitable life insurance programs. The flow of economic value as well as the risk differs, depending upon the method of financing used:

- **Investors provide initial funding** – These programs involve one or more outside investors who provide the funding to make the initial and sometimes the ongoing payments for the insurance. Such programs generally provide economic benefit to the charitable organization only upon the death of the insured. Should the insured live longer than expected, the charity will receive the death benefit later than anticipated and, of course, if the insured dies sooner than expected the charity receives its benefit sooner. In either case, the value ultimately received by the charity is unlikely to be precisely the amount projected.

  The timing of this economic benefit is generally no different than if the insured had purchased an insurance policy and named the charity as the beneficiary. Charitable organizations must understand that the timing of the receipt of the death benefit is uncertain, regardless of what may be represented in the program proposal.

- **Charity provides initial funding** – In these programs, the charitable organization makes the initial and sometimes the ongoing payments for the insurance, either through borrowing or the use of its own internal funds. Of course, the charity also assumes the significant additional risk if the program does not perform, since it is the charity's funds that are invested. The timing of the death benefit, which is usually used to refund the initial expenditure by the charity, is uncertain, which can cause the charity's funds to be encumbered longer than anticipated.

  In these programs, the charity may also enjoy certain economic benefits while the insured is alive, as well as the death benefit when the insured dies. If the charity provides the initial funding and is the owner of the policy, it may have the right to collect cash dividends, borrow against the policy, and make partial or complete surrenders of the policy.

Some charitable life insurance programs use a hybrid mix of these two funding mechanisms. As explained more fully in the section on Financial Analysis, the charitable organization should fully explore and understand any collateral agreements or encumbrance provisions that could make the charity liable for portions of the financing under certain circumstances.

Net Present Value Analysis

The methodology outlined in PPP's *Valuation Standards for Charitable Planned Gifts* should be used to conduct a present value analysis of the expected expenses (outflows) over time and the anticipated economic benefit (the death benefit expected to be received from the policy or policies) in the future.

The objective of the present value analysis is to provide the charitable organization with some indication of:

- the real value of the proposed charitable life insurance program in terms of the amount of charitable activity that it is likely to support
- the costs and benefits of the proposed program over time
- the financial effectiveness of the organization's involvement in the program

In those charitable life insurance programs where outside investors provide the funding, the analysis is relatively straightforward: the present value of the expected death benefit(s) should be calculated, with appropriate discounting for the probability of lapse or failure of the program. The result is an indication of the value, in today's dollars, of the charitable life insurance program to the charity and can be used to compare the program with other fundraising efforts.

Valuation Example

The objective of the net present value calculation is to estimate the value, in today's dollars, of the charitable work that the proposed life insurance program is likely to provide. This will enable the organization to evaluate the impact the insurance program will have on the organization's charitable purpose. The PPP Valuation Standards provide a conceptual framework for the valuation of planned gifts that is applicable to the evaluation of proposed charitable life insurance programs.

Estimating the net present value of a charitable life insurance program involves a number of key assumptions, many of which are specific to the organization. Three key assumptions are:

program life expectancy – In most cases funds will not be available for charitable purposes until the end of one or more lifetimes. In order to calculate the present value of the life insurance program, an estimate must be made of the date(s) at which funds will be available for charitable purposes. In most premium financed programs, a number of individuals are insured and, depending upon the rate at which they die, net funds may begin to be available for charitable purposes once enough individuals have died to provide death benefit receipts in excess of the expenses of the program. The most precise estimate of the timing of availability of charitable funds would involve calculating the present value of the projected death benefit for each of the participant's life expectancies based upon his or her age. However, for most purposes, an estimate based upon the life expectancy of the youngest insured may be sufficient.

organizational cost rise rate – Since funds will not be available for charitable purposes until some time in the future, an estimate must be made of the effect of inflation over time. The most accurate calculation will use an estimate of the rate at which the organization's cost of providing its charitable services is expected to increase. In many cases, the general inflation rate as reflected in the Consumer Price Index may be used if more precise measures are not available.

expenses – In most cases the organization will incur expenses in the stewardship of the participants throughout their lifetimes. The marginal additional expense may be minimal if the participants are donors or other constituents involved in the organization. If, however, the participants are unique to the insurance program, the costs of maintaining these new relationships might be more significant.

For example, assume an organization is considering a premium financed charitable life insurance program that envisions the recruitment of 100 individuals who agree to be insured for the benefit of the charitable organization. The program is designed to be self financed and does not require direct expenditures of cash by the charitable organization. According to the materials developed by the promoter, the charity will receive $10 million toward its endowment, after all of the participants have died and all of the debt and other expenses of the program are paid.

First the organization must take several steps to set the assumptions for its net present value calculation:

1. In order to determine the number of years until the program will be completed, the organization must make an assumption about the ages of the participants it will recruit. After reviewing its pool of potential prospects, the organization determines that the youngest of the 100 participants is likely to be age 55 when the program begins.
2. After considering the expense and difficulty involved in estimating the program life expectancy based upon 100 different lives, the organization chooses to use the life expectancy of the youngest participant, recognizing that this represents some sacrifice in precision[1]. According to the Annuity 2000 Tables, the life expectancy of a 55 year-old is 28.5 years, which the organization uses as an estimate of the program life expectancy.
3. Based upon past experience, the organization expects the costs of delivering its charitable services to rise at an average rate of 3.5% per year for the duration of the program.
4. Considering the amount of contact and additional staff time that will be required for each participant in the charitable life insurance program, the organization estimates that it will spend an average of $40 per year per participant, in today's dollars, on these activities.

Given these assumptions, the organization can make a preliminary estimate of the net present value of the proposed life insurance program as follows:

$3,750,000	the present value of $10 million after 28.5 years discounted at 3.5% per year[2]
$100,000	one half[3] of the present value of servicing expenses averaging $40 per participant per year
$3,650,000	estimated net present value of the program

Obviously, enormous amounts of time and effort could be devoted to the construction of highly precise estimates of the net present value of such a program. In performing the net present value analysis, the organization will need to make trade-offs in order to produce a sufficiently accurate estimate without an inordinate expenditure of resources.

Those programs that require investment or expenditure by the charity of its own funds require a more complex analysis. In addition to calculating the present value of the death benefit(s), the analysis should also account for the present value of all expected expenditures by the charity over the lifetime of the program. A precise analysis will also include a further discounting factor to account for the risk that the charity may lose some or all of its investment in the program.

---

[1] Although a full discussion of the actuarial science involved in estimating the life expectancy of a group of individuals is beyond the scope of this paper, two technical elements should be kept in mind when setting assumptions regarding the timing of the availability of charitable funds. First, individual life expectancy estimates are usually the average expectancy, the point at which one half of all individuals of a given age are expected to have died. Second, because life expectancies are measures of probabilities, the life expectancy of a group is usually longer than the life expectancy of the youngest individual in the group.

[2] This estimate is only approximate in that it assumes that *none* of the funds are available until the last of those insured has died. A more accurate estimate would recognize and take into account that funds are likely to become available for charitable purposes at various points over the duration of the program.

[3] Since servicing expenses will decrease as participants die each year, the organization has decided to reduce by one half the expense projection. A more accurate estimate would correlate the estimated expenses with the life expectancies of the individual participants.

Financial Analysis

Where does the money come from and where does it go before it reaches your charitable organization?

The financial analysis of the charitable life insurance program should produce a clear understanding of the financial consequences of the proposed program. Questions should include:

- What is the charitable organization's commitment?
- How much will it cost the organization and/or its donor(s)?
- How much are the commissions, to whom are they paid, and are they reasonable in relation to the value added for the charity?
- How long will the charity and/or its donor or donors be financially committed?
- How much will the charitable organization receive when the insured dies?
- What is the probability of the charity receiving that amount (is it guaranteed)?
- Under what conditions might the charitable life insurance program fail to deliver the projected benefit?

Outright Contribution of Policy

The most straightforward application of life insurance in charitable giving is the case where the donor simply contributes a life insurance policy to the charity. If the donor transfers ownership of the policy to the charity, he or she may be entitled to an income tax charitable contribution deduction for a portion of the value of the policy. Further premium payments are the responsibility of the charity.

Often a generous donor will agree to make annual contributions to the charity in the amount of the premium. The charity then pays premiums, and the donor receives a deduction for the amount donated (deductible up to 30% or 50% of adjusted gross income). **See figure 1.**

In a slight variation on the above, the donor may continue to make premium payments directly to the insurer after ownership of the policy is transferred to the charity. In addition to the initial deduction for a portion of the value of the policy, the donor receives an income tax charitable contribution deduction for the premium amounts paid on behalf of the charity as well. **See figure 2.**

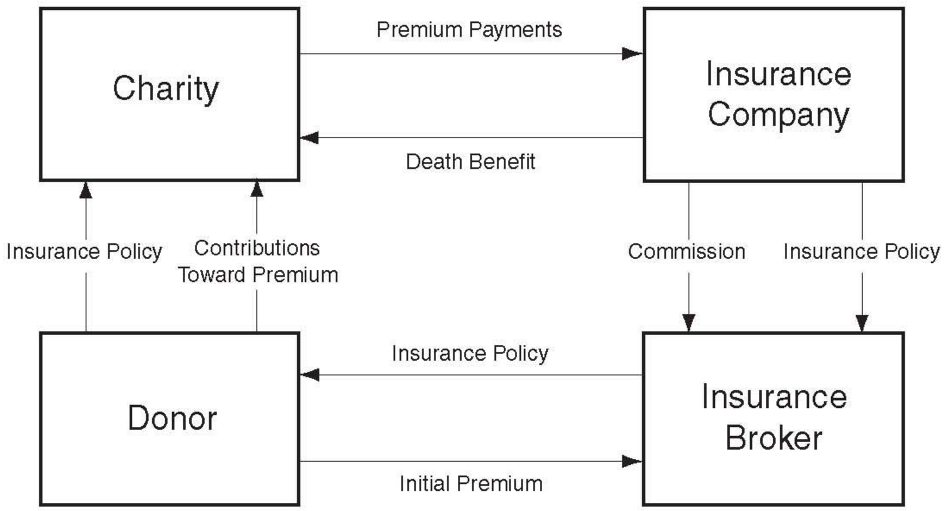


Figure 1:
Outright Contribution

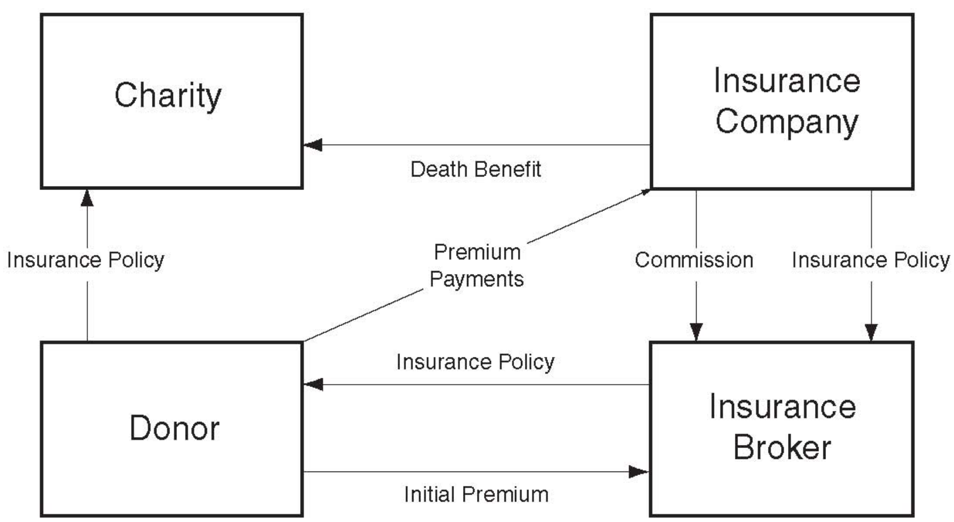


Figure 2:
Variation on Outright Contribution

Figure 3: Premium Financed Plans

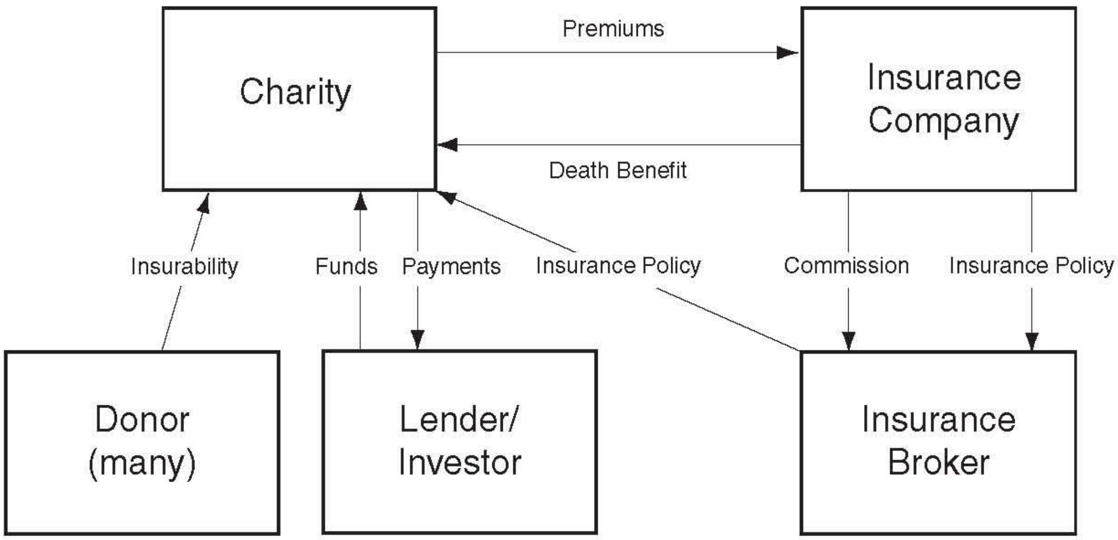
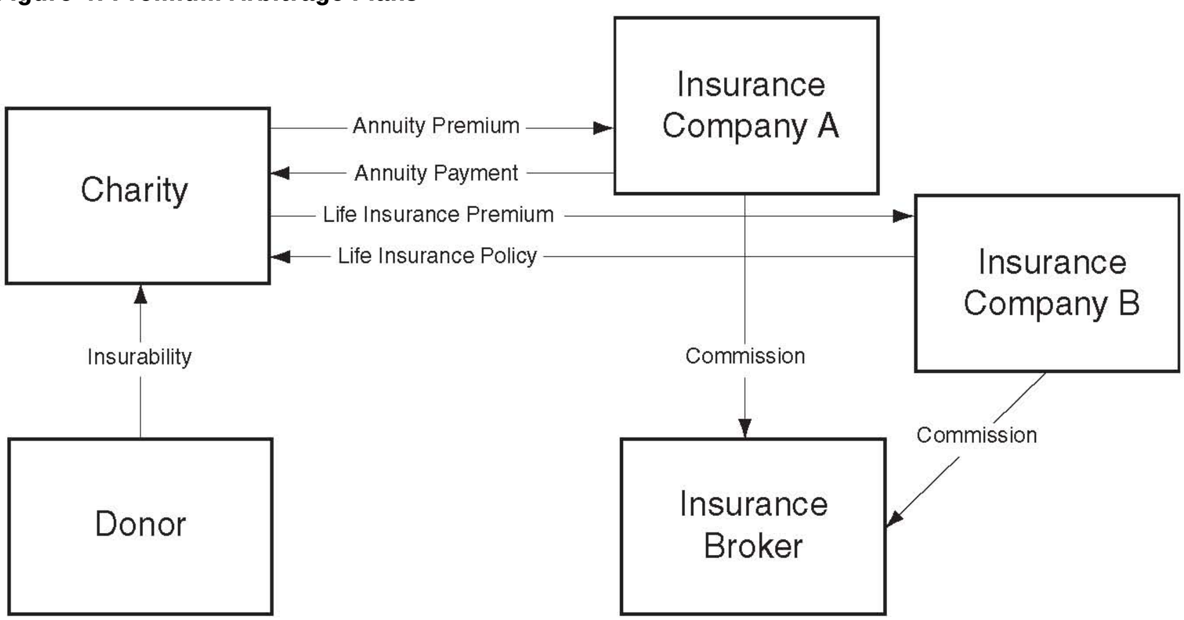


Figure 4: Premium Arbitrage Plans



Premium Financed Plans

These programs consist of two elements:

- A leveraged source of funding pays the premiums on the life insurance policies. The source is usually some type of loan or other debt facility, but it can also be funds invested by one or more entities.
- A number of life insurance policies issued on the lives of a group of individuals, usually constituents of the charitable organization.

The program relies on a projected number of insureds dying on schedule in order to ensure that the death benefits collected are sufficient to retire the debt and continue to provide the premium payments required by existing policies.

When all of the insureds have died, the charitable organization is projected to be left with a significant amount of money or economic benefit despite having invested little or, sometimes, no cash over the course of the program. **See figure 3.**

Premium Arbitrage Plans

These programs involve the simultaneous purchase of both an immediate annuity contract and a life insurance policy on the same individual, but usually from different insurers. The program may be offered as an "investment" for the charity's endowment funds, or outside investors may provide capital or the charity might be encouraged to borrow to provide funding for the program. Regardless of the funding, the transaction usually involves two steps:

- The funds, from whichever source, are used to purchase a single premium fixed payment immediate annuity on the life of an individual. This contract provides a fixed annual payment for as long as the individual lives.
- Then, a life insurance policy is purchased on the same individual with a death benefit in the amount that has been spent on the annuity contract.

Conceptually, the annuity payments provide the source of funds to pay premiums on the life insurance policy and, when it is finally received, the death benefit from the insurance policy will "reimburse" the initial expenditure for the annuity contract.

Premium arbitrage plans usually require that the individual to be insured meets certain specific health and age criteria in order to secure the favorable premium pricing. The promoters maintain that under these conditions they can obtain an annuity that pays significantly more than the amount of the premium for the life insurance policy, leaving enough excess to pay the interest on the loan (if any) and still leave funds to provide a current return to either the charitable organization or the outside investors. **See figure 4.**

Commissions

Insurance agents and brokers earn a commission on the sale of life insurance policies and annuity contracts. Commissions are one way financial professionals are compensated for their advice and expertise. For a life insurance policy, the commission can typically approximate 50% or more of the first year's premium with a smaller amount, in the range of 3% to 5% as renewal commissions for the next several years. Determining the "reasonableness" of a commission can be very difficult. Donors especially should be aware of the reality of commissions and consider this expense when choosing between life insurance as a charitable gift vehicle versus making an outright gift.

Financial Soundness

An important component of the analysis is an evaluation of the insurer (see discussion on page 22). Insurance companies are rated according to their financial soundness, credit rating, and debt rating, which are important factors that can directly affect the likelihood that projected investment returns will be met and projected death benefits will be paid. A.M. Best Company is the oldest of the many insurance company rating services. Standard and Poors, Moody's Investor Services, Duff & Phelps/MCM Investment Research, and Weiss Ratings, Inc., also provide ratings. A.M. Best rates the largest number of companies, and uses a 15 point scale from A++ (superior) to F (in liquidation). When evaluating an insurance company's financial strength, A.M. Best examines the company's balance sheet strength, operating performance and business profile.

When determining the financial soundness of an insurer, a good strategy is to compare the ratings from two or three of the rating services and to review the ratings over a period of several years.

Charity's Obligations

The financial analysis should include a careful review of the policies, debt instruments, contracts, and other legal instruments associated with the charitable life insurance program, in order to ensure that all of the actual and potential obligations of the charitable organization are identified and clearly understood.

The financial outlay that the charitable organization is expected to make over the course of the charitable life insurance program should be clearly outlined. In addition, it is important to identify contingency and other provisions that might require a large financial commitment on the part of the charity under certain circumstances. You should identify the probability that your charitable organization might be required to make additional payments into the charitable life insurance program.

This analysis will help you decide whether the charitable life insurance program makes financial sense for your organization. In addition, it will allow an evaluation of the opportunity cost of using funds for the charitable life insurance program versus allocating those funds to other efforts.

Collateral

The insurer or the lender may require the charitable organization to provide collateral or guarantee that premium payments will be made. It is important to identify and quantify any provisions that require the charitable organization to pledge or hypothecate its assets for the charitable life insurance program. Such collateral requirements should be evaluated very carefully to ensure that you have a clear understanding of what those obligations are and if they have to be reflected on your balance sheet as a liability. The most conservative analysis requires consideration of the possibility that the assets the charity pledges as collateral might be lost.

Stress Test

Finally, it is important to analyze and understand the terms and conditions of the life insurance policies themselves. Most insurers provide policy illustrations based upon assumptions regarding investment return, mortality rates, and the cost of insurance over time. If those assumptions prove wrong, additional premium payments may be required or the anticipated death benefit may be reduced.

A good financial analysis should include a "stress test" projecting the performance of the charitable life insurance program under adverse circumstances, such as a prolonged period of depressed investment performance or significantly extended life expectancies or (if applicable) a significant change in loan rates. An analysis of these worst case scenarios can help determine whether or not to embark on the charitable life insurance program.

Structural and Risk Analysis

How sound is the structure of the program? What risks are associated with the program and how can the organization anticipate those risks?

Insurable Interest

Early in the history of life insurance, it was not uncommon for people to "wager" on the lives of others by purchasing life insurance on a third party without that person's knowledge or consent. Since, under these circumstances, the owner profits from the death of the insured, there could be a temptation to speed up the demise of the insured, especially if he or she is a third party unrelated to the owner of the policy. To prevent this, insurable interest laws were instituted that restrict the owners and beneficiaries of a life insurance policy to those who have an interest in the continued life of the insured.

It is permissible, in most states, for a charitable organization to own life insurance on its supporters or even potential supporters. However, the details of insurable interest laws vary by state to state, with some being less restrictive than others. Therefore, it is important that the charitable organization seeks guidance from its own advisors to ensure that participation in an insurance program complies with applicable state insurable interest laws.[1]

Some life insurance programs marketed to charitable organizations involve funds provided by outside investors. Charitable organizations should verify that such arrangements are allowed under the applicable insurable interest laws of the various states that may have jurisdiction.

Charitable organizations should also be mindful of the concerns expressed by representatives of the insurance industry [2] and various legislative and regulatory authorities, including Senate Finance Committee Chair Charles Grassley, who has stated, "In entering any transaction, charities need to be very careful that their tax-exempt status is not providing inappropriate benefits to a corporation. A penny of benefit to charities doesn't excuse a pound of profit to the corporations."[3]

Private Benefit Payments

Some charitable life insurance programs offer to provide a partial death benefit to the heirs of the insured as an enticement to encourage individuals to agree to be insured under the program. If the program you are considering includes such incentives, be aware that Federal law prohibits a charitable organization from providing financial benefits to an individual outside of the organization unless that benefit is provided as part of the charitable purpose of the organization or as payment for services performed for the charitable organization. Charities that engage in plans that provide incentive benefits to others may be in violation of these laws.[4]

Insurance Capacity

Individuals agreeing to be insured under a charitable life insurance program should consider the risk that participation may consume life insurance capacity and prevent the acquisition of additional coverage for personal or other planning needs in the future.

This is a complex matter because the individual's maximum insurability or "insurance capacity" is largely a facts and circumstances determination, based upon the underwriting guidelines of the insurer. Although an individual has an unlimited insurable interest in his or her own life, the "need" for insurance usually governs the maximum amount of life insurance an insurer will issue on the life of one individual. Sometimes additional or excess insurance comes at a higher premium cost.

Insurers use a number of different methods to set the maximum amount of life insurance that may be issued on an individual's life, typically either a function of the need to replace income when the insured dies or the need to pay future estate taxes, and sometimes a combination of the two. A typical approach to determining maximum insurance capacity based upon the need to replace income involves multiplying the potential insured's income by a factor that is a function of age. For example: under some guidelines, an insured between 26 and 30 years of age would have a maximum insurability, or insurance capacity, of 16 times annual income; for an insured between 41 and 45 years of age, the maximum may be only 12 times income; while someone 61 to 65 years of age might be limited to insurance of not more than five times their annual income.

Maximum insurance capacity may never be an issue for the average constituent. Still, the issue of insurance capacity should be carefully explained to each participant in a charitable life insurance program. Participants should fully understand that they may be precluded from acquiring additional life insurance to meet personal or other needs in the future as a result of their participation in the charitable life insurance program.

Viability of the Companies

As discussed more fully on page 19, it is important to determine whether or not the insurance companies involved are viable. If not, the policies may, ultimately, become worthless. If a loan is to be used as a part of the charitable life insurance program, you should determine if the lending institution is viable. If not, they may not be there to renew their loan.

The reputation and viability of the insurer and other companies involved must be carefully considered. Researching the reputation and background of an insurance company has become much easier due to the significant amount of reporting required of insurers and the wide availability of public data.

A first step is to contact your State Insurance Commissioner to be certain that the company is licensed to do business in your state.

In addition, you can check the company's financial condition by reviewing its rating and other data. Several rating agencies, including A.M. Best Company, Fitch Ratings, Moody's Investor Services, Standard and Poor's Insurance Rating Service, and Weiss Ratings, assess the financial strength of companies. Rating information is available on the Internet or in publications usually found in the business section of a public library.

---

[1] J.J. McNab, an independent planner, analyst, and author who specializes in advanced tax, charitable and insurance analysis, has created a state-by-state list of insurable interest laws on her website at www.deathandtaxes.com/insint.htm

[2] Update: Investor-Owned Life Insurance (IOLI), NAIFA Frontline

[3] Senator Charles Grassley, "Charities Look to Benefit from a New Twist on Life Insurance," *New York Times*, June 5, 2004.

[4] Debra E. Blum, "For Charities, a New Twist in Raising Money: Corporate Investors in Life-Insurance Policies," *Chronicle of Philanthropy*, April 12, 1999 at www.deathandtaxes.com/insint.htm

Appendix 1:
Glossary

Life insurance employs a very specific and technical vocabulary. An understanding of several key terms will be helpful in the evaluation and comparison of charitable life insurance proposals:

account value – the sum of all premium payments adjusted by periodic charges, credits and partial withdrawals.

annuity – a contract issued by an insurer that promises to periodically pay an amount to a beneficiary (the amount of the annuity can be fixed or variable and continue for the lifetime of the insured or last for a shorter period according to the terms of the contract).

beneficiary – the individual or entity to whom the death benefit or periodic annuity is to be paid.

cash surrender value – the value available upon surrender of the contract.

death benefit – the amount paid upon the death of the insured (the amount of the death benefit can be guaranteed and fixed at the time the policy is issued or it can vary according to the terms of the contract; the net amount available may be reduced by loans or withdrawals made before the death of the insured).

guaranteed value / guaranteed rate – policy illustrations (see Appendix II) usually include certain minimum or guaranteed rates as well as assumed rates; guaranteed values are those projected based upon the guaranteed rates while values based upon the assumed rates are not guaranteed.

insured – the individual upon whose life a policy or annuity is issued.

insurer – the insurance company that issues the policy or annuity.

owner – the individual or entity that owns the policy.

policy – a contract issued by an insurer that promises to pay a death benefit to the beneficiary upon the death of the insured.

policy year – the "fiscal year" of the policy, generally beginning the first day the life insurance coverage is in place; premium payments and other outlays are usually assumed to be made at the beginning of the year, while cash values are usually shown as of the end of the policy year.

premium – the amount paid to the insurer in exchange for the contractual promises (insurance policies usually require periodic payment of premiums during the lifetime of the insured; annuities usually require a single premium payment when the contract is issued).

Appendix 2:

Understanding the Limitations of Policy Illustrations

Most life insurance policy presentations include illustrations showing how the policy might perform over time. These illustrations present financial projections based upon a number of assumptions about the policy.

Policy illustrations include assumptions about interest rates, investment return, future cost of insurance (premiums) and other policy expenses. Some illustrations also include assumptions about mortality rates (life expectancy of the insured) and other important variables.

Illustrations typically include at least two projections: one based upon assumed or hypothetical rates and another based upon guaranteed minimum rates. In addition, illustrations may include a projection upon a "mid-point" assumption, which is usually the average between the assumed and guaranteed rates.

The ending values contained in projections based upon the minimum rates are usually guaranteed.* Policy illustrations include explanations of the assumptions upon which the projections are based. Understanding and evaluating the reasonableness of the assumptions is critical to the evaluation of the likelihood that the policy will perform as expected. Most states require written warnings explaining the basis of the illustrations. A typical assumption disclaimer reads as follows:

> "This illustration assumes that the currently illustrated non-guaranteed elements will continue unchanged for all years shown. This is not likely to occur, and actual results may be more or less favorable than those shown.
>
> Based on Guaranteed Values, the policy would not terminate. Based on Midpoint Assumptions, the policy would not terminate. Based on Current Assumptions, the policy would not terminate."

Note that even though the second paragraph is phrased in a favorable way ("the policy would not terminate") there is no guarantee that the policy *will* perform as illustrated. In analyzing the policy, the gift planner should heed the advice contained in the first paragraph: "this is not likely to occur … actual results may be more or less favorable than those shown."

In addition, many states require the recipient, often the applicant or initial owner of the policy, to sign an acknowledgment of the assumptions and the limited reliability of the illustration. A typical acknowledgment reads as follows:

> "I have received a copy of this illustration and understand that any non-guaranteed elements illustrated are subject to change and could be either higher or lower. The agent has told me they are not guaranteed."

In many charitable applications, the charity is not the initial purchaser of the policy and may not be required to consider such an acknowledgment. Nevertheless, the charity should acquire and carefully review a current policy illustration.

*Note: The "guaranteed values" in the illustration may represent the amount available to the charity. In evaluating a life insurance proposal, the gift planner must take into account the effect of certain transactions, including loans, withdrawals, and items that may be deducted from the death benefit or policy ending value. These items can reduce the ultimate value of the policy to the charitable organization.

Appendix 3:
Evaluation Checklist

1. **Threshold Questions**

   1.1. **What was your initial reaction?** If the program sounds too good to be true or may not be legal or ethical, your instinct may be right. Before your brain got involved, did your gut tell you that something may be wrong? Don't get caught up in the sales pitch.

   1.2. **Do you feel that the program will work?** Don't check the numbers yet. Don't research the Internal Revenue Code. Just ask yourself: Does your gut allow you to believe that this program, if all goes as planned, will work?

   1.3. **Does the value flow logically?** Follow the money. It should flow from point to point much like water flowing down a river. It should never move upstream unless there is a reason.

   1.4. **Do you feel that government officials will react favorably?** How will the IRS react to the deduction that will be taken? How will your State Attorney General's office react to the actions of the board of directors who approved of using a gift to form a business relationship with the donor? How will the State Insurance Commissioner react to your charity insuring the life of a donor?

   1.5. **Does the program make economic sense for the donor?** Will the donor receive a benefit from the program and is that benefit what the donor expects?

   1.6. **Does the program make economic sense for the charity?** Will your organization receive a value that will exceed your time and effort? Will the long term economic gain exceed the potential long term cost?

2. **Meeting Organizational Priorities**

   2.1. **How does the proposed insurance program fit within the priorities of your institution?**

   2.2. **Does your organization ordinarily borrow money to make investments?** If not, why not, and why should you consider borrowing in this case?

   2.3. **Are there more efficient ways to spend the time and effort of staff?**

   2.4. **Are there more optimum gifts that could be sought from prospective donors in the group to be targeted for the insurance program?** Might a donor reduce other contributions because of this program?

   2.5. **Does the promoter require you to sign a "non-disclosure" or similar agreement?** If so, what are the ramifications for your organization? Will a non-disclosure agreement prevent your outside counsel or other trusted advisors from reviewing the program?

2.6. **Is the relationship and compensation of *all* parties appropriate and fully disclosed?**

2.7. **Are those individuals who will be insured under the program truly connected to the charitable organization** through previous contributions or services, or are they previously unknown individuals attracted by the appeal of becoming a "donor" for free?

2.8. **What other charitable organizations have participated in similar programs with this promoter?** How many programs of this type does this promoter have in force?

2.9. **If third parties are involved, is this permissible under state insurable interest laws?** Will donors be aware of the involvement of these third parties? Will the donors be comfortable with the third party having an interest in their lives?

3. **Economic Analysis – know how your organization might benefit**

3.1. **What is the present value of the projected future pay-off for the institution?** What is the probability of achieving the future pay-off as projected?

3.2. **What is the present value of the required expenditures during the projected lifetime of the gift?**

3.3. **What are the contingencies that might require additional contributions in order to achieve the projected future pay-off?**

3.4. **What is the risk that (and amount of) additional payments or contributions may be required to achieve the target pay-off to the institution?**

3.5. **What is the present value of the cost of staff time and resources needed to manage this program over time?**

3.6. **If donors live longer than expected, what is the impact to the program?**

3.7. **What is the impact on the program if interest rates (or loan rates, if applicable) change over time?** Are rates modeled realistically? (Consider asking for a worst-case model as a "stress test.")

3.8. **How many years must the program be in effect in order to achieve the expected pay-off?** Are there truly "guaranteed" aspects to the program?

3.9. **If this program requires moving existing endowment assets, will the future value of the death benefit exceed the future value of the endowment at life expectancy?**

3.10. **If this program requires annual contributions from a donor, will the future value of the death benefit exceed the future value, including earnings, of the cumulative contributions?**

4. **Financial Analysis – understand where the money comes from, where it goes**

   4.1. **Have you created a simple flow-chart or model** that explains where the money comes from and goes before it arrives at the charity?

   4.2. **Who gets paid, how much and when?**

   4.3. **What is the financial soundness of all of the companies involved (insurers and lenders)?**

   4.4. **How much will the charitable organization likely be required to pay, and when?**

   4.5. **Is the organization required to provide collateral or other guarantees?** If so, what is the value? How will these liabilities affect the organization's financial statements? If your organization is willing to provide collateral, how much is it willing to lose in a worst-case scenario?

5. **Structural and Risk Analysis**

   5.1. **What is the source of the value added by each party?** What are the expenses involved with each party? Are the expenses reasonable compared to the value added?

   5.2. **What are the roles and responsibilities of each of the parties?** Will these be fully disclosed to all involved?

   5.3. **Are the insurance company, lender and others involved viable business entities?**

   5.4. **What is the reputation risk for the charity and its relationships with its donors?**

   5.5. **Does the donor understand and accept the risk** that his or her participation may consume life insurance capacity that could prevent him or her from acquiring additional coverage for personal or other planning needs in the future?

   5.6. **Are the insurance and other financial products involved priced reasonably?** (Under-pricing may be an even more significant risk than overpricing.)

Appendix 4:

Quick Start Questions

The following questions may be useful as a "quick start" guide to help the gift planner ascertain whether or not there is reason to consider the proposed program.

OUTCOMES

- What is the projected financial benefit to your organization?
- What is the projected financial benefit to the investors?
- What are the assumptions used in the projections?
- What actuarial assumptions are being used?

COMPENSATION

- How are commissions applied?
- Will any death benefit be paid to the heirs of the insured?
- On what will the death benefit be based?

LOANS

- What will be the interest rate on the loan?
- Is the interest rate fixed or adjustable?
- Is collateral or other pledges required from your organization?
- To what extent is the charitable organization liable to the lender in case of a default on the loan?

INVESTOR INFORMATION

- What is the financial strength of the participating insurance companies?
- Are there issues that may affect this rating in the future?
- Do the investors have a vested relationship with each other?
- Do the investors maintain the right to sell their interests to another party?
- If yes, under what conditions?
- Will the charity be notified in advance of such a sale?
- Will the charity have veto power?
- How will the charity be able to track who has invested in the policies and who owns them at any time?

REGULATORY ISSUES

- Will a trust established for purposes of the plan be subject to regulation under securities laws?
- Will payments issued by the investors to the charity be treated as UBIT?

Appendix 5:

Model Standards of Practice for the Charitable Gift Planner

Preamble

The purpose of this statement is to encourage responsible gift planning by urging the adoption of the following Standards of Practice by all individuals who work in the charitable gift planning process, gift planning officers, fund raising consultants, attorneys, accountants, financial planners, life insurance agents and other financial services professionals (collectively referred to hereafter as "Gift Planners"), and by the institutions that these persons represent.

This statement recognizes that the solicitation, planning and administration of a charitable gift is a complex process involving philanthropic, personal, financial, and tax considerations, and as such often involves professionals from various disciplines whose goals should include working together to structure a gift that achieves a fair and proper balance between the interests of the donor and the purposes of the charitable institution.

I. Primacy of Philanthropic Motivation – The principal basis for making a charitable gift should be a desire on the part of the donor to support the work of charitable institutions.

II. Explanation of Tax Implications – Congress has provided tax incentives for charitable giving, and the emphasis in this statement on philanthropic motivation in no way minimizes the necessity and appropriateness of a full and accurate explanation by the Gift Planner of those incentives and their implications.

III. Full Disclosure – It is essential to the gift planning process that the role and relationships of all parties involved, including how and by whom each is compensated, be fully disclosed to the donor. A Gift Planner shall not act or purport to act as a representative of any charity without the express knowledge and approval of the charity, and shall not, while employed by the charity, act or purport to act as a representative of the donor, without the express consent of both the charity and the donor.

IV. Compensation – Compensation paid to Gift Planners shall be reasonable and proportionate to the services provided. Payment of finders fees, commissions or other fees by a donee organization to an independent Gift Planner as a condition for the delivery of a gift are never appropriate. Such payments lead to abusive practices and may violate certain state and federal regulations. Likewise, commission-based compensation for Gift Planners who are employed by a charitable institution is never appropriate.

V. Competence and Professionalism – The Gift Planner should strive to achieve and maintain a high degree of competence in his or her chosen area, and shall advise donors only in areas in which he or she is professionally qualified. It is a hallmark of professionalism for Gift Planners that they realize when they have reached the limits of their knowledge and expertise, and as a result, should include other professionals in the process. Such relationships should be characterized by courtesy, tact and mutual respect.

VI. Consultation with Independent Advisors – A Gift Planner acting on behalf of a charity shall in all cases strongly encourage the donor to discuss the proposed gift with competent independent legal and tax advisors of the donor's choice.

VII. Consultation with Charities – Although Gift Planners frequently and properly counsel donors concerning specific charitable gifts without the prior knowledge or approval of the donee organization, the Gift Planners, in order to insure that the gift will accomplish the donor's objectives, should encourage the donor, early in the gift planning process, to discuss the proposed gift with the charity to whom the gift is to be made. In cases where the donor desires anonymity, the Gift Planners shall endeavor, on behalf of the undisclosed donor, to obtain the charity's input in the gift planning process.

VIII. Description and Representation of Gift – The Gift Planner shall make every effort to assure that the donor receives a full description and an accurate representation of all aspects of any proposed charitable gift plan. The consequences for the charity, the donor and, where applicable, the donor's family, should be apparent, and the assumptions underlying any financial illustrations should be realistic.

IX. Full Compliance – A Gift Planner shall fully comply with and shall encourage other parties in the gift planning process to fully comply with both the letter and spirit of all applicable federal and state laws and regulations.

X. Public Trust – Gift Planners shall, in all dealings with donors, institutions and other professionals, act with fairness, honesty, integrity and openness. Except for compensation received for services, the terms of which have been disclosed to the donor, they shall have no vested interest that could result in personal gain.

Adopted and subscribed to by the National Committee on Planned Giving (now the Partnership for Philantrhopic Planning) and the American Council on Gift Annuities
May 7, 1991. Revised April 1999.