Gifts of Life Insurance From Younger Donors?

Brian Sagrestano Explains the Pluses and Minuses

QUESTION

Should I suggest/promote to younger donors (ages 30-45) the idea of buying a new life insurance policy, either single premium or ongoing premiums, naming our charity as the owner and beneficiary of the policy?

ANSWER

I am asked this question all the time. As a general rule, unless your charity is very small or does not have an adequate way to invest its endowment, I recommend against asking younger donors to purchase new life insurance policies and naming the charity as the owner and beneficiary.

Discussion:

I base my recommendation not on ethical considerations, but practical and economic ones. The practical consideration is the effort involved in tracking the donors and collecting premiums.

You thought it was hard to ask for *gifts?*

Example:

I once worked with a charity which had asked donors to buy single premium life insurance policies. Years later, when the policies were underwater and additional premiums ended up being due because the initial investment assumptions were unrealistic, most of the donors were still alive but the charity – a hospital system – had lost track of thtem (many donors had simply moved out of the area). They could not find them to ask for additional premiums, and had to make the hard choice to either liquidate or reduce the death benefit on each of the policies.

These choices run counter to donor intent, as they had hoped to create endowments and created gift agreements to that effect. But unfortunately it's a fairly common occurrence.

Even if the charity can keep track of the donors because there are regular premiums due, it suddenly becomes a staff function to collect those premiums. If fundraisers think it is hard to ask for gifts, they have never been tasked with asking donors to make premium payments on life insurance policies when the donor no longer feels connected to your mission, or has somehow been slighted by your organization, or his/her interests have simply moved elsewhere.

Compelling Economic Considerations:

When a donor buys a new life insurance policy and donates it to the charity, the donor is effectively choosing an investment for the charity. As a general rule, life insurance is not a great economic investment. If the charity has an endowment and investment acumen to invest with average market returns, the charity can outperform the investment in a life insurance policy by having the donor make the gift to the endowment and just letting it grow until the donor reaches age 80.

Example:

I recently reviewed a plan which called for a 40-year-old to pay a one-time, $4,625 premium for a $25,000 face value policy. If the charity put that same gift in its endowment and it grew at 6%, it would be worth over $50,000 when the donor reached age 80. At 5% growth it reaches over $34,000. At 4%, the charity only receives $23,000, but the charity should be able to do better than 4% return in the endowment.

The reason it takes such a low return to outperform life insurance is that it is not designed for charitable giving. The proceeds of a life insurance policy come to beneficiaries tax-free. But since charities are tax exempt, there is no tax benefit to the charity to be the beneficiary of the life insurance.

Over...

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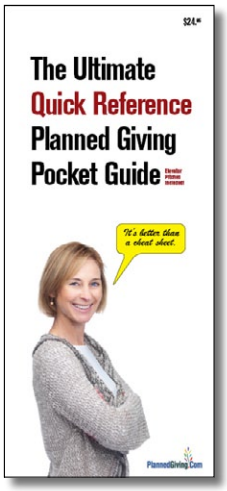

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In addition, insurance companies have huge overhead including staff, actuaries, commissions, profits to shareholders, etc., which all come from the premiums, frequently up front. With less money to invest in the policy after all of these fees, there is less opportunity for growth. In the end, the costs of investing in the endowment should be substantially less than the costs of investing in an insurance policy.

Endowment Drawbacks:

There are four typical disadvantages to endowments, but none of them is particularly compelling.

- First, the donor may not live to age 80, and the charity could have the funds sooner.
- Second, the charity's endowment could underperform, meaning it will take longer for the funds to reach full value.
- Third, the donor cannot make the same big splash because the post-contribution growth does not count in gift totals (and some charities count the face value of a life insurance gift up front).
- Fourth, the life insurance plan has likely been suggested by the donor's insurance/financial advisor, and it may be difficult not to offend the advisor by suggesting endowment as an alternative.

None of these disadvantages make the gift of life insurance a better arrangement. You simply need to discuss them with the donor to overcome them.

Life Insurance was not designed for charitable giving.

Some Life Insurance Positives:

There are, however, some considerations in favor of gifts of life insurance, and charities should tajke them into account when reviewing such gifts.

This type of product is a great idea for small charities which do not have any investment acumen and no ability to manage an endowment. It is safe and secure for them and they are sure to get the resources as donors die, provided that the single premium is based on realistic assumptions and truly guaranteed (many times they are not and the charity ends up making premium payments to keep the policies in force) or the donors really pay the ongoing premiums.

If the donor also sells insurance, it may make sense to do this, since the donor will get a commission on the policy, lowering the cost of the gift for this particular type of donor.

Finally:

Keep in mind that life insurance does have its place in charitable giving. I love the idea of wealth replacement life insurance to keep heirs whole while also supporting charities at death. Gifts of existing policies which the donor no longer needs are usually fantastic gifts.

The real objections come when the donor buys a new policy to give to charity. Try to encourage the donor to make an outright gift instead.

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