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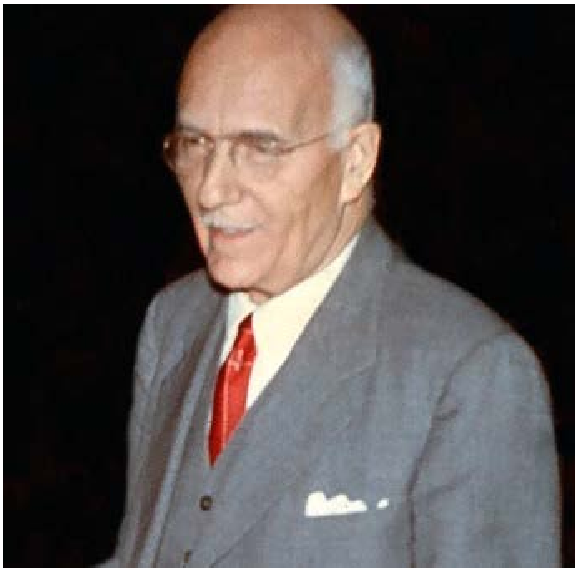
# The Actuarial Revolution in Charitable Fundraising

## Part 4 of Calculating Gifts: George A. Huggins and the Conferences on Annuities, 1927-1959

**by Ronald A. Brown**



***George Augustus Huggins***

Photo taken on December 23, 1955 provided by Michael Mudry and Molly Hill of Hay-Huggins, Inc.

> **As rates have differed, as methods of soliciting and handling the annuity business have varied . . . it has become highly important, almost imperative, that some common standards and uniform methods should be agreed upon, lest financial weaknesses develop, disaster follow and heavy reproach ensue, damaging to all parties concerned and to the interests which they represented.**
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> Preface to the first Conference on Annuities report (1927)[1]

In the long history of charitable gift planning in America, no period is more important than the 1920s. Thousands of nonprofit organizations began raising money through issuing charitable gift annuities, advertising them as "annuity bonds."[2] Gifts poured in; current expenses were low; and wishful thinking minimized the risks of financial obligations.

With the eyes of an experienced actuary, George A. Huggins saw that America's non-profit organizations were on the path to fiscal doom. Leaders did not understand the investment returns needed to meet their payment commitments. Some had not set aside a reserve fund, but paid annuities from current operations. Most were not paying attention to the length of annuitants' lives; their annuity programs were too young to have much experience of mortality.

The most popular method of setting payment rates for a married couple was to divide the age of the older annuitant by ten: a couple age 75 and 68 would receive an annuity rate of 7.5%.[3] And far too many charities competed with one another by raising their rates to land a gift commitment.

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[1] Preface by Alfred Williams Anthony, **Annuity Agreements of Charitable Organizations** (NY: Abbott Press & Mortimer-Walling, 1927), Wise Public Giving Series no. 18.
[2] See **Calculating Gifts, Part 3: An Annuity Campaign Catches Fire** at http://giftplanninghistory.org
[3] "Perhaps the greatest difficulty has arisen in the case of two-life rates, for if one has been accustomed to consider that the continuance of the annuity to a second beneficiary is not a matter of great importance, it becomes difficult to get used to the fact that it may involve a material

Huggins knew that unless there was an intervention, people would be sorely disappointed with the amount of financial support left over for charitable purposes by annuities. He could not have foreseen three national shocks that might have wiped gift annuity programs off the map:

1. A Great Depression struck the industrialized world in the fall of 1929 and continued for a dozen years, decimating the U.S. stock market and vaporizing millions of jobs.

2. The yield on fixed income investments, which made up virtually 100% of a typical annuity reserve account, fell farther and longer from 1920 to 1946 than in any previous time in American history.[4]

3. Life expectancies in the United States improved dramatically. Year after year, new national mortality tables had to be developed. In 1931, Huggins' conference report discussed the strengths and weaknesses of <u>eight</u> different mortality tables for setting gift annuity payment rates.[5]

Huggins, Rev. George Darlington, Dr. Alfred Williams Anthony, and a remarkably small group of other volunteer leaders intervened to head off the worst

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reduction in the rate if properly calculated." Huggins, "Annuity Rates and Reserves," **Conditional Gifts Annuity Agreements** (NY: Abbott Press & Mortimer-Walling, Inc.), Wise Public Giving Series no. 31, pages 28-29.

[4] After a "false start" from 1926 to 1929, bond yields continued a long, unbroken descent. In 1920 the annualized average yield for corporate and municipal long-term bonds was 5.27%; in 1932 the average yield was 4.61%. Bond prices rose and yields fell steadily in the United States' "greatest bull bond market": by 1946 the annualized average yield was 2.45%. Sidney Homer and Richard Sylla, **A History of Interest Rates**, 4th edition (Hoboken, NJ: John Wiley & Sons, 2005), pages 346-356.

[5] "During the recent years, a great deal of study has been given to the mortality experienced among annuitant lives. The insurance companies located in the United States, Canada and Great Britain have an ever-growing number of annuitant lives under observation, as the volume of annuity business grows, and therefore, there is being built up more and more data upon which to base tables of mortality among annuitant lives, male and female." Huggins, "Uniform Maximum Rates," **Rules, Regulations and Reserves in Using Annuity Agreements**, ed. by Alfred Williams Anthony (NY: The Sub-Committee on Annuities of the Committee on Financial and Fiduciary Matters, 1931), Wise Public Giving Series no. 38, page 10.

consequences of the Depression: there are no indications of widespread defaults in gift annuity programs in the reports of the Conferences on Annuities.[6]

Huggins enabled charities issuing annuities to survive by creating a national security system based on actuarial science. He showed charities how to set responsible annuity rates, maintain adequate reserve funds, and build support for effective public policies. The Huggins system is now enshrined in Federal and state laws that protect charities as well as their annuitants.

The actuarial revolution in charitable gift planning was not limited to gift annuities. Anyone who enters a beneficiary's date of birth in a computer program to calculate the benefits of a charitable remainder trust, pooled income fund, or retained life estate is using the actuarial system introduced by George Huggins in 1927.

This two-part essay examines the presentation, development, and gradual acceptance of what Huggins called "an ideal plan of conducting the annuity business" from the first Conference on Annuities in 1927 to the tenth conference, held less than a month before Huggins died on December 23, 1959.

Measuring the value of fixed payments for the uncertain term of a person's life during times of rapid change presented quite a challenge. The tumultuous era of the Depression and New Deal, World War II and postwar recovery, and continual improvements in the longevity of gift annuitants compelled Huggins to accommodate new data, make adjustments, and expand upon his reasoning at each of the Conferences on Annuities. His presentations laid the foundations for modern philanthropic planning.[7]

By introducing ideas and methods drawn from his work with company pension plans, commercial annuities, and life insurance, Huggins elevated the

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[6] A few charities did default on their annuity obligations: "It is no secret that some religious societies and colleges defaulted in their annuity payments in the years of the depression, because they did not have adequate reserve funds." Kenneth W. Moore, "Securing Annuity Gifts," **Annuity Agreements of Charitable Organizations** (NY: Federal Council of the Churches of Christ in America, 1939), Wise Public Giving Guide no. 44, page 34.

[7] The conference reports from 1927-2012 are now available at no charge on the American Council on Gift Annuities website at http://www.acga-web.org/resources-top/surveys-reports-conference-papers-and-brochures

sophistication of charitable fund raising. The Huggins system makes it possible to use statistical norms to determine the likely costs and benefits of philanthropy, similar to the methods that donors and professional advisors use to manage businesses and personal finances. Appealing to the wisdom and critical judgment of successful men and women was an explicit goal of the Committee on Gift Annuities.[8]

Demand grew for specially trained professionals to explain how annuities work, people who could manage an annuity program that applies statistics and probabilistic reasoning to mortality experience and long-term investment performance.

The big question in 1927 was: could George Huggins persuade thousands of independent and cash-poor organizations – churches, synagogues, day care centers, hospitals and clinics, colleges, foster homes, Red Cross chapters, Salvation Army missions, and many others – to adopt a common, sustainable business model for their gift annuity programs in time to avoid a national scandal?

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[8] The Committee on Financial and Fiduciary Matters (CFFM) was the sponsor of the Sub-committee on Annuities from 1927 until the Committee on Gift Annuities became an independent organization in 1955. The founding chair of CFFM was Alfred Williams Anthony, later succeeded by George Huggins. In 1926, Anthony wrote that the overriding goal of CFFM was to provide a persuasive case for giving to charitable organizations based on the sound business practices that wise and successful donors demand in their own lives: "We are recognizing, therefore, a variety of methods, because there are a variety of circumstances in which people are placed, and we must bear in mind that men [and women] who have had judgment and perseverance and self-denial sufficient to accumulate property, and those who having inherited it have shown ability adequate to the administration and the preservation of the same, are not men [and women] who can be hoodwinked, cajoled or jollied into charitable impulses. They will think and act for themselves. But they will respond to the plans which wise people, looking even farther than they, may propose, if those plans are accompanied with a manifest indication of good sense and good purposes . . . It is our task and our conscious undertaking, thoughtfully to consider, adequately to foresee, patiently to state and repeat and graciously to urge the ways of wisdom and of generosity." Anthony, **Linking Christian Education with Financial Agencies: What Has Been Done and What It Means, A Report for 1926** (NY: Federal Council of Churches in Christ, 1927), Wise Public Giving Series no. 12, pages 12-13.

At a Conference on Financial and Fiduciary Matters held on March 22-24, 1927 Huggins urged the creation of a "strong committee" on gift annuities, and convinced the conference leaders that the new committee should "make an immediate study of rates and . . . call a conference of interested parties on this matter at the earliest possible date."[9] A small group of volunteers got to work, and on April 29, 48 representatives of international religious denominations and churches, colleges, the national YMCA and YWCA, two actuaries, a management consultant, and a trust company gathered in New York City for an emergency conference.

Huggins brought a plan to the first Conference on Annuities: he aimed to shine new light on the entire set of annuity practices.

> As a basis for the consideration of the subject of annuities, offered to donors by the various organizations, we show schedules illustrating the fundamental principles that underlie the whole subject.

His brief paper entitled "Actuarial Basis of Rates" is a turning point for American philanthropy.[10] Huggins showed American charities how to use mortality tables and the time value of money to manage unavoidable risks: the unknowable length of a particular annuitant's life and the uncertainties of investment performance.

He and other members of the Committee on Gift Annuities understood from the start that changing core practices of American philanthropy through education and voluntary acceptance of new ideas and methods would take time. Economic crises soon captured everyone's attention: the Depression compelled the entire nation to seek answers for coping with a broken economy. Interest in applying actuarial science to charitable annuities intensified: the Committee on Annuities held four conferences between 1927 and 1931. All three presenters in 1931 were actuaries.

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[9] Huggins, "Proper Handling of Annuities and Creation of Committee on Annuities," **Cooperation in Fiduciary Service: Papers Presented at a Conference on Financial and Fiduciary Matters, Hotel Chalfonte, Atlantic City, N.J., March 22-24, 1927,** edited by Alfred Williams Anthony (NY: Abbott Press & Mortimer-Walling, Inc.), Wise Public Giving Series no. 14, page 152.

[10] Huggins, "Actuarial Basis of Rates," **Annuity Agreements of Charitable Organizations**, ed. Alfred Williams Anthony (NY: Abbott Press & Mortimer-Walling, 1927), Wise Public Giving Series no. 18, page 9.

## What Did Huggins and the Committee on Gift Annuities Achieve?

Educating American charities and reforming their practices was not easy or simple, but Huggins was extremely successful. In a statement before the U.S. Commissioner of Internal Revenue in 1955, he listed what his Committee on Gift Annuities had accomplished:

> During this period, through a series of conferences and by the adoption of uniform rates we have practically eliminated competition in annuity rates between organizations issuing gift annuity agreements. We have taken the lead in establishing good practices in advertising literature; in the wording of the annuity agreements; in discretion as to what is acceptable as the consideration for gift annuities when other than cash; in the investment of the funds; in the segregation of reserves; and in the keeping of records and accounts. We have endeavored to keep abreast of supervisory and tax laws and regulations and to keep our constituency informed accordingly.[11]

Quite a list, and yet it is too modest. Huggins and fellow Committee members enabled American charitable annuity programs to avoid the worst consequences of the Depression. They provided opportunities for philanthropic planners from diverse nonprofit organizations to meet face-to-face and share best practices in a spirit of friendly collaboration. They published a series of reference materials that address virtually every aspect of a gift annuity program. They conducted systematic national research on life-income gifts, and they shaped state and Federal policies through effective lobbying.

## Major Ideas in the "Actuarial Basis of Rates"

The heart of our modern system of charitable gift planning consists of three major ideas in George Huggins' "Actuarial Basis of Rates." These will be explored in the concluding section of this essay.

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[11] Statement of George A. Huggins, Vice-Chairman, Committee on Gift Annuities to the Commissioner of Internal Revenue, dated November 1, 1955. Copy located in the archives of the ACGA.

**1. A target for the charitable residuum.**

Huggins demonstrated that charities were looking at annuity payment rates "from the wrong angle":

> That is, rather from the standpoint of what we would like to give or the least amount that can reasonably be given, and yet obtain subscriptions [gifts] . . . We ought to approach it from the other angle, namely – what residuum on the average do we desire to have ultimately released from the original gift – 65%, 70%, 75% or 80% or whatever it may be. We ought to know either what average residuum our rates will produce, but better still the rates that can be allowed in order to produce the desired average residuum.[12]

Gift annuities are gifts, not investments. How much of the original amount will be left over to change and save lives? At a minimum, charities need to know what residuum their payment rates are producing. Ideally they should choose specific rates in order to hit a specific residuum target.

Focusing on the residuum shifts attention from high payments and competition over rates, to the spirit of philanthropy. When charities agree to set rates with a common residuum target in mind, people will support the mission they care about most. The annuity payment rate tables developed by Huggins in 1927 were set by a charitable objective, not by the investment market.

Huggins' original residuum target was 70%, which he described as "reasonable in its returns, both to the donors and the organizations, and at the same time consistent with the objects of the annuity gifts."[13] The severe business recession and improvements in longevity compelled Huggins to recommend lowering the residuum target to 50% in 1946. That dramatic change was adopted by the Committee on Gift Annuities in 1955. ACGA continues to use a 50% target today.

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[12] Huggins, "Proper Handling of Annuities and Creation of Committee on Annuities," **Cooperation in Fiduciary Service**, page 98.
[13] "Actuarial Basis of Rates," **Annuity Agreements of Charitable Organizations**, page 9.

## 2. The uses of mortality experience.

Steady improvements in American longevity from 1900-1950 created challenges for rate-setting and reserve fund valuation for life insurance companies and pension fund managers as well as charities issuing gift annuities.

In this age of Big Data it may be surprising to learn that the first mortality table for American annuitants was not created until 1899. Huggins devoted quite a lot of attention to a series of new mortality tables, describing their history and biases, and selecting the ones most useful in setting the rates and conducting actuarial audits of the reserve funds for charitable gift annuities.

There was very little research on charitable annuitant mortality data until surveys were conducted by the Committee on Gift Annuities in the 1930s. At the 10th Conference on Annuities in December, 1959 (his last conference), Huggins reported the results of the largest charitable annuitant mortality study yet conducted.[14]

## 3. The challenge of predicting long-term investment performance.

Huggins and fellow members of the Committee on Gift Annuities taught charities that setting responsible annuity payment rates and maintaining adequately funded annuity reserve accounts depend on having reasonably accurate assumptions about future investment returns. He provided hard lessons in measuring the time value of money: a charity that provides high annuity payments is betting its reputation and perhaps its survival on the likelihood of above-average investment returns throughout the lives of its annuitants.

[14] A dynamic, generational 2012 Individual Annuity Reserving table has been adopted by several states for commercial and charitable annuities issued after January 1, 2015. This is the first annuitant mortality table intended to incorporate annual improvements in mortality experience, thus alleviating the need to create new mortality tables. The ACGA Rates Committee continues Huggins' practice of fitting standard annuitant mortality tables to the actual experience of charitable annuitant lives as determined by national surveys.

Developing adequate investment assumptions during economic cataclysms was extremely challenging, and exceptionally important.  Conference speakers did not predict the stock market crash, the Depression, and the long, slow decline in yields on fixed-income investments.  Even the experts were surprised that the Federal government succeeded in keeping yields low through the end of World War II. Good times returned with the re-privatization of investment markets and a “great bear market” in bonds (lower prices, higher yields) from 1947-1959.

The job of analyzing conditions affecting future returns and suggesting model investment portfolios for the benefit of annuity conference participants was filled by a succession of well-qualified economists, bankers, and business professors.  In the end, it was up to George Huggins to recommend interest rate assumptions for use in his payment rate calculations.

Conference participants debated Huggins’ proposed investment assumptions and recommended payment rates with vigor.  With some notable exceptions, they followed his lead.

The next, concluding part of this essay explores in depth the three main ideas in “Actuarial Basis of Rates” and their development over the 32 years of Huggins’ service as America’s consulting actuary for charitable gift annuity programs.