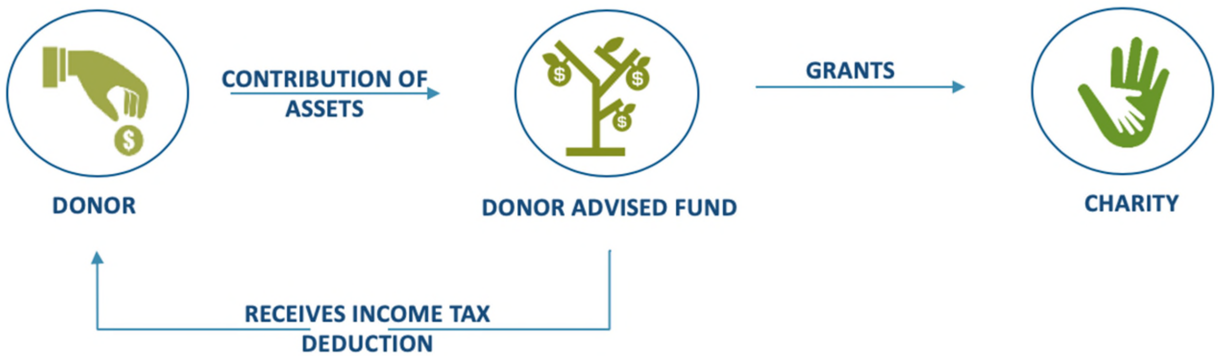
Making Donor Advised Funds a Win for Your Organization

When we asked Google, "What is a donor advised fund", we were told that about 14,400,000 results were found in 0.44 seconds. That is a lot to sort through so to make it more practical, we thought we would simply say that a Donor Advised Fund (or DAF, for short) is an account a donor/investor establishes with a qualified charity's program that permits the donor the right to make certain non-binding recommendations to the charity with respect to the account's administration.



Let's break that down.

"A donor/investor…" We use "donor" and "investor" interchangeably here because, generally speaking, most people today establish DAFs with their *financial advisor*, rather than a gift officer employed by a charity. The financial advisor may attempt to make the concept of a DAF simpler by explaining that a DAF is like a "charitable savings account." It is a special account with certain tax benefits that enables an investor to be more intentional and strategic about his/her/their giving.

Financial Advisor: "Mr. Investor, I know from years of working with you that you are charitably inclined. How do you go about deciding how much to give and to which charities each year? What if we could establish a sort of 'charitable savings account' for you where your money would stay actively invested in the market until you decide when, and to whom, to give it? This way you can have your charitable deduction now, but decide who to support when you are ready."

"…establishes a DAF with a qualified charity…" What you—and your donor—may not know is that a DAF is, in and of itself, an asset owned by a 501(c)(3) organization. Many *investors* do not realize that they automatically become *donors* to the qualified charity sponsoring the DAF program as soon as they establish and fund their DAF account.

"…that permits the donor the right to make certain non-binding recommendations to the charity with respect to the account's administration." The Donor Advised Fund itself—that is, the Donor Advised Fund's sponsoring charitable organization—has *full control* over where (to which organizations) grants can be made, and the donor simply has the right to make *recommendations* as to the disbursement of the funds. Once a donor establishes a DAF account, that money is technically no longer his/hers/theirs. Those funds are now the property of said Donor Advised Fund.

Generally speaking, *most* Donor Advised Funds will approve a grant request to any domestic qualifying 501(c)(3) organization, and some may even approve grants to foreign and for-profit entities on a case-by-case basis, as stated in a document that outlines the DAF's particular policies and procedures (a "donor circular"). All grant recommendations are reviewed by the charity sponsoring the Donor Advised Fund program. Some will have the charity's entire Board of Directors review the grant recommendations, while others might have a smaller committee of its Board.

DAF Benefits for a Donor

While the history of DAFs in the United States dates back to 1931, little thought or emphasis was given to these charitable vehicles by either the financial advisory or philanthropic community until the last couple of decades.

Before we dive into the DAF benefits for a donor, it is important to understand what began driving significant money into DAFs to begin with. In reality, it was the shift in the wealth management industry from transactional business to "managed money" that began to make the DAF so appealing for promotion by custodial firms. And what do charitable organizations do? We follow the money.

In the 1990s financial services organizations began to place emphasis on "wealth management" and "managed money" versus traditional transactional business. What does that mean? Think back to movies like Wall Street or Boiler Room. Brokers/advisors traditionally sold stock (and other investment vehicles) to their clients in exchange for a commission. That commission first and foremost pays the firm and the broker/advisor receives their compensation in the form of a percentage of that payout. Some might say that investment firms were reliant on their advisors to generate millions of transactions each and every year to continue to grow. While there is certainly nothing wrong with transactional business and it has its place, regulatory bodies became increasingly concerned about the overall suitability, or appropriateness, of certain investments for certain investors. Anyone remember the 2013 movie, The Wolf of Wall Street? To combat many abuses, both real and perceived, a variety of laws and regulations were enacted with the goal of protecting investors from unscrupulous firms and financial advisors. Thus, the concept of managed money, or fee-based business was born.

Presumably you have seen commercials for Fisher Investments, with their tagline: "Our fees are structured so that we do better when our clients do better." This is the way managed money works at many financial institutions, not just at Fisher Investments. Instead of charging a single commission on a trade, with a managed account clients pay a percentage fee based on the amount of assets in an account. When the account value rises, the firm (and the advisor) makes more. When the account value declines, the firm makes less.

What does this have to with Donor Advised Funds? Imagine you are the CEO of an investment firm. Your company manages a portfolio of $1MM for a client and you charge him/her/them 2% to manage his/her/their account. Now imagine that every year, your client gives away (donates) $50k to his/her/their charities of choice. What happens to your overall revenue as the account value decreases as money flows out to charity? What happens to the total assets under management of the firm? ***What if you could help your client give that money away, but still retain it as part of the assets your firm manages for some additional period of time?***

In 1991, Fidelity Investments founded a new charity, Fidelity Charitable, which started a DAF sponsor program. Fidelity Investments was then hired by the independent Board of Fidelity Charitable to manage the investment of the donated funds. At a time when technology companies were beginning to take off and many new millionaires were being created seemingly overnight, Fidelity Investments was in a strong position to capitalize on the strength of its marketing ability and diverse distribution channels to promote Fidelity Charitable to its investment customers. Not to be outdone, Vanguard and Schwab followed suit in 1997 and 1999, respectively, to create new charities that sponsored DAF programs. These events, and others, accelerated the growth and popularity of the DAF as a formidable charitable vehicle. This development also allowed Fidelity Investments, Vanguard, Schwab (and others) to *retain assets* at their firms through their relationships with the DAF sponsoring organizations for a longer period of time. Additionally, because many DAF programs affiliated with commercial firms require donors to be clients of the firm in order to qualify to open a DAF account, advisors are also able to grow their relationship with their clients in new directions. In addition to retaining client assets and expanding a revenue stream, establishing charitable divisions within their organizations also allowed financial organizations to play a greater role in their communities and to give back in a meaningful way. Now all they had to do was educate advisors on why their clients should establish a DAF.

NOW we're ready to talk about the benefits of the DAF to the donor. Let's go back to the conversation the financial advisor began having with her client on page 1.

Targeted Philanthropy Over Time:

"Mr. Investor, after speaking with your CPA, you were advised to make a sizeable charitable donation this year to offset the tax obligation from the sale of your business. I know philanthropy is important to you and your family, but the amount your CPA is recommending you donate is 5 times what you usually donate to charity. What if we did some planning where you donate your usual annual gift and place the remainder of the recommended amount in a sort of 'charitable savings account' where the money stays invested and has the potential to grow over time. You still receive the charitable deduction you need for tax purposes this year, and *you can take your time to be thoughtful and intentional about your giving in the future."*

Legacy Planning:

"Mr. Investor, the beautiful thing about a donor advised fund as opposed to a foundation is that you are the advisor of the account (like a trustee) and you get to choose a successor advisor (or advisors). Then every successor advisor thereafter has the right to choose his/her/their own successor advisor. Imagine, the funds with which you seed this account today have the potential to benefit the charities you care about for generations to come."

Growth Potential:

"Mr. Investor, think of the impact you could have on the charities about which you care most after years of growth in the market. Rather than donating everything this year, why not establish a DAF account, take the charitable tax deduction this year, and give your hard earned funds a chance to grow to something that will be truly impactful in the future?"

No Annual Required Distribution:

"Mr. Investor, unlike private foundations, which are required to distribute 5% of their assets each year to charitable organizations, there is no legal distribution requirement from a DAF account. The sponsoring charities, however, have policies that encourage donors to make grant recommendations, but donors can set his/her/their own timetable subject to those policies."

No Ongoing Compliance for Donor:

"Mr. Investor, DAFs are also low maintenance. Unlike their foundation counterparts, there are no annual filings to make every year. The sponsoring charity does all of the work for you."

Anonymity or Recognition:

"Mr. Investor, you can typically name you DAF account however you want (i.e. The Donor Family Foundation), as well as provide as much or as little information to the recipients of their grant recommendations from the DAF you. This allows you and your family, who value privacy, to remain completely anonymous. To the extent you would like recognition or to cultivate ongoing relationships with the organizations you patronize through grant recommendations, you have the option of doing so."

Why are Nonprofits thinking about DAFs and what are the criticisms?

We have now established why many investment firms might think about DAFs. Not only are community involvement and philanthropy core values of many financial institutions, but DAFs allow companies to retain a greater share of assets than traditional philanthropy models.

What about non-profits? Why are they thinking about DAFs? Again, follow the money. While total giving in the US has increased by 85% over the last decade and half, DAFs have seen a growth rate of more than twice that amount—190% in the last ten years alone. This is money that, presumably, would have gone to form new private foundations, further fund existing foundations or been given directly to charities that is now being held with investment firms, without a legal requirement for distribution.

For non-profits, the DAF presents one more layer between the donor and the gift. When donors start building long-term strategies around their giving with their financial advisors, they are often making donations to a parent charity (the DAF sponsor) that manages all contributions into the their account and receiving reporting (statements) back as to how that account is doing—similar to a retirement savings or brokerage account.

Only upon the recommendation of the donor will the parent charity (DAF) initiate a grant to a charity. It may feel a little like charitable donations are being held hostage by DAFs!

In addition, unlike a foundation, Donor Advised Funds do not have to disclose to which charities they make grants and, more importantly, ***they do not disclose who their donors are***. With little transparency, it is impossible to research DAFs who support specific causes. Furthermore, DAFs generally do not accept grant applications.

Finally, according to the 2020 Giving USA report, foundation giving accounted for approximately 17% of giving in the U.S. in 2019. What you do not see reflected in that number is that about half of that 17% represent grants made from Donor Advised Funds—the non-transparent pooled funds to which a charity cannot submit an application for support.

As a charity, you might be thinking, "This sounds terrible. It's hard enough to raise money without adding in this additional layer," and be inclined to blame the financial services industry for stealing your next gift and begin search for a new line of work. It is worth mentioning that private grant-making foundations could also suffer from some of the same criticisms, as the mandated 5% payout is not a particularly large requirement, especially for extremely well-funded foundations. Foundations that take advantage of program related investment opportunities might not distribute any grants at all.

So again, why do non-profits care about Donor Advised Funds? Because that is where the money is, and increasingly where the money is going.

Beyond the encouragement donors receive from their financial advisors, each year many private foundations are dissolving and moving to DAFs. Why? By and large the next generation has little interest in managing mom and dad's foundation and dealing with all the associated logistics and requirements, such as holding quarterly board meetings, being legally obligated to distribute funds, complying with annual tax filings and paying excise taxes. Further, since children, more often than not, do not value the same things the founders once did, maintaining a private foundation leaves little to be excited about.

The simplest solution is to convert a foundation to a DAF. When the original donor/advisor dies, he/she/they have the option of either a) naming a successor advisor(s) or b) simply dissolving the account by making grant recommendations totaling 100% of the DAF's balance to a single, or multiple, charitable organizations. It is clean, it is efficient, and you do not need an entire board, let alone a lawyer or accountant, to agree upon it.

Like it or not, DAFs are not only here to stay, they will play an increasingly larger role in philanthropy in the decades to come.

Are the Criticisms Real? Are they Justified?

There can be no argument that the criticisms are real. Looking through one lens DAFs present an obstacle to traditional, direct forms of fundraising. But are all the criticisms justified?

In 2019, approximately 70% of all giving in the U.S. came from individuals during their "living" years. 9.5% came from bequests. Guess what? Bequests are made by individuals. And we already established that 17% came from foundations, but that approximately half of foundations are actually DAFs which are mostly advised by…you guessed it! Individuals. When you look at the larger picture, you see that a whopping 88% of gifts made in the United States last year were made by individuals.

Are the criticisms leveled against DAFs justified? It depends on your perspective. If your perspective is focused on what the non-profit organization needs, then perhaps. But if your view is that it's all about *the donor*, then the flexibility, growth potential, planning structure, and overall creative benefits a DAF offers a donor outweigh the perceived challenges DAFs seemingly present to non-profits, especially once non-profits shift their perspective to embrace the ways in which DAFs can open or enhance development opportunities.

The Benefits of a DAF for Non-Profits

Donor Advised Funds offer gift officers another quiver in their arrow, so to speak, to not only engage the donor, but to learn more about him/her/them.

In all our years working with donors, one truth has become evident: By and large, many gift officers do not ask enough questions. Whether they are new to the profession and afraid of what they do not yet know, or they have been in the profession for many years and are accustomed to doing things a certain way, it is the questions we ask that define the donor/gift officer relationship and ultimate charitable gift.

Engagement, Cultivation, and Stewardship:

Upon receiving a grant from a donor's DAF, here a few questions you can ask that will help you learn more about your donor:

Question	Motivation/Learning Potential
Jean, we just received your incredibly generous gift from ABC foundation and cannot thank you enough. I didn't realize you had a foundation/DAF in place. That's wonderful! I'd love to learn more about what prompted you to set that up.	Who is advising Jean on her philanthropy? Her financial advisor? Her children? Is this part of a larger, wealth management solution? Is it part of her legacy planning?
How do you go about deciding how much to put into your DAF each year?	Is this something she actively maintains, or was it something she just set up one year as part of a tax strategy? Is she using it to its fullest potential?
How do you decide who to give to from your DAF each year?	This is an easy way to ask if Jean makes her own charitable decisions, or if she seeks the advice of others (children, friends, spouse, trusted advisor). You'll likely also find out how Jean prefers to learn about charities—mail, email, Facebook, YouTube, TV, etc.
Do you still make charitable gifts from assets other than your DAF?	Has Jean made a bequest? Is she a sustaining giver somewhere? Does she only make major gifts out of her DAF? What does "major gift" mean to her?

Question	Motivation/Learning Potential
What kinds of assets have you donated to your DAF? Did you know you can also donate appreciated securities to a DAF? Have you ever done this? Why or why not?	Many people do not know (and in fact, many financial advisors do not educate their clients) that they can make gifts of appreciated securities to DAFs. This is valuable information for a donor. In addition, your donor may open up about what other assets they have.
What other charities do you support through your DAF?	Don't fool yourself—your donor IS supporting other charities. Do not ignore that. How can you help your donor better support all the charities they care about? This will only benefit *your* charity in the long run.
How has having a DAF made giving easier for you?	This gives you a sense about how intentional your donor is about giving. Are they a planner?
Should something happen to you, have you designated one or more family members to become a successor advisor on your DAF? Have you considered using the remaining funds to endow program X?	This opens the door to understanding your donor's long-term thinking. Who else in the donor's life is important? How can we pivot to other planned gifts?

You likely will not ask all of these questions every time, but do you see how you can use the DAF's existence to learn more about the donor? What other questions might you ask your donor or donor prospect?

<u>Donor Centric Programming and Endowment Support</u>

Due to the special tax treatment of DAFs, they can offer a planning tool unlike any other. Below are two examples of how the use of a DAF can benefit a donor in his/her/their overall financial planning strategy, and how a savvy development professional can secure support through a DAF structure:

Advancing a Bequest:

- **Situation**: Jasmine is single, no children, in her 50's, and owns her own business. She is not overly charitably inclined, but she is a mid-level donor to her alma mater. In meeting with Jasmine, you discover she had an exceptional year with her business this year and it's going to hit her hard from a tax perspective. Her CPA is advising that she give away more this year than she usually does, but it's not overly exciting to her. She's also thought about making a bequest to her alma mater, but only being 50 with no heirs, estate planning is not at the top of her priority list.

- **Solution**: The tax incentives estate planning can offer do little to excite Jasmine. She will be gone and without heirs, there is not a lot of motivation to invest in the estate planning process. However, with just a few simple forms and no trip (or fees) to see a lawyer, Jasmine can:
    - Establish a DAF account;
    - Experience the tax-deduction incentive she is seeking this year; and
    - Name her alma mater as the sole beneficiary of her DAF account

  What's more, every time Jasmine has a big year, she now has an easy place to make a quick transfer for tax planning purposes. Each year, her alma mater can further engage Jasmine on bigger projects that might capture her excitement and longer term support. With the investment opportunities for growth, she may end up leaving an even larger bequest to her alma mater. Finally, should her alma mater engage in a project she gets excited about in the future, she has the funds set aside to make a significant impact gift, rather than her customary mid-level gift.

Re-Inheriting his Heirs:

- **Situation:** John has been saving for retirement his whole life and is also charitably inclined. In fact, more than half of his investable assets are in a pre-tax (traditional) IRA. John has 4 children and he planned to leave that IRA in equal parts to his kids upon his death, knowing they would be able to "stretch" their distributions out over their lifetimes and still have a meaningful sum for their own retirement. However, with the passing of the SECURE Act in January 2020, all 4 of John's children will now have to liquidate the inherited IRA within 10 years of receiving it, causing a major taxable event to them—the exact thing he was trying to avoid.
- **Solution:** John can convert (all or part) of his traditional IRA to a Roth IRA and, unless John knows precisely how and what he wishes to support, he can make a donation to a DAF program from an after-tax account (cash or securities) in roughly the same dollar amount as the conversion.
    - The tax deduction generated by the donation to the DAF will offset the tax obligation on the conversion (as always, John should consult with his CPA);

- His 4 children can now stretch their inherited Roth IRAs throughout their lifetime and avoid a major tax event; and
- John has also created a legacy giving opportunity for his children

When looking through the lens of the donor, a DAF offers opportunities to accomplish myriad goals that traditional giving simply does not. Understanding the reasons donors find DAFs attractive can equip a development professional to work with a donor's preferences while still emphasizing donor stewardship and benefitting his or her organization.

What are the Options?

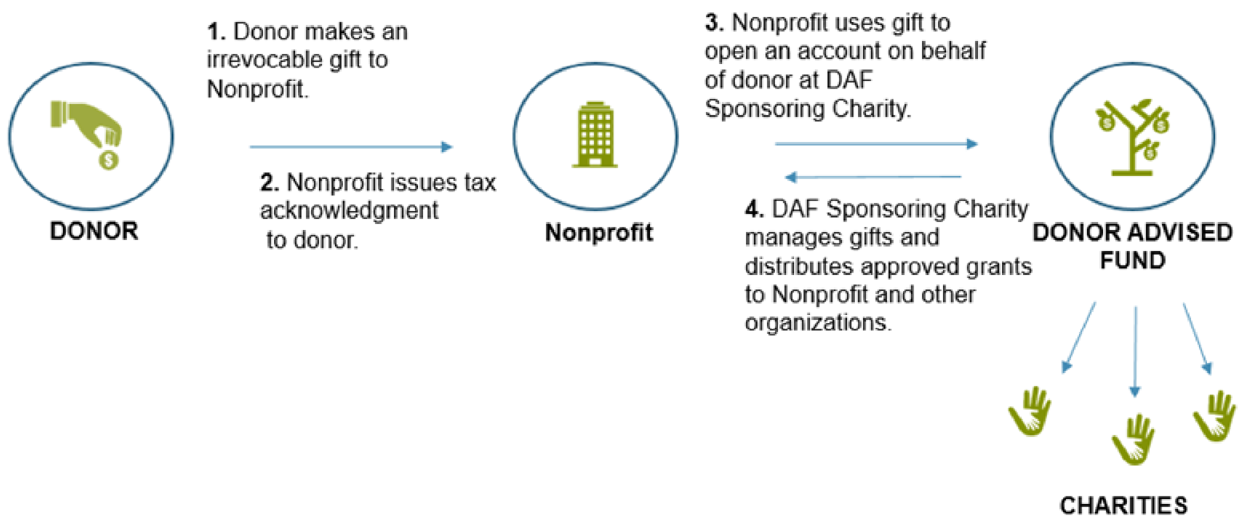
Existing Programs

If you work for a large organization, you may already have a DAF program established that you can leverage for a more donor-centric approach to fundraising. If you work with a smaller organization, get to know some of the community foundations sponsoring DAF programs in your area or get familiar with Fidelity and Vanguard. Being able to speak confidently to your donor about the benefits of a DAF in charitable planning and being able to offer them some resources when it comes to setting up a DAF will only benefit you in the long run.

When you stop to think about it, most people have a financial advisor to advise them on financial matters; they may have an insurance specialist to advise them on insurance; they have a CPA to advise them on taxes; and they have a lawyer to advise them on legal issues. Who is advising them on their philanthropy? Why can't that person be you?

White Label DAF Programs

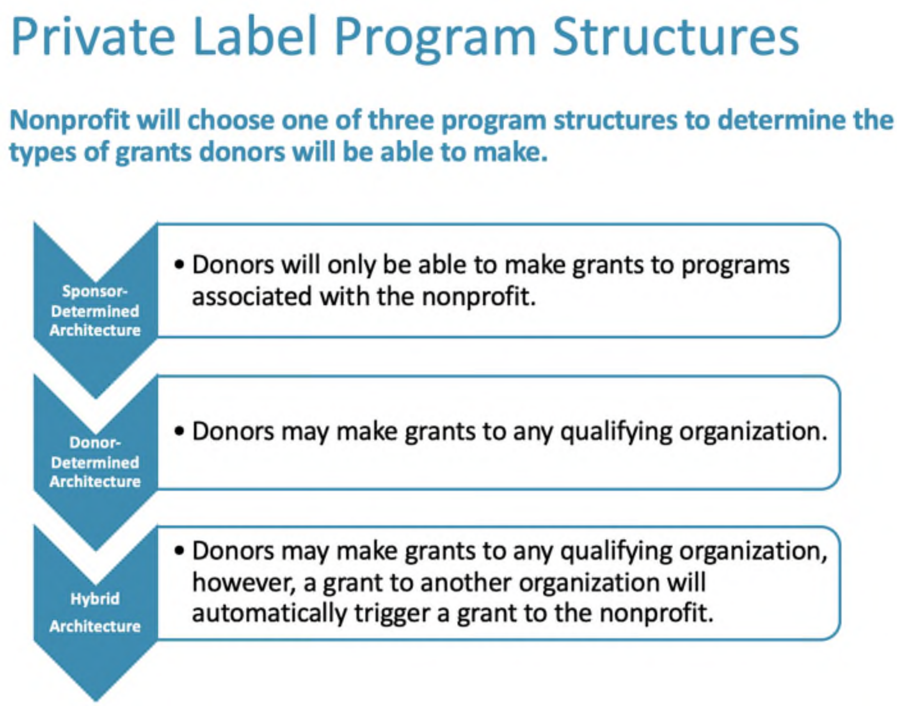
If your organization does not already have a DAF of its own, start your own program. A "White Label" program can be a cost-effective way to launch a DAF within your own organization. Your organization's name and branding are on the face of the DAF, but the administration and regulatory aspects are left to the experts.



Your donors already know and trust you. To a donor, establishing a DAF with a trusted charity is no different than establishing an endowment, except that 1) the donor has a say about how the assets are invested; 2) the assets have the potential to grow over time, giving a greater chance for impact; 3) the donor has greater control as he/she/they will ultimately request a grant for a specific purpose at a time that feels right to him/her/them.

For the non-profit, they now have a pool of assets they *know* they can count on for future use. Imagine—knowing with a degree of certainty what may be coming your way in the next 5-10-20 years!

When you establish your own DAF at your non-profit, you decide how best to structure the program in order to serve your donors and your organization's needs. What type of architecture will be the most donor-centric for you?



The Nature Conservancy, for example, has a large and robust DAF program that only allows donors to make grants back to The Nature Conservancy, though donors can choose the various programs and initiatives to support. In this way, the sponsor-determined architecture is creating a pooled endowment to benefit the organization long term while offering tax incentives to benefit donors today. This gives their donors a greater sense of control and ownership over their giving, while also increasing donor stewardship opportunities.

On the flip side, Mercy Home for Boys & Girls has a DAF program that allows donors to make grants to *any* qualifying 501(c)(3) organization through its donor-determined architecture. Their staff turnover is so low that donors develop deep, trusted relationships with their gift officers. As such, by allowing and encouraging charitable giving wherever the donor desires, gift officers can better serve their donors by helping them maximize their giving potential by taking into account *all* of a client's assets and goals, which also strengthens the donor's relationship with the organization.

Concluding Thoughts

It is not uncommon to hear charities and gift officers complain about Donor Advised Funds. In fact, the non-profit industry is leading the charge to establish required distribution laws for DAFs, meaning that donors would be *legally forced* to provide grant recommendations to charities that sponsor DAF programs in order to ensure that they give away a percentage of the DAF assets each year or else the charity itself would make that decision for the donor.

Here is what we know: giving is not decreasing. In fact, adjusted for inflation, total giving in 2019 reached the second highest level on record, just slightly below the all-time dollar amount achieved in 2017. *(https://givingusa.org/giving-usa-2020-charitable-giving-showed-solid-growth-climbing-to-449-64-billion-in-2019-one-of-the-highest-years-for-giving-on-record/)*

Of the $449.64 billion given to U.S. charities last year (88% of which was given by individuals), only 12% of that was given to foundations/DAFs. While the DAF has become the scapegoat for many non-profits and gift officers as to why their funding has dropped, the numbers tell a different story.

DAFs are not a hindrance to fundraising. In fact, they are just another account from which charities can receive a donation. It is our job, as an industry, to inspire the donors to give.

Fundraising is simple. It is not easy, but it is simple. Effective fundraisers establish caring relationships with people (individuals), learn what is important to them, and to find ways to help them accomplish their goals for their family, themselves, and the charities and causes for which they care deeply. The DAF is a donor-centric tool that, properly used, can *help a donor* accomplish multiple goals, create an impact gift for multiple charities, all with a few simple forms and no legal work involved. Simplicity. That is the power of the Donor Advised Fund.