AFP Association of Fundraising Professionals

Advancing PHILANTHROPY

SUMMER 2015

Rethinking Philanthropy

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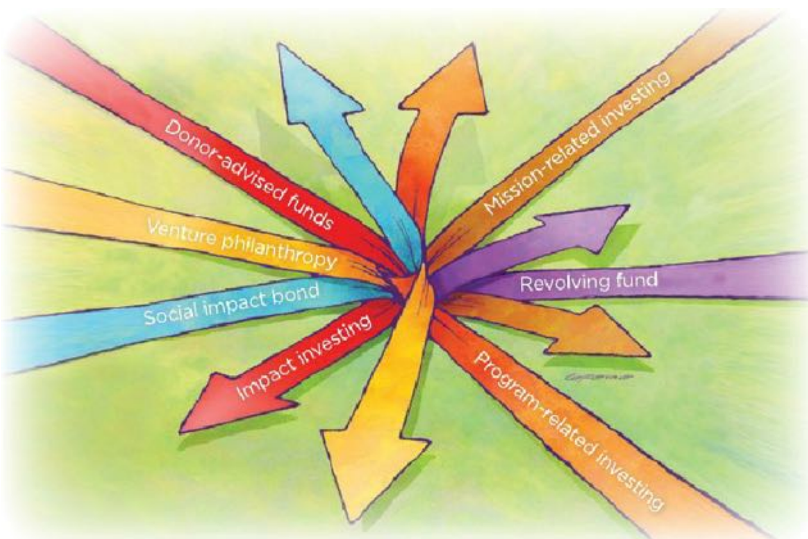

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These are days of innovation in social problem solving. A playing field that used to be dominated by traditional public charities funded by selfless gifts of largess working quietly has changed. There seem to be as many bankers as social workers on the playing field. Do you understand that field and the rules?

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Deciphering DAFs

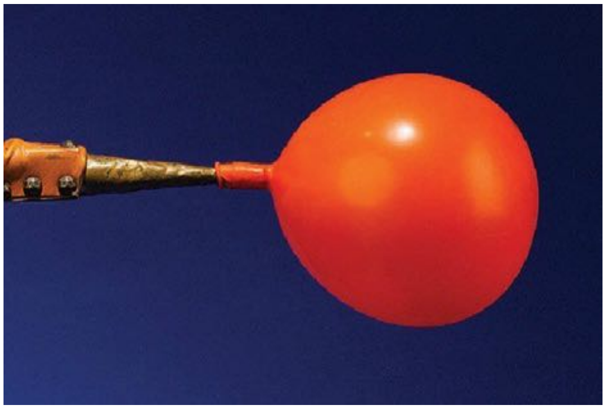
How the simplicity of donor-advised funds may be creating complex issues for fundraising professionals

By Paul Lagasse

"Donor-advised funds [DAFs] are changing the face of giving, and we can't underestimate their impact," says Michael Moody, Ph.D., the Frey Foundation Chair for Family Philanthropy at the Dorothy A. Johnson Center for Philanthropy at Grand Valley State University (**www.johnsoncenter.org**) in Grand Rapids, Mich., and co-author of *Next Gen Donors: Respecting Legacy, Revolutionizing Philanthropy,* a research project on giving trends among young donors undertaken by the Johnson Center and 21/64 (**www.2164.net**). "I think Mark Zuckerberg is ahead of the curve."

Moody is referring to Facebook co-founder Mark Zuckerberg's two gifts of stock valued at $1.5 billion to

JEFFREY COOLIDGE/GETTY IMAGES



Like their parents, Generation X and Millennial donors are values-driven, but they are also deeply interested in strategies that are hands-on, innovative and the result of due diligence.

the Silicon Valley Community Foundation (SVCF) in 2012 and 2013. In many ways, the billionaire was acting like a typical member of his generation. Many affluent Generation Xers and Millennials use DAFs, such as those managed by SVCF, to administer their philanthropic giving. And because younger donors stand to inherit an estimated $59 trillion in wealth from their parents, the way they choose to manage their giving will have an enormous impact on philanthropy—and fundraising professionals.

DAFs and Younger Philanthropists

Donor-advised funds are charitable accounts established by donors and managed by public foundations, such as a community foundation or a foundation set up by a commercial brokerage. When a donor contributes money, stock or other liquid assets into a DAF, the foundation takes ownership of the deposits and invests them. The assets in a DAF can be used only for charitable purposes, and a donor recommends/advises their disbursement to nonprofit organizations of his or her choosing. In turn, the foundation provides value-added services such as due diligence on recipient charities and investment advice and allows the donor to claim a full charitable tax deduction upon deposit of assets into the fund. Unlike private foundations, public foundations in the United States are not legally required to distribute a minimum portion of their assets every year.

Donors may choose to set up advised funds for any number of reasons. Malcolm D. Burrows, the head of philanthropic advisory services at Scotia Private Client Group in Toronto (**www.scotiaprivateclientgroup.com**), has identified four.

1. **Convenience.** Public foundations handle day-to-day administrative and management burdens, freeing up donors to focus on other things.
2. **Tax benefit.** By turning over control of deposited assets to a foundation, donors can take the charitable tax deduction right away and make disbursement decisions later.
3. **Support for causes, not charities.** Donors who support causes, such as land conservation or inner-city education, can use advised funds to take a long-term view with their giving.
4. **Flexibility.** If a donor's charitable interests change, the fund can be used to support more, fewer or entirely different organizations right away.

Another selling point of DAFs is their low initial contribution, explains Jo-Anne Ryan, vice president of philanthropic advisory services at TD Waterhouse Canada Inc. in Toronto and executive director of its Private Giving Foundation (**www.tdwaterhouse.ca/privategiving**). This is particularly appealing to young, early-career professionals who are looking for ways to engage in philanthropic activities with their own growing wealth.

Ryan points out that the wealth of two-thirds of her foundation's clients is self-made, whereas just a decade ago, the majority of the wealth had been inherited. Furthermore, savvy young donors are more familiar with how finances work and are comfortable using investment vehicles. "They want to be more hands-on, and they want to engage more in their giving," Ryan explains of a typical advised-fund user. "The more options they have, the wider the net is, and ultimately, that's going to represent more money going to charity."

Like their parents, Generation X and Millennial donors are values-driven, but they are also deeply interested in strategies that are hands-on, innovative and the result of due diligence. "If donor-advised funds make it easier to be a donor now, and without the administrative requirements of a foundation, then I can see how they would appeal to that kind of mindset," Moody says.

Jeffrey M. Gorris, a partner at the Wilmington, Del., law firm of Friedlander & Gorris, P.A. (**www.friedlandergorris.com**)—and a Millennial—uses a DAF to manage his philanthropic activities. He says that DAFs offer several advantages for early-career professionals like him. Because of their lower financial thresholds and ease of use, DAFs appeal to young donors who want to support their favorite charities but for whom traditional foundations are not a feasible option. The low threshold allowed Gorris to establish the fund and start giving in meaningful amounts earlier than if he had had to wait to set up a foundation. Another advantage of the fund is that it helps even out his giving over time. "In certain years, the tax deduction may be worth more to me as my income fluctuates," he explains. "If I'm going to contribute to a charity, I'd rather not have the gift fluctuate up and down, too."

Gorris says that his donor-advised fund suits his giving preferences, which may differ from those of others, and he considers that another advantage. "I think it makes me more willing to give to a charity that I like," he says.

At the same time, DAFs are also increasingly popular with older donors.

Simplifying Giving

Neil and Elizabeth ("Betsey") Cullen understand the financial needs of nonprofits. Both are retired from positions at an independent coeducational high school, where Betsey was the leadership gift officer and Neil served as CFO. Around the time they retired, the Cullens decided to set up a donor-advised fund with Vanguard Charitable as a way to streamline the process of managing their charitable giving. "Instead of having to sit down with 20 envelopes every December, now we have a single fund that takes care of all the administration," Betsey explains.

The Cullens chose to set up an advised fund with a public foundation for a variety of practical reasons. "We don't have the name recognition to set up a foundation," Betsey says. "Also, you need a sufficient corpus in order to make that a wise move." By handling the legal and administrative burdens, the fund approach saves both of them a lot of time.

"It's no different from having a savings account," Neil adds. "We do some modest giving outside of the fund when a last-minute thing comes up, but normally, if the gift is going to be at least $500 [the minimum donation allowed by Vanguard], we give through the fund."

The Cullens also have used their fund to instill the value of philanthropy in their children and grandchildren. "It offers a way to steward the funds so that we can pass them on to our heirs," Betsey says. "I look at it as a way to fulfill our objectives of helping organizations that are meaningful in our lives." The fund will receive a significant portion of the Cullens' estate, with 5 percent of the estate going to their children and the rest to be distributed to charities according to their instructions.

One problem that they have noticed when using their DAF is that some of the charities they support do not properly acknowledge the gift. Fundraisers may mistakenly assume that since foundations disburse gifts from DAFs, acknowledgments and solicitations should be sent to the foundation, not to the donor. While that may be true for many traditional community foundations, it may not be the case for funds managed by other types of public foundations. "Before you give, make sure that the charity can account for transactions directly and acknowledge the real donors," Betsey suggests.

The Cullens say they still feel close to the nonprofits they support, and the advised fund has not come between them. Nor is it threatening to make stewardship obsolete.

In practical terms, the explosive growth of DAFs means that while a lot of money is still being designated for charities, a lot less of it is being distributed to them.

"We're still making our decisions every year based on those relationships," says Betsey. "Fundraising is still a person-to-person activity, and this doesn't make those relationships less important. I'm sure we've become more philanthropic because of the ease of using this method. For us, it's been a win-win."

However, not everyone shares this view.

Tough Questions

Many are concerned about the as-yet still largely unknown impact of DAFs on the philanthropic economy, particularly their ethical and policy implications. "I think the discussion about donor-advised funds, like the discussion of overhead, is long overdue," says Karla A. Williams, M.A., ACFRE, principal of The Williams Group in Charlotte, N.C. While there may not be an economic argument against saving money instead of spending it, Williams believes there are other, more compelling arguments against doing so. "Given the historically low patterns of charitable distribution in this country, we need to look at the charitable distribution of donor-advised funds," she says. "If the money is not being distributed, is it or is it not a charitable act?" The available evidence suggests that DAFs may not, in fact, be boosting charitable giving as much as advocates have hoped.

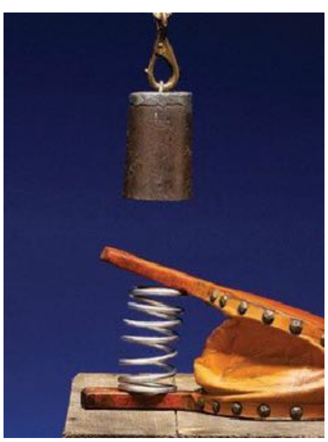
While public foundations report that the average annual disbursement of advised funds is significantly higher than the federally mandated 5 percent floor required of private foundations, this number is an aggregate of the entire corpus of donor-advised funds. According to the 2012 study *An Analysis of Charitable Giving and Donor-Advised Funds* from the Congressional Research Service, more than 70 percent of DAFs paid out less than 5 percent annually, and more than half made no payments at all. In practical terms, the explosive growth of DAFs means that while a lot of money is still being designated for charities, a lot less of it is being distributed to them.

"In a world of urgent needs, we are encouraging the saving of money, not the spending of it for charitable purposes," Williams says. The rapid rise of charitable savings accounts, she argues, is forcing the profession to confront a novel, but vital, ethical question: Do the benefits of saving money outweigh the benefits of spending it?

One way to ensure that donor-advised funds are distributed would be to set a time limit on them. When he was chair of the House Committee on Ways and Means, Michigan Representative Dave Camp proposed a five-year cap on DAFs. In his article "Avoiding Misuse of Donor-Advised Funds"(*Cleveland State Law Review,* 2010), Michael J. Hussey of Widener University argued for reforming DAFs along the lines of IRAs, requiring penalties if regular distributions are not made after a certain period and termination of the account four years after the death of the donor.

Alan Cantor, principal at Alan Cantor Consulting LLC (**www.alancantorconsulting.com**) in Concord, N.H., is an advocate of the required payout approach. "Donor-advised funds serve a purpose, but ultimately, the money has to go out the door to fulfill that purpose," he says. "I don't think the money should be kept in perpetuity. I believe in investing in people and mission now."

Cantor also argues that savings vehicles such as DAFs, endowments and private foundations are being oversold to donors at the expense of the nonprofits they are designed to support. He argues that, ultimately, the issue is one of public policy, not of economics. "Investing money now lessens the need to invest even more later," he says.



Fundraisers, advocates say, should treat donor-advised funds as simply another means of directing charitable gifts to nonprots, no different from monthly and annual giving, online donations, bequests, family foundations or major gifts.

He encourages fundraisers to see DAFs as a way for donors to find more ways to get involved with the causes and charities they support, not to set up intermediaries between them.

In addition, Cantor is calling for greater transparency and accountability in public foundations with ties to commercial financial firms to ensure that the interests of the fund advisers are not at odds with the philanthropic interests of the donors or the ethical standards of the fundraising profession. For example, do the management fees that fund advisers receive violate the *AFP Code of Ethical Principles*? Without proper oversight, Cantor says, fundraisers cannot be certain that they do not.

Are such solutions feasible?

"All the proposed solutions either don't address the problem or address it badly," says Eugene Steuerle, Ph.D., an Institute Fellow and Richard B. Fisher Chair at the Urban Institute (**www.urban.org**) in Washington, D.C., and former Deputy Assistant Secretary of the Treasury for Tax Analysis. According to Steuerle, there are three key questions that must be answered before an effective solution can be determined.

- Do the objections make sense?
- Do the proposals align with the objections?
- Can the proposals be implemented reasonably and fairly?

And, where does this leave fundraising professionals?

Make the Case to Donors Who Use Advised Funds

Proponents of donor-advised funds, especially commercial funds, often describe them as "philanthropic savings accounts," allowing donors to manage their charitable giving in much the same way, and with the same ease, as they manage their household finances. Fundraisers, advocates say, should treat donor-advised funds as simply another means of directing charitable gifts to nonprofits, no different from monthly and annual giving, online donations, bequests, family foundations or major gifts.

"For a seasoned fundraiser who understands the landscape, donor-advised funds are probably the best news in the nonprofit sector in the last 20 years," says Ted Hart, CEO of Charities Aid Foundation of America (**www.cafamerica.org**) in Alexandria, Va., which specializes in grant support for international charities. "For the average fundraiser, on the other hand, they are still a mystery."

Fundraisers have expressed concern that, like money in a bank account, assets in a DAF are essentially out of circulation until disbursed. Hart counters that it is a fundraiser's job, not the law's, to get that money into circulation. He explains that asking donors to recommend a gift from an advised fund—assuming the foundation makes that information available to recipients and that the donor has not chosen to remain anonymous—is no different from asking a donor to make a bequest or a monthly gift. "The money is already in a charitable bank account, and the donor can advise that money to you at any time," he tells fundraisers. "So make the case. What discussion are you having with your donors to make the case that they should advise their fund to you?"

Steuerle agrees. He describes DAFs as "time-delayed philanthropy." "There's no economic argument against saving the money as opposed to spending it," he says. "The main alternative to donor-advised funds is not other charities. It is people's consuming money or else giving money to their children to consume." Donor-advised funds, he says, are a way for donors to set money aside to spend on others instead of on themselves.

Good prospect research and stewardship,
he says, will meet donors at least halfway.

Furthermore, Steuerle says, DAFs let donors try things with their charitable gifts that they otherwise might not do, such as allowing fund assets to accumulate to the point where they can make larger, more impactful gifts. "It's a way to get donors to think about giving from their wealth, not from their income," he says. While high-net-worth donors often give from their wills and estates after their deaths, Steuerle says donor-advised funds allow others to play that game a little earlier.

Jason Franklin, Ph.D., the first W.K. Kellogg Community Philanthropy Chair at the Johnson Center for Philanthropy, agrees. "With the rise of donor-advised funds, you have to treat your mid-level donors more like your major-gift donors," he says.

Indeed, DAFs symbolize a change in the way fundraisers think about relationships with tomorrow's philanthropists, according to Danielle Oristian York, a director at 21/64 in New York City. Until now, she says, fundraisers have had the benefit of efficiency, thanks to tools such as relationship management software that allows them to manage donors in the aggregate, while donors were left to deal with the complexities of setting up and managing foundations. However, tools such as DAFs have flipped that power relationship on its head. Now, it is the donors who have the convenience.

Nevertheless, none of this means that the role of fundraisers will diminish. "I think there's a false fear that somehow fundraisers are losing relevance," Franklin says. "Donors have always been in control of their giving. The difference is that more donors now have a vehicle for their giving beyond just writing checks." Good prospect research and stewardship, he says, will meet donors at least halfway.

As Burrows explains, "We tell people that [setting up a donor-advised fund] isn't a shelter. It's about giving more thoughtfully and having more time to engage." He encourages fundraisers to see DAFs as a way for donors to find more ways to get involved with the causes and charities they support, not to set up intermediaries between them. "Don't assume that it's about damming funds," he says. "It's about opening up the flow."

Paul Lagasse is a freelance writer in Annapolis, Md. (www.avwrites.com).

Resources and Additional Reading

An Analysis of Charitable Giving and Donor-Advised Funds by Molly F. Sherlock and Jane G. Gravelle, Congressional Research Service, 2012
http://fas.org/sgp/crs/misc/R42595.pdf

An Inside Look: 15,330 donors who are giving to charity with a donor-advised fund
www.vanguardcharitable.org/inside_look_paper

"Avoiding Misuse of Donor-Advised Funds" by Michael J. Hussey, *Cleveland State Law Review*, 58 Clev. St. L. Rev. 59 (2010)
http://engagedscholarship.csuohio.edu

"Donor-Advised-Fund Tool Sends Gifts Directly to Charities"
https://philanthropy.com/article/Donor-Advised-Fund-Tool-Sends/155031

"Gifts to Donor-Advised Funds Grew 24% in 2013, According to a Study"
https://philanthropy.com/article/Gifts-to-Donor-Advised-Funds/152265

Next Gen Donors: Respecting Legacy, Revolutionizing Philanthropy by Michael Moody and Sharna Goldseker, 2013
www.nextgendonors.org

"Next Gen Donors and Their Plan for Greater Impact" by Michael Moody, Ph.D., and Sharna Goldseker, *Stanford Social Innovation Review*, Feb. 12, 2013
www.ssireview.org/blog/entry/next_gen_donors_and_their_plan_for_greater_impact