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Competing for the 21st-Century DONOR

How private-label donor-advised funds can open opportunities for your organization

By R. Daniel Shephard, CFRE

There is no ignoring donor-advised funds.

National Philanthropic Trust (**www.nptrust.org**), the largest national, independent donor-advised fund sponsor in the United States, issued 25,026 donor-recommended grants totaling more than $643.7 million to charities in 2015. "Donor-advised funds (DAFs) are the fastest-growing giving vehicle for a reason: They are easy to create and manage and give donors the opportunity to streamline their philanthropic vision," says Eileen Heisman, president and CEO of National Philanthropic Trust. "Whether it's turning a collection of 18th-century Chinese furniture into charitable dollars or issuing a $300 grant to help victims of the Nepal earthquake, we are proud to help donors realize their charitable intentions."

A growing number of direct public charities are considering opening DAFs in order to compete—for both the distributions from these funds and the corpus—with the DAFs offered by indirect charities, such as community foundations and especially commercial sponsors. However, far too few have pursued the idea due to perceived burdens and obligations they believe will be impractical for them.

Yet, there is a solution that may encourage more direct public charities to confidently enter the world of charitable giving through their donors' DAFs.

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A 21st-Century Trend

Table 1 represents contributions received by the 10 largest "qualified public charities" in the United States for fiscal 2014. It signals a radical shift in the giving habits of Americans since the emergence of donor-advised funds. Three of America's top 10 charities are commercially sponsored donor-advised funds and two others owe their growth largely to DAFs. That is five of the top 10. This was unheard of even a decade ago.

The charitable giving world is increasingly competitive. Within a given charitable cause and within a given community, an ever-increasing number of direct public charities vie for the attention of a fairly static number of prospective donors. The addition of indirect public charities to the mix has intensified what for decades has been a benign competition. However, the rising dominance of commercial indirect public charities has made this competition rather more hostile. It has

Table 1

Rank	Organization	Total private support in fiscal year 2014	Previous year's rank
1	United Way Worldwide	$3,872,917,029	1
2	Fidelity Charitable Gift Fund	$3,849,430,422	2
3	The Salvation Army	$2,115,646,000	3
4	Feeding America	$2,016,270,036	5
5	Silicon Valley Community Foundation*	$1,969,244,288	8
6	Schwab Charitable Fund	$1,814,889,301	4
7	Task Force for Global Health	$1,660,876,321	6
8	Harvard University	$1,155,610,000	Not Top 10
9	National Christian Foundation*	$1,136,775,000	Not Top 10
10	Vanguard Charitable Endowment Program	$ 988,105,537	10

Source: "The 2014 Philanthropy 400," The Chronicle of Philanthropy, *November 2015*

* *The growth of Silicon Valley Community Foundation and National Christian Foundation is due largely to donor-advised funds they respectively administer.*

Goldman Sachs, which came in at No. 11 on the list, is also a commercially sponsored donor-advised fund.

generated a heated debate over their missions, their true intent and even their legality. At the heart of this debate—and this competition—is the growing popularity of donor-advised funds to aspiring philanthropists.

Look at DAFs Differently

When considering DAFs, think about an analogy to direct public charities' encouraging donors to make deferred gifts through their estates: will bequests, life insurance and deferred compensation plan beneficiary designations, pay-on-death instructions of various asset accounts, etc. Recipient direct public charities understand that those estate gifts will not mature for some time, but they are more than willing to invest the time and resources required to acknowledge and steward those donors in order to secure their future gifts.

Direct public charities should look at a DAF as one more estate gift-planning strategy. This is a solution largely based on a shift in perspective, an attitude adjustment by those direct public charities that want to compete for this significant pool of philanthropic dollars.

The pertinent distinction between stewarding a bequest donor and a DAF donor is the obligation to conduct due diligence research on, and make distributions from the DAF to, other direct public charities according to the donor's instructions. Indeed, the greatest obstacle for many direct public charities' competing in the new charitable giving world of DAFs is the obligation to administer donors' requests for distributions to other direct public charities, just as a community foundation or a commercial sponsor of a DAF would. The leaders of many direct public charities see this as a time-consuming burden, and this attitude keeps them from competing for the attention of their donors to whom DAFs appeal.

A New Solution

A direct public charity that wishes to secure both a donor's immediate and perpetual gift commitment may open a private-label donor-advised fund for that donor. The sponsoring direct public charity serves as fund administrator and contracts with a third-party vendor to provide back-office services.

A small number of vendors offer back-office administration of private-label DAFs, which carry the name of the donor and the name of the direct public charity (*the [donor's name] Fund at [name of direct public charity]*). These vendors operate similarly to those that administer charitable remainder trusts for their nonprofit clients, providing the paperwork, the gift distribution tracking and the reporting that the client charity is happy to outsource for a small fee.

DEFINITIONS

Donor-advised fund (DAF): A charitable giving tool for donors who want to avoid the hassle of a private/family foundation or the effort required by making multiple contributions to various direct public charities by giving to a charitable fund managed by someone else (commonly referred to as the "sponsoring organization"). A DAF may be established at a community foundation, with one of a number of commercial sponsors (investment firms, banks, etc.), or at one of a small but growing number of direct public charities. Any direct public charity that does so will usually require that a significant portion of all grants from the DAF go to that direct public charity and will usually require a minimum initial contribution to establish the DAF.

Direct public charity: A qualified public charity organized under section 170(b)(1)(A) of the Internal Revenue Code that directly provides services to its identified constituencies and is deemed to receive the major part of its support from the public rather than from a small group of individuals.

Indirect public charity: Although community foundations, supporting organizations and donor-advised funds with commercial sponsors are legally regarded as "qualified public charities," none directly serves a charitable mission. Nor does a private foundation, which typically has a single major source of funding and has as its primary activity the making of grants to other charitable organizations and to individuals rather than to the direct operation of charitable programs. All are required to pass through contributions to one or more direct public charities (see above) if they are to execute their stated missions. Therefore, they may be considered indirect public charities, or pass-through entities.

Donors with a special affinity for the sponsoring direct public charity are now offered a special opportunity to enjoy convenient charitable giving during their lifetimes using the DAF at their favorite direct public charity, and can rest secure in the knowledge that an eventual major gift will be made to that favorite direct public charity.

The Case for the Private-Label DAF

In all public appearances, the DAF is administered by the sponsoring direct public charity, which helps it promote this distinctive giving vehicle to other potential donors. Donors remain happy through the active, hands-on stewardship of their DAFs, while the sponsoring direct public charity is relieved of the burdens of DAF administration.

The private-label DAF agreement typically offers gift distribution options to the donor that include:

- **Closed option:** All distributions must be to some activity or program of the sponsoring direct public charity.
- **Open option:** Distributions may be made to any qualified public charity.
- **50/50 option:** Any distribution to any qualified public charity other than the sponsoring direct public charity will trigger an automatic grant in the same amount to the sponsoring direct public charity.

Outright and Deferred Gift Opportunities

The ability to offer such distribution options provides the sponsoring direct public charity a way to encourage its constituents to open DAFs with it and to enjoy outright distributions from those DAFs, with the added benefit of knowing all their DAF donors so they may actively steward those relationships.

The sponsoring direct public charity also may offer the option, when any new DAF is created, that any remaining balance in the DAF at the donor's death shall pass to the sponsoring direct public charity. The DAF then effectively becomes another gift by bequest.

And there is another bonus: Once the DAF is established, a donor also can transfer into the sponsoring direct public charity's DAF assets that are currently held by other private foundations, community foundations or commercial DAFs.

Donors with a special affinity for the sponsoring direct public charity are now offered a special opportunity to enjoy convenient charitable giving during their lifetimes using the DAF at their favorite direct public charity, and can rest secure in the knowledge that an eventual major gift will be made to that favorite direct public charity. When the private-label DAF is established, the donor's instructions may even include the eventual establishment of a permanently endowed fund to continue the donor's support of that favorite direct public charity in perpetuity.

Not a Passive or Reactionary Strategy

The direct public charity that wants to enter this market must work proactively, however. In order for the donor who establishes a DAF to qualify for an income tax charitable deduction, control of the gift must be relinquished when the DAF is established. That means the donor must make decisions upfront, including selecting distribution options and stating instructions for ultimate distribution of the DAF's assets. A direct public charity cannot simply ask its donors who already make distributions from DAFs held by external sponsoring organizations to change the distribution instructions or the beneficiary designation. It is already too late. *The key to competing is to establish in-house private-label DAFs.*

Of course, not every nonprofit is prepared to take this step. You may decide your nonprofit is not large enough or that you do not have enough major donors to warrant opening a private-label DAF. There may be an alternative solution. If there is one nearby, ask to partner with a community foundation willing to administer DAFs brought to them through your efforts with your donors.

This creates a simple win-win relationship between your nonprofit and the community foundation. Through your efforts, the community foundation receives new gifts to DAFs they will administer. They are likely to negotiate gift distribution options (see above) beneficial to their charitable purposes as well as those of the donors you bring them. But your nonprofit is also in the gift conversation. You get to know up front which of your donors are making gifts to DAFs because you invite and negotiate those gifts, with ongoing opportunities to discuss outright distributions from those DAFs. This is the valuable part: You get to participate in the conversation about what happens to the corpus of each DAF at its termination. Remember, the only time to negotiate distribution options and instructions for ultimate distribution of a DAF's assets is when it is established.

As donors who have established DAFs begin to die, many fund administrators are facing a growing pool of "orphan" funds—those established by donors who gave no forethought to the eventual distribution of their fund's corpus, leaving the fund administrator to figure it out. This often has meant that the fund administrators have continued to make distributions from the funds with little or no guidance.

If you are not in the conversation with your constituents who are considering establishing DAFs, you are already too late to invite them to make their ultimate gifts—the eventual assignment of the corpus—to your nonprofit instead of to a donor-advised fund held by some indirect public charity.

Donor-advised funds are here to stay. Direct public charities that wish to compete for today's donors now can, effectively and affordably.

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Resources and Further Reading

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https://philanthropy.com/article/Donor-Advised-Funds-Expected/229425

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"Mystery Money: The Art of Seeking Gifts From Donor-Advised Funds" by Alex Daniels, *The Chronicle of Philanthropy,* Oct. 29, 2015
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