Breckinridge CAPITAL ADVISORS

Giving and Investing Trends Converge for More Powerful Philanthropy

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Leading trends in charitable giving and investment strategy are merging to offer more powerful options for investors who want to donate to charities. Donor-advised funds (DAFs) and environmental, social and governance (ESG) investment strategies are converging for greater philanthropic impact.

Consider the increasing predominance of DAFs and ESG. During 2020, according to the National Philanthropic Trust (NPT), the world's COVID-19 response and the social justice movement spurred historic DAF charitable giving.[1]

Also, during 2020, EY reported, almost half of investors are currently investing in ESG products, which is almost double the prior year's number. "Nearly all investors (88 percent) ask managers how ESG is incorporated into their investment decision-making," the report said.[2]

These giving and investing trends, leveraged in combination, mean investor-donors aiming to increase and enhance their philanthropy now have a way to align their donor assets and their values from the time they establish a DAF through and beyond the time they allocate grants to charitable causes.

"It's not surprising that the most generous charitable givers might also want to align their investments with their values," wrote Rene Paradis, NPT Chief Operating Officer.

As an example, investor-donors might establish a DAF to support environmental causes. They may recommend assets held in the DAF be invested in ESG or values- or mission-aligned investments such as fossil-fuel free strategies or portfolios that only hold securities of producers assessed to be the cleanest in the Energy sector. The invested assets support positive environmental outcomes even during the time the investor is deciding the ultimate grantmaking plan.

The example points up the important role played by each of three key participants—a donor-advised funds sponsor, such as a community foundation, the financial advisor and an investment manager.

The power of three to advance positive outcomes for investor-philanthropists

Here's a quick look at each key player and the role they can play.

- A community foundation is a public charity that typically focuses on supporting a geographical area, addressing and supporting local community needs. Community foundations offer grantmaking vehicles such as DAFs and endowments, for example. According to the NPT, in 2020 the average size of DAF accounts at community foundations is higher than at two other types of charitable sponsors: national charities and single-issue charities.
- Financial advisors work with investors to construct personalized financial plans that aim to achieve the investors' financial goals. These plans may include savings, budget, insurance, tax strategies and charitable giving, for example. Financial advisors also typically have a view of the broad field of investment managers. They can help clients select the managers and the investment vehicles most appropriate for their investment and donation plans.
- Investment managers determine what investments to make, or avoid, that will grow a client's portfolio. Typically, the manager will invest in products such as equity, fixed income, real estate, commodities, alternative investments and other securities. Investment managers also develop and offer investing products such as mutual funds or separate accounts, for example, through which investors' assets are managed.

Together, these service providers can help investor-donors reach their objectives.

DAFs Place a Powerful Philanthropic Vehicle in the Hands of Investor-Donors

Historically, institutions and the wealthiest have been the largest investors. A decades-long evolution has democratized financial markets. Discount brokers, 401(k) plans, IRAs, mutual funds, exchange traded funds, robo-advisors and more placed the activity of investing in the hands of millions more.

In a similar fashion, DAFs place the activity of philanthropy in the hands of millions of investor-donors. DAFs allow investor-donors to allocate cash, securities or other assets to a fund for the sole purpose of supporting charitable activities.

Investor-donors also can recommend where DAF assets are invested while grantmaking decisions are considered. DAF assets are invested for tax-free growth. Generally, investor-donors are eligible to take an immediate tax deduction for assets allocated to the DAF. Investment returns accumulate tax-free and can be reinvested or used to make charitable grants.

When ready, investor-donors recommend grants to eligible IRS-qualified public charities. NPT, the largest national, independent public charity that manages DAFs, granted $4.47 billion on behalf of its donors in 2020, representing an increase in value of 171 percent compared to 2019. NPT's donors recommended 85,837 grants to nonprofits in all 50 states and the District of Columbia in 2020.

One of the key features of a DAF is grantmaking flexibility. Unlike private foundations, which have an annual 5 percent payout requirement under federal tax law, DAFs do not have a payout requirement. In practice, according to NPT, "DAFs pay out at a higher rate (20 percent annually) than private foundations."

The NPT and others point out that as investor-donors are considering their grantmaking strategy over time, they can have an immediate positive impact. Investor-donors can recommend that their DAF assets be invested in ESG strategies and other investment approaches gathered under the broad umbrella of socially responsible investments.

ESG Investment Strategies Blend Values Investing with Investment Value

In reflecting on Breckinridge's 10-years of experience integrating ESG into our investment process, Founder and President Peter Coffin recently wrote, "It is fair to say that ESG can be traced to socially responsible investing (SRI), which dates to the colonial era in the U.S. Religious groups refused to invest endowment funds in the slave trade.[3] Similar expressions of investment views through the allocation or withholding of investment capital on issues central to what is called ESG today can be found in the many decades that followed."

In 2011, with the intention of better understanding corporate and municipal bond risks, Breckinridge developed a formal sustainability modeling framework that integrated fundamental financial measures with ESG metrics. At the time, the world had just survived the Great Financial Crisis.

We believed the extraordinary market dislocation was largely the consequence of investors overlooking long-term risks in pursuit of short-term thinking and near-term profits. We saw that integrating ESG analysis with traditional fundamental analysis could offer a more holistic and forward-looking way to identify, analyze, and understand risks.

Because integrated ESG analysis can be used to raise up the profiles of so-called best-in-class practitioners of ESG principles from among their sector peers, we believe we are better positioned to identify responsible corporate and municipal bond issuers who are more likely to meet their near- and long-term obligations to bonds holders, as well as have positive impact on their stakeholders and communities.

DAF and ESG Convergence Adds Dimension to Investor-Donor Philanthropy

As Katherine Pease, managing director and head of impact strategy at Cornerstone Capital Group, observed in a 2018 report, "Donor-advised fund holders who really want to use DAFs to make a difference through charitable giving can use their DAF capital that isn't being used for charitable contributions at a given time to augment their philanthropic activities.[4]" Cornerstone is a registered investment advisory firm that researches impact investing and incorporating ESG factors into portfolio design.

Working together, community foundations, financial advisors and investment managers can combine powerful financial market trends to bring new dimensions to the philanthropic activities of investor-donors across the wealth spectrum.

FOOTNOTES:

1. *National Philanthropic Trust 2020 Annual Report*
2. *Does accelerating adaptation present obstacles — or increase opportunities?*
3. *Breckinridge Marks a Decade of ESG Integration in 2021*
4. *Money in donor-advised funds can make impact before distribution*
5. *This brochure is intended to provide general information and should not be construed as investment, legal or tax advice.*

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