

Giving and Investing Trends Converge for More Powerful Philanthropy



Author



ARIANA POLK
RELATIONSHIP MANAGER,
SALES ENABLEMENT

Key Takeaways

- Donor-advised funds (DAFs) and environmental, social and governance (ESG) investment strategies are converging for greater philanthropic impact.
- These giving and investing trends, leveraged in combination, mean investor-donors aiming to increase and enhance their philanthropy.
- A DAF sponsor, such as a community foundation, a financial advisor and an investment manager can combine to play important roles to support philanthropic and investing goals.



Leading trends in charitable giving and investment strategy are merging to offer more powerful options for investors who want to donate to charities. DAFs and ESG investment strategies are converging for greater philanthropic impact.

Consider the increasing predominance of DAFs and ESG.

- During 2021, according to the National Philanthropic Trust (NPT), DAF grantmaking grew by more than \$10 billion, extending a 400 percent growth in annual DAF grants over the past decade.¹
- *Bankrate* reported, “Interest in ESG investing has been on the rise in recent years as more investors prioritize the impact of how their money is invested. Global ESG fund assets reached about \$2.5 trillion at the end of 2022, up from \$2.24 trillion at the end of the third quarter.”²

These giving and investing trends, leveraged in combination, mean investor-donors aiming to increase and enhance their philanthropy now have a way to potentially 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.

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 are intended to 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 2021, grants from DAFs at community foundations totaled an estimated \$9.58 billion in 2021, up by 16.5 percent from \$8.22 billion granted in 2020.

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 investments to make, or to avoid, that will be intended to 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 can 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.³ 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.

A key feature of a DAF is grantmaking flexibility. Unlike private foundations, which have an annual distributable amount⁴ payout requirement under federal tax law, DAFs do not have a payout requirement. In practice, according to NPT's 2022 Donor-Advised Report, in 2021, "The DAF grant payout rate was 27.3 percent, the highest grant payout rate on record. Payout has remained above 20 percent for every year on record, reflecting the consistent charitable support that DAF donors provide. The ten-year average payout rate from DAFs is 22.2 percent."

As investor-donors are considering their grantmaking strategy over time, they can have an immediate positive impact. In recommending where their DAF assets are to be invested, investor-donors can choose ESG strategies and other investment approaches gathered under the broad umbrella of socially responsible investments.

ESG investment strategies blend values investment with values in mind

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.

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



4 / PERSPECTIVES / Giving and Investing Trends Converge for More Powerful Philanthropy

FOOTNOTES:

1. 2022 Donor-Advised Fund Report, National Philanthropic Trust. <https://www.nptrust.org/wp-content/uploads/2022/12/2022-DAF-Report.pdf>
2. "ESG investing statistics 2023," Bankrate, by Brian Baker, CFA and Mercedes Barba, January 31, 2023. <https://www.bankrate.com/investing/esg-investing-statistics/>
3. "What Is a Donor-Advised fund," National Philanthropic Trust, <https://www.nptrust.org/what-is-a-donor-advised-fund/>
4. Distributable amount is equal to the minimum investment return of a private foundation reduced by the sum of any income taxes and the tax on investment income, and increased by 1) amounts received or accrued as repayments of amounts taken into account as qualifying distributions for any tax year, 2) amounts received or accrued from the sale or other disposition of property to the extent that the acquisition of the property was considered a qualifying distribution for any tax year, and 3) any amount set aside for a specific project to the extent the amount was not necessary for the purposes for which it was set aside. If a private foundation has income from distributions from a split-interest trust attributable to the income portion of amounts placed in trust after May 26, 1969, this income is included in the distributable amount. If a split-interest trust distributes income from amounts placed in trust both on or before and after May 26, 1969, these distributions must be allocated between those amounts placed in trust during these periods to determine the extent to which the distributions are included in the foundation's distributable amount. For more information on Internal Revenue Service guidance regarding the distributable amount, please visit "[Tax on Private Foundation Failure to Distribute Income: 'Distributable amount.'](#)" This article is neither intended as nor should it be relied upon for legal or tax advice and investors should consult a legal or tax advisor for guidance.

BCAI-07192023-B4M1FOJL [7/31/2023]

FOR INVESTMENT PROFESSIONAL AND INSTITUTIONAL USE.

DISCLAIMER: This material provides general and/or educational information and should not be construed as a solicitation or offer of Breckinridge services or products or as legal, tax or investment advice. The content is current as of the time of writing or as designated within the material. All information, including the opinions and views of Breckinridge, is subject to change without notice.

All investments involve risk, including loss of principal. Diversification cannot assure a profit or protect against loss. Fixed income investments have varying degrees of credit risk, interest rate risk, default risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer-term securities. Income from municipal bonds can be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the IRS or state tax authorities, or noncompliant conduct of a bond issuer.

Equity investments are volatile and can decline significantly in response to investor reception of the issuer, market, economic, industry, political, regulatory, or other conditions.

Breckinridge believes that the assessment of ESG risks, including those associated with climate change, can improve overall risk analysis. When integrating ESG analysis with traditional financial analysis, Breckinridge's investment team will consider ESG factors but may conclude that other attributes outweigh the ESG considerations when making investment decisions.

There is no guarantee that integrating ESG analysis will improve risk-adjusted returns, lower portfolio volatility over any specific time period, or outperform the broader market or other strategies that do not utilize ESG analysis when selecting investments. The consideration of ESG factors may limit investment opportunities available to a portfolio. In addition, ESG data often lacks standardization, consistency and transparency and for certain companies such data may not be available, complete or accurate.

Breckinridge's ESG analysis is based on third party data and Breckinridge analysts' internal analysis. Analysts will review a variety of sources such as corporate sustainability reports, data subscriptions, and research reports to obtain available metrics for internally developed ESG frameworks. Qualitative ESG information is obtained from corporate sustainability reports, engagement discussion with corporate management teams, among others. A high sustainability rating does not mean it will be included in a portfolio, nor does it mean that a bond will provide profits or avoid losses.

The effectiveness of any tax management strategy is largely dependent on each client's entire tax and investment profile, including investments made outside of Breckinridge's advisory services. As such, there is a risk that the strategy used to reduce the tax liability of the client is not the most effective for every client. Breckinridge is not a tax advisor and does not provide personal tax advice. Investors should consult with their tax professionals regarding tax strategies and associated consequences.

Federal and local tax laws can change at any time. These changes can impact tax consequences for investors, who should consult with a tax professional before making any decisions.

The content may contain information taken from unaffiliated third-party sources. Breckinridge believes the data provided by unaffiliated third parties to be reliable but investors should conduct their own independent verification prior to use. Some economic and market conditions contained herein have been obtained from published sources and/or prepared by third parties, and in certain cases have not been updated through the date hereof. All information contained herein is subject to revision. Any third-party websites included in the content has been provided for reference only.
