Giving and Investing Trends Converge for More Powerful Philanthropy

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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.

DAF 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 features of a DAF is grantmaking flexibility. Unlike private foundations, which have an annual distributable amount[4] 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.

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.

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