



Are we there yet... Is the Financial Services Industry finally ready for Donor Advised Funds?

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Like a small child waiting impatiently to see Santa, financial services firms waiting for the philanthropic revolution to impact their industry feel as though it's been a long time coming. For almost two decades the investment community has been slowly testing the charitable waters by introducing new donor advised fund (DAF) products to their advisors, planners, and clientele – all the time waiting impatiently for the promised "...Next Big Boom¹." The question as we enter 2005 is, again ...are we there yet; and for a variety of reasons unique to today's society, we feel the answer is a resounding yes; the time has finally arrived.

Donor Advised Funds and Philanthropy – First, a little history ...

Since the first community foundation was established in Cleveland in 1914, the ranks of these organizations have grown to include over 600 independent local entities that collectively manage more than \$30 billion in assets.² A major contributor to this asset growth, donor advised funds today represent one of the fastest growing elements of fundraising within the community foundation arena. A simple, powerful, and highly personal approach to giving, the DAF presents donors with an ideal blend of flexibility, control, and cost efficiency.

For many of these same reasons, the use of donor advised funds began to spread beyond local community foundations to other charitable institutions as well. Colleges and universities such as Harvard and Cornell began to offer donor advised fund options as a gifting alternative to their alumni, many of who were uncomfortable with the restrictions and high costs associated with private foundations.

Currently over 80,000 individuals, families, trusts, investment clubs, private foundations and corporations have established donor advised funds, with total assets exceeding \$15 billion and new accounts opening at rates exceeding 8% a year.³ According to a study by the Chronicle of Philanthropy, assets in the biggest donor advised funds increased by 231% between 1995 and 1999, and data provided in 2004 noted \$11.3 billion in assets and \$2.1 billion in distributions for 2003.⁴

Historically however, two issues have continued to present challenges to community foundation fundraising efforts. Initially, community foundations traditionally have day-to-day contact with a very limited number of potential donors. Compared to the financial services industry, their annual contacts with potential donors represent a fraction of the 91 million individuals and 53.3 million households currently holding investments in mutual fund accounts.⁵ Mutual fund account assets which have grown from \$2.1 trillion at the end of 1993 to \$7.4 trillion at the end of 2003.

A secondary issue began to surface in the mid 1980's when donors first began to take a closer look at their charitable giving efforts, and began seeking to take more control over where their contributions were being spent. It became apparent to foundations such as the Greater Kansas City Community Foundation (GKCCF), that long-term success required a new level of collaboration and commitment with donors, community advocates, and local organizations.

The combined effect of donors exploring the use of donor advised funds to retain more direct control and involvement in their charitable giving, and the pro-active impact of the foundation's donor-focused thinking, enabled the GKCCF to experience a dramatic increase in DAF donations from \$110 million in 1992 to \$540 million in 2002⁶

Toes in the water – To boldly go, where ...no investment firm ...has gone before

Shortly after the community foundations began to explore increased use of DAF vehicles to enhance their donor development efforts, the financial services industry began a similar assessment of their various lines of business with a view toward increasing profitability in the new millennium.⁷ Beyond the fundamental recognition that assets under management provide the highest profit margins, they also rediscovered that offering a broader range of products to a customer could significantly enhance the stability and permanence of the

relationships. National financial institutions began to see significant business opportunities in supporting the charitable gifting market beyond their typical life insurance efforts targeting wealth replacement trusts.

It's been noted that the entry of the mutual fund industry into the realm of charitable endowments has finally placed the concepts of structured gifting and philanthropic planning within reach of people with average means.⁸ While private or family foundations have been perceived as – and in fact are – utilized almost exclusively as tools of the wealthy, many donor advised funds accept a minimum endowment of as little as ten thousand to twenty-five thousand dollars.

Former IRS Commissioner Fred Goldberg has noted that:

“Donor Advised funds move very much in the direction of ‘simplification’ in the sense that they put the record-keeping burdens & reporting burdens on institutions that are more able to carry out those responsibilities, and can achieve economies of scale and efficiency in discharging those responsibilities.”⁹

Over the last decade several investment companies have recognized the potential for the DAF as a new wealth management solution for their shareholders. Once Fidelity broke-the-ice in 1992 with the Fidelity Charitable Gift Fundsm, it wasn't long before several additional firms began to offer their own programs. These included the Vanguard Charitable Endowment Program (1997), the Oppenheimer Funds Legacy Program (2000), the Eaton Vance U.S. Charitable Gift TrustTM, J.P. Morgan Chase (2000), the Franklin Templeton Charitable Giving Fund (2002), and the Smith Barney Citigroup Charitable Investment Fund (2001). All were early entries into the expanding circle of financial services firms attempting to add DAF solutions to their investment platforms and led to the early media references of “...a proliferation of donor advised funds within the investment industry.”¹⁰

Old Dogs and New Tricks – it's not your father's Mutual Fund

While several financial services firms have had the vision to step into the charitable surf, unfortunately many of their brokers, advisors and planners – who are ultimately responsible for the direct client acquisition and sale of these new vehicles – have shown

less capacity for change. This can be seen by the huge disparity between the largest financial services DAFs, the Fidelity Charitable Gifting Fund with \$2.7 billion and the Vanguard DAF with \$700 million in assets, and the rest of the financial services offerings. Most brokers have yet to fully recognize or embrace the opportunity in working with DAF solutions.

As students learn early in the advertising industry, regardless of the packaging, promotion, and price, if the dog won't eat the kibble when the camera's turned on, you've got a tough marketing job ahead. Nationwide Financial learned this lesson several years ago with the introduction of their Best of America[®] America's Future Annuity[™]. This was the first low-fee variable annuity product in the financial services industry, and offered investors a 95 basis point fee when the competitive average was 1.4%. What made this an ideal marketing environment was that it also occurred at a time when the high fees of variable annuity products were gaining increased attention in the national media. Any marketer would have agreed, Nationwide should have captured the market and gained significant market share.

There was only one small problem. The distinguishing characteristic of the new Best of America[®] annuity – the low fee – was a product characteristic that advisors and brokers rarely focused on during presentations to clients. Their mental dilemma was how to highlight a feature that made it look as though they had been selling overpriced products before, and how to embrace this new feature in their sales presentations.

Regardless of how well designed the product is and how well the features fit with the public need and interest, if brokers can't find a smooth and easy way to discuss the product, they won't take the time to learn a new story. Broker and advisor education, sales training and ongoing exposure are critical to comfort and to a successful implementation.

Also, with some of the early DAF programs failing to offer the producer any competitive compensation for the sale, they undoubtedly considered the charitable giving arena a zero-sum game, with every dollar given to charity representing a dollar out of their personal assets-under-management tally.¹¹ Many of the new programs provide for either a front-end or trail based compensation for the advisor, which eliminates much of this distraction.

A secondary issue is the fact that while donor advised funds might contain mutual funds or investment company shares as the underlying investment vehicle, they actually require a much different style of salesmanship than a traditional fund or stock sale. Implementing a charitable giving strategy for a client, regardless of the product solution involved, is both a matter of charitable intent and financial strategy. Discovering intent or developing a strategy for a client requires more time and discussion than many brokers are willing to spend in generating transactional business.

Fortunately today, more and more firms are encouraging their producers to adopt a consultative or planner oriented approach to developing client relationships. Following a model used by the insurance industry for generations, brokers have added a fact-finding stage as a preliminary step in the sales process. This is not only critical to developing needs and interest but serves as a foundation for delivery of solutions and implementation. That step, coupled with solutions learned from the Nationwide example of assisting them with the integration of new product features into their existing sales model and presentations, dramatically improves the chance for delivery success.

Waiting for a Sea Change – Environmental and Economic factors

While all these initial efforts were taking place, John Havens and Paul Schervish of Boston College raised the ante on what was at stake with their research released in 1999, and which projected an intergenerational transfer of wealth occurring between 1998 and 2052 of \$41 trillion – *conservatively* – with double or triple that amount at the high end.¹² The shorter-term results of the same research reduce this to a more conservative \$15.5 trillion over the next 15 years.

The breakdown of this flow is where we find some interesting data. If nothing changes, \$10 trillion of the \$15.5 will go to family inheritors; \$2.2 trillion will go to charities, and about \$3 trillion to Uncle Sam. Much of what is destined to go to Uncle Sam – what has been coined as Involuntary Philanthropy by Renaissance, might easily go to charities if only the financial services advisors, the “gatekeepers” as Charles MacLean has termed them, could get beyond the simple yes or no questions about philanthropy. In other words, by helping advisors develop a slightly different way to discuss charitable intent, they have an opportunity to capture a piece of \$3 trillion dollars otherwise destined for the IRS.

Add to this a heightened regulatory environment for investment companies, pressure from multi-million-dollar settlements for late trading allegations, and we find the financial services industry looking for some good news and a new means of gathering assets. As Brian Jeter, Senior V.P of American Century has noted, "It seems like there's a real opportunity for a fresh, new, good story."¹³ While his comments didn't relate directly to DAF products, they remain very much on-target. The ability to frame a discussion with clients which surrounds philanthropic concepts and motives strikes at a totally new level in the advisor-client relationship and one with a much stronger bond than relationships based on transactional sales.

Lessons from the Tsunami – ePhilanthropy comes of age

On December 26, 2004 a 9.0 magnitude earthquake lifted a 6-mile wide by 700 mile long section of the ocean floor 50 feet, causing a massive displacement of water and leading to a tsunami which left 5 million without basic services and over 162,000 dead. In what has been described as the largest outpouring of corporate and personal giving in the history of international disasters (eclipsing the \$70 million donated after back-to-back hurricanes Georges and Mitch struck the Caribbean in 1998), U.S. industry, charities and individuals have used marketing creativity, high-tech know-how, and business smarts to raise cash and goods for tsunami aid.¹⁴

Corporate websites were immediately modified to begin accepting donations for various local and national relief organizations. One national charity received over 60% of the \$200 million raised in tsunami relief donations through online sources. In a similar scenario, another organization raised more than \$30 million for tsunami relief with their phone contributions totaling only \$1.4 million, compared to online donations of over \$9 million. Interestingly, their online development efforts were so successful that they had to request their bank raise the ceiling on maximum contribution amounts four times; initially jumping from \$1,000 to \$5,000, then \$10,000, \$25,000 and now \$50,000¹⁵.

What we're seeing in dramatic fashion is an increased comfort with the web as a means to distribute and donate capital, an increased comfort with the gifting process, and interest in making gifts online through a variety of websites. In addition, many charitable organizations are leveraging the web's efficiency at managing their online ecommunities representing thousands of donor relationships.

The Internet has dramatically quickened the pace of fundraising. Out of necessity, many nonprofits are beginning to embrace the capabilities of the Internet to support their fundraising efforts. With online giving rising by 48% for some American nonprofit organizations in 2002-2003¹⁶, these ultimate beneficiaries of DAF grants are positioning themselves in perfect alignment with the highly efficient and cost-effective web-based grant distribution models available through the new financial services DAF platforms.

The Perfect Storm – Timing is everything...

While a 10% increase in America's national giving rate from 2% to 2.2% over the last few years hardly seems sufficient to be trumpeting a new "Golden Age" of philanthropy, especially compared to the era of Andrew Carnegie and John Rockefeller, there does seem to be an emerging trend toward increased charitable gifting and the emergence of a new kind of donor in the U.S.¹⁷.

In reviewing data from 375 educational institutions compiled by the Council for Aid to Education (CAE), Bruce McClintock of Marts & Lundy found an unprecedented increase in contribution levels to these institutions from 1992 to 2001.¹⁸ Specifically, the annual gift total for each of the 375 institutions grew from an average \$17.1 million in 1992 to \$41.2 million in 2001. Much of that growth was seen in the last half of that ten year period, with the average surging from \$19.7 million during 1992-1996 period to \$34.3 million during the 1997-2001 period – a 73.9 percent increase¹⁹.

For the first time in history more and more people have more money than they want to leave to their kids. The key is a lack of good ideas on how to "get the basket under the apple tree." With 800,000 charities currently listed on the IRS official roster²⁰ coupled with the specter of cuts in government support, there's certainly no shortage of organizations looking to shake the tree.

Bill Bradley, Paul Jansen and Les Silverman made several observations in 2003 when they pointed out the need for increased efficiency on the part of charities in their fundraising efforts and specifically highlighted the opportunities available through online fundraising and the use of Donor Advised Funds to gain this efficiency.²¹ If we couple this

increased attention and focus on DAF solutions within charitable organizations with the established asset development potential and distribution infrastructure of the trillion dollar financial services industry, the opportunities for synergy and its impact on both industries is unheralded.

We also believe that while some charitable organizations have voiced concern recently about the increased presence of financial services firms in the philanthropic sector, the goal of many community foundations is shifting from "...trying to stop the onslaught of professionals doing charitable planning or the onslaught of financial institutions getting involved, but to learn how to capitalize on it."²²

Conclusion

Despite the fact that early efforts to offer donor advised fund (DAF) solutions through a financial services distribution model have met with selective success, we believe that for the first time there now exists a truly significant opportunity to successfully offer DAF platforms within the investment community and for financial services firms to more fully explore the expanding audience for these offerings among their clients, prospects and community.

By leveraging the charitable community's increasing awareness of the importance of DAF solutions against both the public interest in gaining control and flexibility over their gifting, and the distribution efficiency and market capacity of the financial services sector, both financial services firms and community foundations finally achieve the critical objectives of opportunity, capability and capacity necessary for successful DAF distribution. While the ultimate beneficiaries of this successful marriage will be the local and national causes supported by the charities themselves, the opportunity to become a contributor in these efforts will enable financial services firms to move into a new era of asset development and distribution, unlike anything experienced since their initial steps into the trillion dollar 401(k) market over two decades ago.

About the Author

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William Hewitt has been involved in the financial services industry since his senior year at Syracuse 28 years ago, and has been responsible for broker-dealer management, national and regional investment sales and distribution, investment and financial planning education for advisors and clients. Prior to joining Kintera Inc, Hewitt was president of the 404(c) educational firm Investment Training Associates, LLC. He is currently responsible for national sales and marketing of Kintera's Donor Advised Fund administrative services platform. Bill can be reached at bhewitt@kintera.com

About Kintera Inc.

Software provider Kintera® Inc. (NASDAQ: KNTA) delivers The Giving Experience™ by providing giving convenience to donors and feedback about the financial and social impact of their gifts, creating a sense of belonging and appreciation. Kintera services more than 15,000 accounts in the nonprofit, government and corporate sectors. The company's "software as a service" innovations include its Friends Asking Friends® solicitation program and Kintera Sphere™, an enterprise-grade software system that provides contact relationship management (CRM), a web content management system (CMS), eMarketing and directed giving applications. For more information, visit Kintera at www.kintera.com.

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