

A ROUNDTABLE DISCUSSION

# WEALTH MANAGEMENT:

THE BASICS OF DONOR-ADVISED FUNDS

>>> Donor-advised funds, or DAFs, are charitable savings accounts that allow donors to make contributions to public charities, receive an immediate tax deduction and then recommend grants from the fund over time. Virtually unknown to the public a decade ago, they're among the fastest-growing vehicles on the philanthropic landscape with total assets surpassing \$110 billion last year.

The Tax Cuts and Jobs Act of 2017 further enhanced the benefits of DAFs, allowing Americans to "bunch" several years' worth of giving into a DAF and take a deduction in one year while supporting their favorite charities over time.

Crain's Custom Media asked four experts for their insights on how DAFs operate, who they're best suited for, and strategies for establishing and maintaining one.

## >>>How is your organization involved with DAFs?

**Rose Jagust:** The Jewish Federation of Chicago has operated its DAF program since 1971 and is among the oldest providers in the country. The program has grown to over 1,000 funds and manages assets of more than \$183 million. In 2018, our donors contributed roughly \$55 million to thousands of charities, Jewish and secular, supporting nearly every type of charitable cause. Federation professionals work with donors of all ages and incomes from throughout the Chicago area, helping them

to be better informed, savvy philanthropists. We pride ourselves on working with multiple family generations, helping them act on their charitable interests and pass along their charitable legacies.

**Cale Turner:** My group provides nonprofit and private foundation investment management and administrative services. We work with U.S. Trust and Merrill Lynch advisors to provide solutions to clients focusing on wealth management strategy, planning and charitable giving. Since its inception in 1955, The Bank of America Charitable Gift Fund has provided

donor-advised services to clients in support of the causes important to them.

**James Mabie:** Chicago Capital is a registered investment advisor, providing customized investment services tailored to the specific goals and circumstances of clients, many of whom are families who support a number of charitable and nonprofit activities. We also work directly with several nonprofits, including the Chicago Symphony and Lyric Opera, to help them invest and/or administer their charitable gifts. From families supporting charitable activities to nonprofits benefiting their

community, DAFs play an important role in enabling our clients to meet their charitable goals.

**Phil Zielinski:** Mercy Home offers solutions for kids affected by abuse, neglect, homelessness or other trauma. Because we're a 501(c)3 nonprofit, we often receive grants from DAFs to support our young people on their path to success. But unlike most charities, we're also a sponsoring organization for our own in-house DAF, which is professionally managed by Morgan Stanley GIFT. The Mercy Home for Boys & Girls Donor-advised Fund (MHBG DAF) is a flexible vehicle that helps donors simplify all of their charitable giving—not just gifts to Mercy Home.

help guide your giving, and we are an individual charity, but have structured our DAF as an "open shop," meaning we don't mandate giving to a single issue.

**Turner:** What makes DAFs unique are the offerings being provided by DAF sponsors in the marketplace. This can include national charities, community foundations or single-issue charities. Each DAF sponsor can customize their program and offering for their donor base. This may include varying account and grant minimum requirements, software and technology available, suite of investment options, ability to support international organizations, and even provide philanthropic consulting to support their giving.

## >>>Are all DAFs the same?

**Zielinski:** There are three basic kinds of DAFs. Commercial DAFs are sponsored by financial firms that have filed paperwork to become 501(c)3 nonprofits. These are responsible for the growth of DAFs in recent years, and act as a financial pass-through for philanthropic dollars. They're also usually less expensive to open, and cheaper to manage. Community foundations invented DAFs nearly 90 years ago, and provide an excellent resource for those looking to do good, but who would like guidance on the best way to accomplish this goal. They're also a great way to involve younger generations in philanthropy. The third type, single-issue DAFs, are typically managed by a charity with the intent of directing all or some of the money in the fund toward a specific issue or goal. I like to think of Mercy Home's DAF as the best of all three types—we have the financial backing of Morgan Stanley, an in-house team of philanthropic advisors to

**Mabie:** DAFs can have differing guidelines and approaches to grant-making, donated assets, fund management and administration. We work with a number of DAF providers and help clients find the DAF that's the best fit for their goals and circumstances.

**Jagust:** While the basic structure is the same, what differs are the creative ways donors use their funds. Some use them as vehicles for multi-generational family philanthropy. Some gather like-minded donors to create giving circles focused on common causes. In the Jewish community, some create DAFs to celebrate bar or bat mitzvahs, passing on the Jewish values of charity and the responsibility to repair the world. And some create funds in memory of loved ones, to honor and carry on their charitable legacies.

## >>>What types of investors might want to consider establishing a DAF?



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**Mabie:** DAFs are often used by clients who don't require income from the donated assets and who want to simplify the administration of the charitable contribution. Conversely, clients who require income tend to favor charitable trusts, while those who enjoy more family involvement often use private foundations, and those who are closer to the nonprofits they support often make gifts directly. DAFs aren't for everyone, but they're a great fit for people looking to simplify.

**Zielinski:** A DAF is an excellent tool for anyone who's charitably inclined, looking for a tax deduction and wants to avoid the administrative costs of a family foundation. It's also a great way to consolidate complex assets—such as business interests, closely held stock or real estate—into a single philanthropic account.

**Turner:** The beauty of a DAF is that it's a solution that fits so many individuals across the spectrum of wealth. For example, it offers favorable tax advantages for appreciated stocks when compared against private foundations or other charitable vehicles. DAFs also help individuals offset taxes during major liquidity events, including interests in closely held businesses or private equity holdings.

**Jagust:** But DAFs aren't reserved for the very wealthy. They're also a perfect fit for people of modest means who are committed to charitable giving. The Jewish Federation's minimum to open a fund is only \$1,000, which puts a DAF within reach of many people.

**>>Aside from the tax benefits, how else might donors benefit from having a DAF?**

**Zielinski:** DAFs offer many of the same benefits of a family

foundation, but are cheaper to establish and much more flexible to administer. And like a foundation, a DAF allows you to involve family members in your strategic giving, providing you the opportunity to share the causes that are important to you and learn more about those other family members support. Many DAFs—including Mercy Home's in-house fund—allow you to name a successor to continue managing your giving plan when you're no longer able to do so.

**Jagust:** At the Jewish Federation, each donor has a dedicated staff member who not only handles transactions, but can help them create long-term giving strategies that focus future generations on social issues that are important to them. With the Federation's vast charitable expertise, both locally and internationally, donors have access to educational and networking opportunities that range from philanthropic strategies to tackling society's most challenging issues, such as violence, poverty, education and drugs. And critically important, we perform extensive due diligence on grantees, so donors know they are supporting reputable, fiscally healthy organizations that are transparent in their operations.

**Turner:** For a philanthropic or charitable-minded individual, a DAF offers the most convenient solution available for giving. It's a simple tool and one-stop place to review and ultimately fulfill grant-making activity. DAFs also offer the option of anonymous granting. Many donors see charitable giving as a personal commitment and may not want their name connected specifically to a gift. As such, a DAF offers them the opportunity to give

without being acknowledged. Many private foundations also utilize DAFs in this function to make grants to organizations where they don't want their private foundation name to be known.

**>>Are there unique benefits for nonprofits that receive contributions from DAFs?**

**Turner:** Receiving a gift from a DAF is, in essence, a charity-to-charity transfer. Nonprofits receive the benefit of knowing that the funds from a DAF are coming from a well-known place and provide further clarity on the proper way to receipt the gifts. Many DAF

sponsors also offer their clients the ability to set up recurring grants to the organizations they chose to support on a more regular basis. This can help streamline, consolidate and provide a reliable flow of funds to these nonprofits.

**Mabie:** It's important for nonprofits to have some visibility into recurring support so that they can budget for multi-year projects and goals.

**Jagust:** For many, it's an opportunity to build or strengthen a relationship with donors who are charitably inclined and have a dedicated pool of charitable assets.

Nonprofits also can build relationships with the DAF providers, educating them about their mission and activities so the provider can offer more informed guidance and, possibly, suggest strong matches between donors and grantees.

**>>What types of assets can be transferred to a DAF?**

**Mabie:** Our clients most often contribute securities with a large gain. This allows them to transfer more value to the nonprofit organization and allows the nonprofit to use the resources for greater impact. For clients that give private



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investments, it's critical to find the right approach to fit their circumstances and be diligent in the selection of the folks involved in the process.

**Jagust:** The most convenient assets to donate are cash, publicly-traded stock and mutual funds. However, most DAF providers also will work with donors on contributions of partnership interests, closely held stock and real property. These are slightly more complicated transactions that require some institutional due diligence, but it's typically a painless process that can be accomplished quickly.

**Turner:** Depending on the DAF sponsor or provider, they may even be able to accept unique assets. This includes specialty assets such as oil, gas, mineral, and real estate interests, private equity, closely held businesses as well as thinly traded stocks. There may even be cases where providers have the ability to accept collections including antique cars, artwork and even wine. All of these unique or non-tangible assets are reviewed on a case-by-case basis and may incur additional fees or considerations when being donated.

**Zielinski:** While "cash is king" in most venues, it's usually not the most tax-efficient way to practice your philanthropy. If you're looking to increase your impact and decrease your tax burden, consider making a gift of appreciated asset such as securities into your DAF. You'll avoid paying capital gains tax and receive a charitable deduction based on the amount of the gift. DAFs also offer an efficient way to donate more complex assets. If you want to donate real estate, art, automobiles, or other items that may need to be appraised, transferred or possibly even sold before donation, a DAF can smooth the process and provide you with the necessary resources and documentation to do so.

### >>How much control do donors have over their DAF investments?

**Turner:** Donors of DAFs can choose an investment structure for the assets they contribute in hopes that performance will provide additional funds for grantmaking purposes. Depending on the DAF providers, donors will have the option of selecting from a range of portfolio models

and constructions. Some may even allow a donor's financial advisor to manage the DAF assets on their behalf.

**Jagust:** At the Jewish Federation, when establishing a DAF, donors can recommend up to three investment vehicles from a variety of mutual funds, a money market fund, and the Federation's own Pooled Endowment Portfolio, which holds the Federation's endowment fund. Donors can't micromanage the buying and selling of shares or movement of assets, but may recommend investment changes once annually. If a donor prefers, a trusted investment adviser may manage the assets for donors with at least \$250,000. The adviser must be vetted and accepted by the Jewish Federation as an authorized investor, and additional rules apply.

**Zielinski:** Mercy Home's DAF currently uses five separate investment pools, which are professionally managed by Morgan Stanley, and which represent different investment strategies. A donor's wishes are almost always followed, provided he or she chooses

## ABOUT THE PANELISTS

**Rose L. Jagust** is vice president of donor advised programs at the **Jewish United Fund/Jewish Federation** of Chicago. She also heads the Center for Jewish Philanthropy, which serves thousands of Jewish individuals and families and holds more than 1,025 funds and foundations valued at around \$1 billion. She is a member of the Chicago Council on Planned Giving and has presented at the Council's annual meeting, as well as other meetings and conferences in the nonprofit area. Before joining JUF in 2001, she practiced employment law and worked in the nonprofit sector.



to make grants to qualified tax-exempt organizations and abides by IRS rules.

**Mabie:** DAFs offer less control than direct gifts and private foundations, but they also require less administration. We help clients research investment alternatives, management and control of their DAF investments prior to selecting a provider. This helps avoid miscommunication and enables our clients to select a provider that shares their goals and objectives.

**Jagust:** Donors need to understand that requests for grants from their fund are recommendations only, and that the hosting organization reserves the right to refuse to make any distribution. For example, the Jewish Federation could refuse to make a grant to an organization whose mission and activities run counter to the interests of the Jewish community, or are antithetical to the broad charitable mandate of the Jewish Federation of Chicago.

**Mabie:** Many DAFs are not required to meet the annual gifting requirements of private foundations or charitable trusts. This allows donors flexibility on the timing of gifts, which can have a significant positive impact on their nonprofit recipients.

### >>What types of rules or regulations regarding DAFs should donors be aware of?

**Turner:** From a charity selection point of view, the organization must be a 501(c)3 charity registered with the IRS and in good standing. This does not discount the use of religious houses of worship but additional due diligence may be required by the DAF sponsor to confirm it's a legitimate organization. As far as purposes for the funds to these organizations, grants cannot be used to fulfill personal obligations or commitments from an individual to a charitable organization since the assets are no longer legally owned by the donors.

**Zielinski:** The most common restrictions that we see DAF donors grappling with involve special events and charitable pledges. IRS rules state that a donor cannot receive any personal benefit from their DAF gift. This means that you may not use your DAF to buy tickets to Mercy Home's Ringside Gala event or to fulfill a legally binding pledge.

### >>What should individuals consider when choosing a DAF provider?

**Zielinski:** Like most investments, choosing a DAF provider ultimately comes down to two things—fee structure and customer service. When establishing the account, pay attention to the account minimums. Think about how much you plan to invest when you open the account, and how much you plan to distribute to charity each year. Most DAF providers charge an administrative fee, and often this is lower at financial institutions than at community foundations or individual charities like Mercy Home. But these smaller shops can provide a valuable service in philanthropic advising that can be transformational, especially if you're interested in legacy planning or teaching younger generations about philanthropy.

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**James W. Mabie** is chairman of **Chicago Capital**, a full-service financial services firm he co-founded in 2018. A nearly 50-year financial industry veteran, he previously held senior leadership and portfolio management roles with William Blair and A.G. Becker. Well-known locally as a philanthropist, he serves as chairman of the board of trustees at public TV station WTTW and is a board member for the Chicago Symphony, Lyric Opera and Chicago High School for the Arts. He has held various leadership roles with the Village of Northfield, where he lives, and Williams College, his alma mater.



**Cale M. Turner** is a senior vice president and manager of The Bank of America Charitable Gift Fund for the Philanthropic Solutions Group at **U.S. Trust, Bank of America Private Wealth Management**. Based in Boston, he manages the team that administers and supports the bank's donor-advised fund, consisting of 6,500 accounts with approximately \$1.7 billion in assets. He is also responsible for strategic planning, and works with advisors and internal partners on developing DAF opportunities. He joined U.S. Trust in 2009, originally as an RFP specialist at its New York City headquarters.



**Phil Zielinski** is director of philanthropy for **Mercy Home for Boys & Girls**, a residential care facility that has served Chicago-area kids in crisis for more than 130 years. He and a team of philanthropic advisors work with donors to maximize their impact on the causes they care about while minimizing tax exposure. He has nearly 15 years of philanthropy experience, including previous roles as a lobbyist, grant administrator and planned giving officer. He is a member of the Chicago Council on Planned Giving, and the Association of Fundraising Professionals.



**Mabie:** DAFs provide limited control over fund management and administration, and there can be important differences among providers. We help clients research issues such as the nature of the assets to be donated, investment alternatives, management and control of the investments prior to selection. This helps to avoid miscommunication and helps our clients select a provider that shares their goals and objectives.

**Jagust:** Donors should decide if they prefer a local charity or one of the national commercial providers. Charities like the Jewish Federation that host DAFs tend to offer more individualized service, with staff who will take the time to learn about them and their interests. If donors choose a local charity, they should ensure its mission fits with their values. The commercial institutions provide efficient service, but generally don't assign dedicated staff to each donor. However, this option may be more convenient if the institution also manages the donor's personal investments.

**Turner:** Many DAF providers also offer a donor portal or technology offering for giving and transacting. The purpose of a DAF is convenience, and the technology should match the experience. For many donors, client service is of the upmost importance, including the ability to have individuals support or help them on a demand with any issue regarding their account or experience.

**>>How are DAFs typically addressed in succession planning?**

**Jagust:** Donors can name their DAF as the beneficiary

of their IRA or any part of their testamentary estate. This makes DAFs a particularly powerful tool in managing estate taxes, while also building a charitable vehicle that can be passed to the next generation. Donors can designate successors who would then be able to make charitable gifts from the fund and continue their charitable legacy.

**Turner:** Rather than having an individual be named to take over the account, the funds can ultimately be distributed to a charitable organization. This flexibility is unique and provides different types of planning for a variety of donors.

**Zielinski:** DAFs can be a great way to engage your family and heirs in philanthropy. Giving your children and grandchildren the ability to research their own causes and become involved in building something great can show them the importance of giving back. It's an excellent way to teach loved ones about your values and learn more about their values as well.

**>>Is there anything else you'd like people to know about DAFs?**

**Jagust:** Annual distributions from DAFs generally far exceed the five percent required of private foundations; nationally, they give out around 20 percent of their assets each year. In 2018, the Jewish Federation gifted roughly 30 percent to charities across the spectrum of society. DAFs have become a powerful tool in supporting charitable causes at a time when charitable giving in America is at an historic high. They not only contribute an

outsized percentage of their assets to charity; they help donors build additional wealth that's earmarked solely for charitable use, and encourage engagement in philanthropy across all sectors of society.

**Zielinski:** Philanthropy should be approached with the same level of attention as any investment plan. The challenge is to give intentionally and effectively, so that your gifts make the greatest difference to the people and organizations who need them most. A DAF

can help you maximize your impact and simplify your giving.

**Mabie:** Our clients use DAFs to make meaningful and positive contributions to their community while meeting their charitable goals. At Chicago Capital, we invest in our community and encourage you to join us.

**Turner:** DAFs are a good universal product for charitable giving, but may not be right for every person. We've found that many conversations

between clients and their investment professionals don't include a discussion around giving and the possible usage of a DAF. Doing so encourages clients to become engaged in philanthropy while supplying a benefit to meet an ultimate financial need.

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