

# THE PROMISE—AND A PROBLEM—OF DONOR-ADVISED FUNDS FOR CHARITY

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## About the Author



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From 1987 through 2006, Husock was director of case studies in public policy and management at Harvard University's Kennedy School of Government, where he was also a fellow at the Hauser Center on Nonprofit Organizations. His publications on the nonprofit sector have appeared in the *Wall Street Journal*, *National Affairs*, *New York Times*, *New York Times Magazine*, *Society*, *Chronicle of Philanthropy*, and *Public Interest*. Husock has written widely on U.S. housing and urban policy, including in his book *The Trillion-Dollar Housing Mistake: The Failure of American Housing Policy* (2003) and his monograph *Repairing the Ladder: Toward a New Housing Policy Paradigm* (1996). His work has appeared in the *Journal of Policy Analysis and Management*, *Philanthropy*, and *The Wilson Quarterly*.

A former broadcast journalist and documentary filmmaker whose work won three Emmy Awards, Husock serves on the board of directors of the Corporation for Public Broadcasting. He holds a B.A. from Boston University's School of Public Communication and was a 1981–82 mid-career fellow at Princeton University's Woodrow Wilson School of Public and International Affairs.

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## Executive Summary

Donor-advised funds (DAFs), individual charitable accounts that can be used to make grants over a donor's lifetime, are the fastest-growing way in which Americans set aside money for charity. The sharp growth of DAFs has also attracted criticism, including the allegation that the charitable arms of national financial-services firms—such as Vanguard Charitable, Fidelity Charitable, and Schwab Charitable—impose excessive fees to manage DAFs; and that, because assets placed in DAFs may not be distributed for years, DAFs are “undermining” American charity. This report examines such critiques.

### Key findings include:

- 1. *DAFs are a legitimate vehicle for charitable giving, not a ruse to avoid taxes.*** By reducing donors' tax burdens, DAFs encourage more charitable giving than would otherwise exist. According to the National Philanthropic Trust, as DAF assets grew from \$57 billion to \$70.7 billion during 2013–14, DAF disbursements (i.e., grants) held steady at 21.9% of assets—well above the 5% disbursement rate required of private foundations. (During the same period, grants from private foundations totaled 5.8% of assets.)
- 2. *The use of national financial-services firms to manage DAFs is not diverting money from charitable giving.*** The management fees charged by such firms are comparable with those charged by local community foundations, the other major “sponsor” (i.e., manager) of DAFs.
- 3. *The overwhelming majority of DAF assets are disbursed to charities during their donors' lifetimes.*** However, national financial-services firms do hold small amounts of DAF assets that have not been disbursed at the time of their donors' death and have not been earmarked for disbursement to particular charities. Ideally, these “orphan assets” should be automatically distributed to donors' previous recipients, in proportion to their previous giving patterns.



# THE PROMISE—AND A PROBLEM—OF DONOR-ADVISED FUNDS FOR CHARITY

## I. Introduction

Donor-advised funds are the fastest-growing vehicles that Americans use to set aside funds for charity. In 2010, two years after the IRS clarified rules governing DAFs,<sup>1</sup> there were 184,364 DAFs in the U.S.; in 2014, there were 238,293.<sup>2</sup> During the same period, charitable assets in DAFs grew from \$33.6 billion to \$70.7 billion, and DAF disbursements, i.e., charitable grants, grew from \$7.24 billion to \$12.49 billion.<sup>3</sup>

DAF assets are irrevocably committed to charity, but the donor determines the recipients and the timing of disbursements. DAFs are housed in sponsoring organizations—including the charitable arms of national financial-services firms (such as Vanguard Charitable, Fidelity Charitable, and Schwab Charitable)—which administer DAFs and charge a fee for the service.<sup>4</sup>

The explosive growth of DAFs is reshaping America’s charitable landscape.<sup>5</sup> By 2014, there were nearly three times as many DAFs as private foundations; DAFs were growing four times faster, too.<sup>6</sup>

National financial-services firms—which house some 58% of all DAFs<sup>7</sup>—also offer donors investment services. In 2015, 48 national financial-services firms managed DAFs; 608 local community foundations managed DAFs; and 360 single-issue or specialty sponsors, such as those established by universities, managed DAFs.<sup>8</sup> A strikingly high percentage of DAFs assets are disbursed annually to charity: indeed, even as DAF assets increased substantially from 2013 to 2014, overall grant-making held steady, at more than 21.9% of assets—far more than the 5% of assets required of private foundations, such as the Gates and Ford Foundations.

DAFs, in short, would seem to be uncontroversial: they encourage charitable giving, boost the value of assets dedicated to charity, and disburse funds only at the direction of their “donor-advisors.” Yet DAFs have attracted plenty of criticism. Two prominent DAF critics, Lewis Cullman of the Cullman Foundation and Ray Madoff of Boston College Law School, have even claimed that the growth and practices of DAFs—particularly those managed by national financial-services firms—have led to “the undermining of American charity.”<sup>9</sup>

The question of whether charitable giving follows the intent of the donor is often a concern after the death of those who establish private foundations. Likewise, the question of donor intent lies at the heart of many critiques of DAFs, including: Are DAFs being used as a legitimate vehicle to fund charity? Are the management fees charged by national financial-services firms reasonable? And are DAF donors disbursing sufficient amounts to charity each year?

Drawing on exclusive proprietary data granted to this author by DAF-sponsoring national financial-services firms, this report evaluates some of the most common criticisms of such firms, as well as of DAFs in general.

## II. Why Are DAFs Popular?

Donor-advised funds are not a recent innovation. The New York Community Trust, which manages the assets of donors focused on charitable giving in New York City, was created in 1931. However, the current U.S.-wide explosion of DAFs dates to 2008.

Fidelity Charitable, for example, is now the largest recipient of charitable gifts in the U.S., surpassing the United Way: the former collected \$4.5 billion in 2015 while the latter, the traditional leader, raised \$3.7 billion.<sup>10</sup> In 2014, Fidelity Charitable's donor-advisors disbursed \$2.6 billion to charity, making the organization America's second-largest grant-maker (the Gates Foundation disbursed \$4.2 billion).<sup>11</sup>

This new charitable-giving model has grown rapidly for numerous reasons. Unlike traditional private foundations, where a professional staff decides who receives grants, the individual who establishes a DAF decides where his or her money goes. DAF donors can also avail themselves of the administrative services of national financial-services firms, which make selling equities, say, and transferring the proceeds into DAFs easier.

With DAFs, donors may put aside large sums for charitable purposes in years when their incomes are high and disburse those funds slowly over years (such as during retirement) when their incomes are low. By increasing the tax-reduction value of chari-

table giving, DAFs encourage more of it. With DAFs, donors can even direct funds to favorite causes and organizations after their death.

## III. Common Criticisms of DAFs

At their heart, there are two major criticisms of DAFs. The first is a concern about the intention of donors—to what extent are donors motivated by the traditional charitable impulse? The second is whether the national financial-services firms and other sponsoring organizations manage DAFs in a manner that ensures that the wishes of donors are achieved.

### *DAFs and Taxes*

DAFs make it relatively easy to realize charitable tax deductions. Especially with DAFs managed by national financial-services firms, individuals and households can seamlessly transfer assets from their private, personal accounts into their DAFs. Because Vanguard Charitable and Fidelity Charitable, among others, are tax-exempt nonprofit organizations, donations to accounts housed within them are fully tax-deductible. (Thus, even if a stock holding increases in value, for instance, one can sell it without paying a capital-gains tax, so long as the proceeds from the sale are transferred into one's DAF.)

DAF critics find this situation problematic. Cullman and Madoff, for example, label it “an enhanced tax deduction” and express alarm that donors can realize a tax deduction simply by transferring funds to their DAFs—and not to an operating charity, such as a food bank or homeless shelter. DAFs, they argue, “make it easy for donors to time their charitable donations in a way that produces the most tax benefits.”<sup>12</sup>

True, but so what? The assets moved into a DAF are irrevocably transferred and cannot be reclaimed for personal use by the donor, and they can be disbursed only to bona fide charities. (A grant recipient must be registered with the DAF sponsor—or it will be the subject of an investigation by the DAF sponsor to ensure that it is bona fide.)

Cullman and Madoff note that only 7.9% of DAFs made grants in 2012.<sup>13</sup> But they fail to mention that DAFs disburse far more of their assets than private foundations.

According to IRS data, the median foundation distribution rate in 2013 was 5.1%.<sup>14</sup> This figure is similar to the 5.8% annual median payout rate for endowed foundations for 2007–09, as reported by the Foundation Center.<sup>15</sup> DAFs, on the other hand, disbursed 21.9% of their assets in 2014.<sup>16</sup>

That assets in DAFs are not disbursed in full and immediately to charities should not be a concern, either. Undisbursed DAF assets appreciate in value: at Fidelity Charitable, for example, DAF assets appreciated by \$3.3 billion during 2008–15.<sup>17</sup>

### Management Fees

By far the fastest-growing group of DAFs are those housed in Fidelity Charitable, Vanguard Charitable, and Schwab Charitable, which all charge management fees. Cullman and Madoff claim that “[t]he business model of commercial DAF sponsors is to profit from the fees they secure.”<sup>18</sup>

This criticism leaves out an obvious fact: *Any* charitable donation, except, perhaps, those made directly to an operating charity to pay for current expenses, will inevitably be directed to an investment account—whether an endowment, reserve fund, or bank account—that will incur management fees.

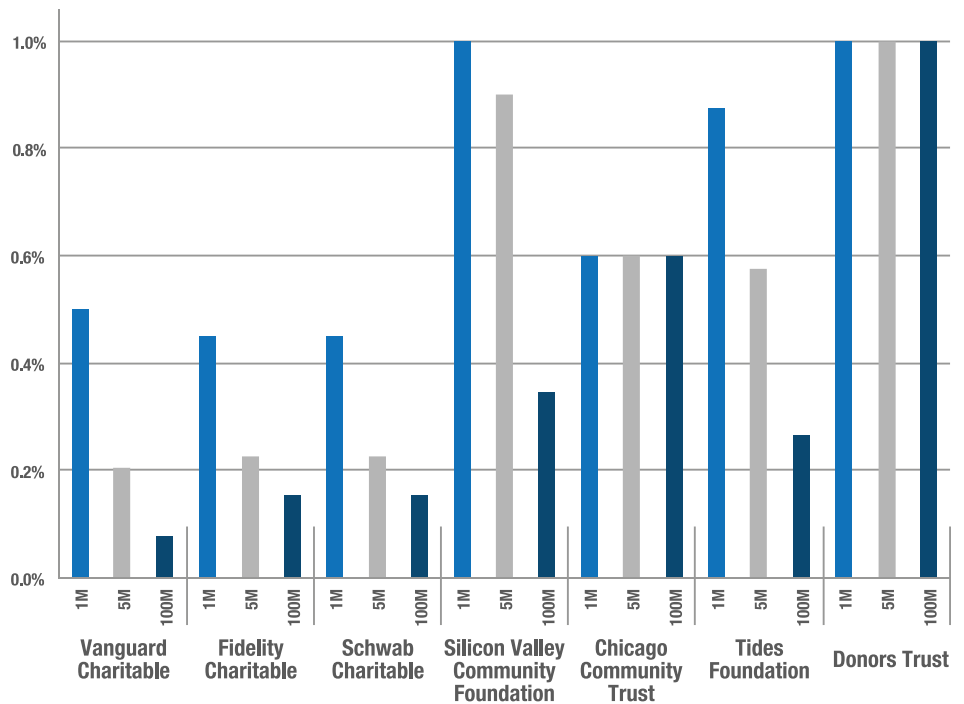
The fees charged to DAFs are not outrageously high. They are, in fact, similar to those charged by local community foundations. **Figure 1** compares the fees charged by Vanguard Charitable, Fidelity Charitable, and Schwab Charitable with those charged by the Silicon Valley Community Foundation, Chicago Community Trust, Tides Foundation, and Donors Trust—some of America’s largest community foundations.

### DAFs and Orphan Assets

National financial-services firms and local community foundations ask—but do not require—donors to specify what should happen to assets that are undis-

FIGURE 1.

### % Management Fee on Asset Value (\$ millions)



Source: Vanguard Charitable, Fidelity Charitable, Schwab Charitable, Silicon Valley Community Foundation, Chicago Community Trust, Tides Foundation, Donors Trust<sup>19</sup>

bursed at the time of their death. Typically, donors can choose one of the following options:

- ◆ Designate individual successors, such as family members, to assume the role of donor-advisor. In this case, the DAF could continue much as it had been operating—potentially receiving new charitable funds and making grants to individual charities.
- ◆ Designate a specific charity, or charities, to receive all remaining assets. The DAF would then be closed.
- ◆ Direct all remaining assets to an “endowed-giving” program, where grants are made to designated charities over time, rather than in a lump sum. When the assets are ultimately disbursed, the DAF would then be closed.

In the case of DAFs sponsored by local community foundations, donors have some assurance that—even



if they do not choose one of the above options—their philanthropic goals will continue to be pursued: at such foundations, if “orphan” (i.e., undisbursed and undirected) assets exist, they are disbursed at the foundation’s discretion, whose broad goals are known to donors before they open their DAFs there.

However, the same does not apply at national financial-services firms, which lack official “cause-related” missions and were established only to facilitate DAFs. At DAFs housed at Fidelity Charitable—America’s largest charitable organization<sup>20</sup>—only 60% of donors have designated a successor or have otherwise directed what should happen, after their deaths, to their undisbursed assets.<sup>21</sup> (At Vanguard Charitable, the comparable figure is much higher: 91%.<sup>22</sup>)

Fortunately, to date, the lack of donor-succession plans has led to only a relatively small amount of orphan assets. In 2015, at Fidelity Charitable, orphan assets—spread over 90 deceased donors—amounted to \$913,000;<sup>23</sup> at Vanguard Charitable, they totaled \$1.38 million.<sup>24</sup>

National financial-services firms transfer orphan assets to general charitable funds, overseen by boards of directors and staff, who then decide where

to direct the assets. Fidelity Charitable, for example, seeks to disburse orphan assets within a year after they are transferred to its general charitable fund.<sup>25</sup> Orphan assets are ultimately disbursed to bona fide charities (Figure 2), as required by such firms’ policies; but the lack of any donor mandate or direction is troubling and will become more so as total DAF assets at such firms—and, thus, orphan assets—rise in future years.

FIGURE 2.  
Sample Grants of Orphan Assets at Fidelity Charitable, FY 2015

Recipient	Locale	Amount of Grant
Center for Employment Opportunities	NY	\$123,500
Exponent Philanthropy	DC	\$150,000
Foundation Center	NY	\$250,000
Mercy Corps	OR	\$115,000

Source: Fidelity Charitable<sup>26</sup>





## IV. Conclusion

The sharp growth of donor-advised funds has attracted criticisms, but most complaints are misplaced. It may be true that donors use these funds to maximize their lifetime charitable tax deduction; but in doing so, donors have an incentive to make larger sums available for charitable purposes. The assets managed in DAFs also increase in value and can be used only for charity.

Any notion that, except for DAFs, most charitable donations would be immediately used by charitable nonprofits misunderstands the workings of such organizations, virtually all of which have reserve funds or endowments whose assets are not used on a first-in, first-out basis. The undisbursed assets in DAFs should be viewed as a fast-growing, rainy-day charitable fund—stocked during prosperous years but available, countercyclically, in lean ones.

As for the fees that national financial-services firms charge for managing DAFs, the reality is that managing charitable assets inevitably incurs fees of some kind, paid to some entity. Moreover, the fees charged by national financial-services firms are comparable with those charged by other DAF sponsors, such as local community foundations.

The growth of orphan assets, however, is a potential problem, as they can be disbursed without regard for the intent of original donors. Such firms could tackle the problem of orphan assets by adopting one of the following policies (because policies one and two are already available to donors, policy three would be most desirable):

- 1. Require donors to designate successors to direct their assets.** This would avoid bequeathing orphan assets but would not ensure that a donor's assets were disbursed immediately after his death—ultimately, the assets would have to be disbursed to charity; but the new donor-advisor would control the timing. (Vanguard Charitable recently began imposing this requirement for new DAFs.)<sup>27</sup>
- 2. Require that recipients be designated for undisbursed assets.** This would ensure that all assets in a DAF after the donor dies are disbursed as instructed by the donor.
- 3. Automatically distribute undisbursed/undirected assets to donors' previous recipients, in proportion to previous giving patterns.** This would ensure that all assets were disbursed after a donor dies, more or less with regard to the donor's intent.



## Endnotes

- <sup>1</sup> As part of its comment on the Pension Protection Act of 2006, the IRS made clear that a donor-advised fund should be considered a public charity. See “Donor-Advised Funds Guide Sheet Explanation,” Internal Revenue Service, July 31, 2008.
- <sup>2</sup> “2015 Donor-Advised Fund Report,” National Philanthropic Trust, p. 6.
- <sup>3</sup> *Ibid.*, p. 5.
- <sup>4</sup> See, e.g., “Donor-Advised Funds,” Internal Revenue Service, Oct. 28, 2016; and “What Is a Donor-Advised Fund (DAF)?” National Philanthropic Trust.
- <sup>5</sup> Assets held by registered U.S. nonprofits, whether housed in private foundations, trusts, or public charities (including the sponsors of DAFs), have increased significantly, from \$3.07 trillion in 2003 to \$5.17 trillion in 2013. See Brice S. McKeever, “The Nonprofit Sector in Brief 2015: Public Charities, Giving, and Volunteering,” Urban Institute, Oct. 2015. Within that universe of total charitable assets, the book value of private foundations grew from nearly \$419 billion to roughly \$693 billion during the same period. See “SOI Tax Stats—Domestic Private Foundation and Charitable Trust Statistics,” Internal Revenue Service, Nov. 9, 2016.
- <sup>6</sup> “2015 Donor-Advised Fund Report,” p. 4.
- <sup>7</sup> *Ibid.*, p. 8.
- <sup>8</sup> *Ibid.*, pp. 3–4.
- <sup>9</sup> Lewis B. Cullman and Ray Madoff, “The Undermining of American Charity,” *New York Review of Books*, July 14, 2016.
- <sup>10</sup> Drew Lindsay et al., “Fidelity Overtakes United Way as New Charity Champion,” *Chronicle of Philanthropy*, Oct. 27, 2016.
- <sup>11</sup> See “2015 Giving Report: A Deeper Look at Fidelity Charitable Donors and the Many Ways They Give,” Fidelity Charitable; and “Foundation Fact Sheet,” Bill and Melinda Gates Foundation.
- <sup>12</sup> Cullman and Madoff, “The Undermining of American Charity.”
- <sup>13</sup> *Ibid.*
- <sup>14</sup> “Domestic Private Foundations, Tax Year 2013,” Internal Revenue Service.
- <sup>15</sup> Loren Renz, “Understanding and Benchmarking Foundation Payout,” Foundation Center, Sep. 28, 2012.
- <sup>16</sup> “2015 Donor-Advised Fund Report,” p. 3.
- <sup>17</sup> Fidelity Charitable’s response to author’s query.
- <sup>18</sup> Cullman and Madoff, “The Undermining of American Charity.”
- <sup>19</sup> See “Fees and Expenses,” Vanguard Charitable; “What It Costs,” Fidelity Charitable; “Account Fees and Minimums,” Schwab Charitable; “Administrative Fees for Donor-Advised Funds,” Silicon Valley Community Foundation; “Donor-Advised Fund with the Chicago Community Trust,” Chicago Community Trust; “Tides: What’s Possible—Donor-Advised Funds,” Tides Foundation; and “Administrative Fees for Donor-Advised Funds,” Donors Trust.
- <sup>20</sup> “Fidelity Overtakes United Way as New Charity Champion.”
- <sup>21</sup> Fidelity Charitable’s response to author’s query.
- <sup>22</sup> Vanguard Charitable’s response to author’s query.
- <sup>23</sup> Fidelity Charitable’s response to author’s query.
- <sup>24</sup> Vanguard Charitable’s response to author’s query.
- <sup>25</sup> Fidelity Charitable’s response to author’s query.
- <sup>26</sup> *Ibid.*
- <sup>27</sup> Donors can designate Vanguard’s general charitable fund as their successor. National financial-services firms, including Vanguard, should publicly list the charities that their general charitable fund supports, as well as explain why they support such charities.





## Abstract

Donor-advised funds (DAFs), individual charitable accounts that can be used to make grants over a donor's lifetime, are the fastest-growing way in which Americans set aside money for charity. The sharp growth of DAFs has also attracted criticism, including the allegation that the charitable arms of national financial-services firms—such as Vanguard Charitable, Fidelity Charitable, and Schwab Charitable—impose excessive fees to manage DAFs; and that, because assets placed in DAFs may not be distributed for years, DAFs are “undermining” American charity.

## Key Findings

1. DAFs are a legitimate vehicle for charitable giving, not a ruse to avoid taxes. By reducing donors' tax burdens, DAFs encourage more charitable giving than would otherwise exist.
2. The use of national financial-services firms to manage DAFs is not diverting money from charitable giving. The management fees charged by such firms are comparable with those charged by local community foundations, the other major “sponsor” (i.e., manager) of DAFs.
3. The overwhelming majority of DAF assets are disbursed to charities during their donors' lifetimes. However, national financial-services firms do hold small amounts of DAF assets that have not been disbursed at the time of their donors' death and have not been earmarked for disbursement to particular charities. Ideally, these “orphan assets” should be automatically distributed to donors' previous recipients, in proportion to their previous giving patterns.