Wall Street Muscles In

Posted on October 28, 2013by Alan Cantor

I really wish I'd been wrong in my earlier warnings about the growth of commercial donor-advised funds. But the latest Philanthropy 400 rankings from the *Chronicle of Philanthropy* indicate that the Wall Street acquisition of the nonprofit sector is, if anything, ahead of schedule.

It turns out that for the second year in a row, the second-largest "philanthropy" in terms of funds raised in the U.S. is an entity called Fidelity Charitable. Fidelity Charitable's growth rate was an astonishing 89% over the year before, and with donations of $3.2 billion, it is positioned to overtake United Way Worldwide (that is, the combined United Ways of the entire country), which only grew 1% and raised $3.9 billion.

How is something named Fidelity considered a charity at all, let alone one that is poised to become the nation's largest? Here's a history lesson.

In 1991 the Internal Revenue Service issued a ruling that drew little notice, but that over time has turned the nonprofit world on its head. The IRS decreed that Fidelity Corporation could create an entity – at the time called the Fidelity Charitable Gift Fund, since rebranded as Fidelity Charitable – as a 501(c)(3) public charity. Gifts to Fidelity Charitable provide the donor with the same tax deduction as if she had donated the money to a soup kitchen or community health clinic or symphony orchestra. But rather than going directly toward some actual charitable good, the money is held in a donor-advised fund and invested in Fidelity mutual funds. It is presumed that some or all of the money will eventually be granted at the discretion of the donors to actual operating charities.

Donor-advised funds had long been the province of community foundations and national religious charities, but now, with the blessing of the I.R.S., Wall Street could create charities of its own – what I call NINOs, or Nonprofits In Name Only. Vanguard and Schwab followed suit with tremendously successful donor-advised funds of their own, which rank 13th and 18th in the latest philanthropy standings. (By comparison, the not inconsiderable fundraising machine of Harvard University checks in at number 21; Yale lands at 24.) Over the years practically every financial services firm has created its own version of donor-advised funds. Everyone on Wall Street is greedily grabbing a piece of the donor-advised fund action.

Why is Wall Street so invested in donor-advised funds? The answer becomes clear if you simply follow the money. Say you're a wealthy client at Acme Financial Services. You go to Bill, your financial

advisor. You tell him that you'd like to transfer $250,000 in stock to East Hackensack Community Music School as a donation for their capital campaign.

Let's keep in mind how Bill gets compensated. If he is like many brokers, his company takes a percentage of your total funds under management with his firm as an annual fee, and Bill gets his share of that percentage as his own compensation. If you donate $250,000 to the Community Music School, then Acme Financial Services and Bill are managing a smaller account, and so both get a smaller fee. In other words, your charitable contribution will cause Bill to lose income. In the ancient past – say, twenty years ago – Bill would have smiled and processed the contribution, perhaps groaning inwardly. But now he can present you with an alternative.

"How about putting that $250,000 into the Acme Donor-Advised Fund?" he'll say. "You can get the same full charitable deduction as if you gave the money to the Music School. And then next year, or the year after, you can donate the funds to the Music School or anywhere you'd like! You can have your cake and eat it too!"

What Bill doesn't say is that if you pop those funds into the Acme Donor-Advised Fund, he will continue to draw his fees on that money, as though it were still in your personal account. And the longer money sits there, the longer he will get paid. In other words, he has a financial incentive to dissuade you from actually distributing money from your donor-advised fund to charity.

Many people ask me why I rant on about donor-advised funds. Isn't the rise in donor-advised funds promoting charitable giving? No, it's not. That's the problem. Overall charitable giving in the U.S. has been very steady – up only 1.5% above the inflation rate in the last year studied, according to the 2013 Giving U.S.A. Report. So when Fidelity's take of the charitable haul is up 89% in one year, and when another donor-advised fund mill, the American Endowment Foundation, the outfit I examined in my last post and in the *Chronicle of Philanthropy*, finds its donations up a cool 103% over 2011, you have to realize that many actual charities are *not* getting funded as they had been previously. The money is going, instead, into donor-advised funds.

Yes, my challengers will say, but the money *will eventually* be going out to charity, so what's the big deal? Well, I respond, that money *won't* necessarily be going to charity at all. There is no federal requirement that funds in a donor-advised fund *ever* be distributed to charity. Though the more responsible donor-advised funds have policies requiring some sort of distribution, most do not, or they describe such requirements with a wink and a nod. A few months ago I called Schwab Charitable and said I was interested in opening a donor-advised fund. I asked: "Would I have to actually send money out to charity?" The woman on the phone chuckled and said that if I failed to make any charitable grants from my fund for five consecutive years, they would call to remind me to make at least one grant – but, she said, laughing, the minimum grant size is only $50, so that shouldn't be much of a hardship for me.

It’s fashionable to mock United Way as a tired model, where donors give to a common fund mostly through payroll deductions. “The donors have no control!” say its critics. But think about how funds from United Way dollars are used: to underwrite the operating expenses of the community’s most vital social service agencies. United Way keeps the lights on at health clinics for the poor, childcare centers for immigrant kids, mental health centers, drug rehab agencies, Boys and Girls Clubs, after-school programs, and Meals on Wheels for the elderly. Now United Way is about to lose its position as the leading philanthropy in the U.S. The new model? An entity established by a major financial firm that warehouses charitable dollars on behalf of the wealthy, distributing charitable deductions to the donors, commissions to their brokers, profits to the sponsoring corporation, and nothing at all to charity until the donors give the nod.

I’m not against capitalism. I simply think the values and incentives of capitalism should not take over the charitable sector. I don’t think it’s possible to undo the damage caused by that IRS ruling in 1991. We can’t unscramble the egg. But we *can* minimize the damage by requiring a hefty annual pay-out of 20% from all donor-advised funds. Then the money would, indeed, do some actual good.

Copyright Alan Cantor 2013. All rights reserved.