

# GIFT PLANNING *in Canada*<sup>™</sup>

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## Taking Stock: More Options With Stock Options

BY JO-ANNE RYAN

Happy New Year!

As we are working our way out of one of the deepest, darkest recessions in history, it is reassuring to see some light at the end of the tunnel. A recent CRA administrative position related to employee stock options provided just that bright light for me.

Over many years of working with executives in an advisory capacity, I have been struck by their commitment to charitable giving, not only in terms of their time, but also in terms of financial support. However, opportunities to maximize tax benefits, especially through the exercise of employee stock options, are often overlooked.

### The ABCs of stock options

An employee stock option is a right, but not an obligation, to acquire a specified number of shares of his or her employer's company at a certain

price (the "exercise price") during a predetermined period of time. The exercise price is almost always set at not less than the fair market value of the share at the date the option is granted. Stock options generally vest, or become exercisable, after a specified time. Once the options vest, the employee has the right to purchase the underlying securities at the exercise price. Typically, the employee stock option will expire after a specified number of years (e.g. 10 years). Therefore the executive will want to exercise the option prior to expiry if it has value.

When the market value of the underlying security is higher than the exercise price, the option is said to be "in the money". An employee would normally choose to take advantage of such options and exercise them when they are "in the money". Otherwise, they are "underwater." When an option is "in the money", and not yet vested, the value created is an incentive for the employee to remain employed with the company on a long-term basis. When underwater, or after expiry, the option represents no value to the employee.

### Taxation of stock options

When stock options are exercised, the difference between the stock's fair market value and its exercise price is considered a taxable employment benefit and is taxed as income but at the same rate as a capital gain. This means that 50% of the difference is taxable as income. However, if the stock is a publicly listed security and the stock or the proceeds of the stock sale is donated to a registered Canadian charity within 30 days of the exercise date (provided it is within the same calendar year) the tax is eliminated.

It is important to note that while gifts of publicly listed securities must be donated "in kind" to a charity in order to qualify for the elimination of capital gains tax, when exercising stock options, the cash proceeds of the stock sale may be donated to charity and will still result in the elimination of tax on the employment benefit (subject to certain conditions).

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### Cashless exercise of stock options

One of the challenges with stock options is that the employee has to somehow come up with the money in order to exercise the options (i.e. to purchase the stock at the exercise price). To address this situation, many stock option plans have a "cashless exercise" feature which can help to alleviate that concern.

A "cashless exercise" is the exercise of an option by the employee in a manner that does not require the employee to provide the cash to exercise the option before the exercise, but instead allows the employee to use the equity built up in the option (in other words, the difference between the market value of the underlying stock and the exercise price as a way to exercise the option) to pay the exercise price.

For example, if the employee has options covering 1,000 shares of stock exercisable at \$1 a share, and the fair market value of the stock is \$2 a share at the time of exercise, then the employee can pay the exercise price out of the proceeds of the sale of the stock after it is sold.

In this case the process works as follows:

**Exercise:** The employee confirms he/she wants to exercise and sell the shares on the Trade Date

**Trade Date:** 1,000 shares are sold at market for \$2.00 per share

**Trade Date plus 3:** Employee's brokerage account is credited with \$2,000 when the trade settles. Exercise price to be paid by the employee is \$1,000 (1,000 shares @ \$1.00 per share) and this amount is deducted by the employee's payroll department from the proceeds of the trade in the employee's brokerage account. In addition the payroll department would deduct the applicable withholdings (CPP, EI and income tax).

### Withholding tax on cashless exercise

I was recently approached by an executive with a very noble objective. He wanted to do a cashless exercise of a set of stock options, and to donate the entire cash proceeds after payment of the exercise price to charity. His objective was simple: to get the maximum amount in the charity's hands as quickly as possible. When the executive approached the payroll

department of his company, he was advised that upon completing the cashless exercise of his options, the amount available for the donation would be net of the applicable tax, CPP and EI withholdings.

Their procedures were following the CRA policies around statutory withholdings which provide that:

A) If stock options are exercised and the stock acquired is donated to

charity, no statutory withholdings need to be deducted and remitted

B) If the stock options are exercised, the stock acquired is sold, then statutory withholdings are required.

In other words, CRA did not have a specific policy dealing with the cashless exercise where proceeds are gifted to charity.



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Since in a cashless exercise the stock is always sold, the payroll department indicated it should deduct the withholdings. The executive was planning to complete this transaction in January 2010 and wanted the donation to include the amount which would otherwise be deducted and remitted on account of statutory withholdings. He did not want to wait until April 2011 to receive a refund of those amounts which he could subsequently donate to the charity to top up his donation. It was clear that the tax savings from the donation would more than offset the tax owed from exercising the option, so the deduction and remittance of the withholdings seemed unfair and unnecessary.

After a lengthy discussion with the CRA Income Tax Rulings Directorate (“Rulings”), I received a verbal confirmation that the payroll department did not have to withhold tax if the proceeds were to be donated to charity. They were not prepared to put this in writing however. A verbal confirmation did not satisfy the executive’s payroll department, which took its fiduciary responsibility around statutory withholdings very seriously and they decided to have their own tax advisor speak to yet another person in Rulings. That CRA officer advised that they would have to withhold tax in this situation. Determined to help this executive maximize his charitable gift, I contacted the original person that I spoke to in Rulings who put me in touch with someone from the CRA Trust section (the area responsible for withholdings). After discussions back and forth, including many e-mails, they confirmed that statutory withholdings would not be necessary in such situations, but insisted that the employer be responsible for directing the funds to charity if they were not going to deduct and remit the withholdings. After I explained that the stock options “settle” in the employee’s brokerage account, from which the employer has no authority to direct funds, CRA agreed to waive the withholding and remittance obligations provided the employee confirms in writing to the employer - in advance of completing the cashless exercise - that all of the cash proceeds will be donated to charity.

After reviewing this written confirmation from the Trust section of this position, the employee’s payroll department felt comfortable with completing the cashless exercise without deducting and remitting the statutory withholdings and the executive was able to maximize his gift by donating the full cash proceeds of the cashless exercise to charity.

### **The bottom line**

CRA has now confirmed in writing that for a cashless exercise of stock options where the underlying stock is publicly traded and the cash proceeds are donated to charity, no amounts on account of income tax, CPP or EI are required to be deducted and remitted. A requirement is that the employee must confirm in writing to his/her employer the intent to donate all of the proceeds (after payment of the exercise price) to charity prior to exercising the stock options.

The recent market decline has been challenging for charities. However, stock options granted during the period typically involved exercise prices very close to record lows. As the market recovers and these stock options begin to vest, many executives will have stock options that are “in the money”. Donating the proceeds of a cashless exercise of stock options has just become a lot easier and very tax effective. So while the market decline has been tough on everyone, it appears that every cloud has a silver lining.

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## **Free Wills Programs – the Missing Piece of the Puzzle?**

BY KEN RAMSAY

For a long time I have been puzzled by an unexplained gap in bequest conversion rates in proactive planned giving campaigns. When Legacy Leaders conducts its typical bequest solicitation campaign of supporters and affiliates of a specific charitable

organization, we get positive conversion rates in the 15% to 30% range. There have been rare exceptions of conversion rates of over 30% but these only happen with very passionate supporters of very emotional causes. On the other hand, solid Canadian research (Myers, Mallebone, 2000) tells us that 40% of adult Canadians have a propensity to include a charity in the will (12% have already and 28% would do so if asked.)

The puzzle is why Legacy campaigns do not achieve this 40% mark. There is a gap between our results and the potential out there in the population. There are some hints to the answer of this puzzle. At times, Legacy goes to the public (non-donors, non-volunteers) for bequest support and in all cases, there are positive responses. Strong community hospitals for example, can garner positive bequest support in the 5% to 15% range in a well-defined, cohesive community. So, we know that there is bequest-propensity potential in the general population *at all times*. The question then becomes, is there a fund raising methodology that can efficiently develop this potential in the Canadian marketplace? The answer is yes and it has been around for many years.

### **What is it?**

The methodology is *Free Wills Programs*. A typical program makes this offer to the public – “obtain the drafting of a free will and, if you want, include a sponsoring charity in your will, but you are under no obligation to do so.” On the surface this a simple offer that drives an individual to complete or update his or her will. The driver is clearly the “free” service provided. When these wills are completed, a certain percentage of individuals will include a sponsoring charity in the will. Notice the disclaimer – “you are under no obligation to include any charity in your will”. This methodology taps into the propensity that exists in the general population; that is, the natural generosity of Canadians, and, even though there is no obligation, a consistent percentage of people will elect a charity as a beneficiary.

### **How does it work?**

There are several variations of the *Free Wills Program* successfully deployed

in the United Kingdom. The program was initially pioneered by Cancer Research –United Kingdom (CRUK) which has developed a sophisticated year-round program. CRUK is the largest charity in the UK. In its program, leaflet mail drops are sent to strategically targeted postal codes to encourage the drafting of a free will by select solicitors (lawyers) at any time. This leaflet also encourages the need for an up-to-date will and the CRUK case for support. CRUK has been very analytical in its program, maximizing return on investment (ROI) and overall revenue growth. For the last several years they have expended approximately £1 million annually and received in-the-will bequests totalling £30 million. After 13 years they have approximately £330 million in the pipeline with a net present value (NPV) of £120 million – a huge enterprise. This program includes the development of a network of 1100 carefully selected and managed solicitors across England and Wales, who are coached on the mission and programs of CRUK, but, of course, who at the same time ensure that no undue influence is put on their clients.

For the last four years, a variation of the CRUK program has been successfully developed, also in the UK. Several third party fund raising companies now promote alliances of up to 10 charities that band together to make the same offer to the public for a limited period of time in a specific city or cities. This program is driven by local print media and mail drops. A team of solicitors is developed for each targeted city. The results of these programs show that over 50% of individuals who obtain a free will also include a sponsoring charity in the will. Some programs intensely focus on one city while others skim the surface in a number of cities. The bottom line is that this methodology works. It has been well accepted by the public and has become a valuable source of in-the-will bequests for participating charities, and it is coming to Canada.

### **Transfer to Canada**

Canada is a different country than the UK. The mix of people is different; the geography is different; the wealth distribution is different; and the philanthropic tendencies are different.

Legacy Leaders has asked over 300,000 Canadians for a bequest and we have learned a lot about how to do so successfully, and how people will respond. Based on these noted differences we can estimate the results of *Free Wills Programs* in Canada. The average age of a *Free Wills* donor is age 69 (the program is restricted to age 55 and older) in the UK. The average will be slightly less in Canada because of the greater boomer “bulge” in Canada. The average bequest size in these programs is £8,000 in the UK, but will be significantly higher in Canada because of the significantly higher average wealth level of Canadian families. The response rate will be at least as strong in Canada, and probably stronger, because of the higher charitable-bequest propensity in Canada, and the historically less aggressive bequest marketing.

This analysis suggests that such programs will work in Canada. Because of the different geography wherein cities are more spread out, a better methodology would appear to be to focus on one market at a time and develop the potential more fully in that market by extending the local advertising in scope and frequency. This one-city-at-a-time approach improves efficiency and allows for local charities to participate – another important difference in Canada. In the UK almost all programs utilize strong national brands only. In Canada, such a strategy would eliminate local hospitals and social service agencies and underestimate the strong, local, self-identity of cities.

The Philanthropic Alliance Group, Legacy Leaders’ new sister company, has announced a minimum of 16 Canadian cities coast-to-coast in which it is prepared to build charity alliances in the coming year. The methodology will transfer very well to Canada if one keeps in mind these differences.

### **Who will it work for?**

What charitable organizations will benefit from these programs? Almost all planned giving marketing is directed at existing donors or affiliates (volunteers, members, alumni, service recipients.) As such, the target bequest donor has, for the most part, through his or her actions endorsed the organizational mission or at least is very

aware of it. In a *Free Wills Program* the target may only be aware of your brand. In this case, it is your brand awareness and, subsequently, your mission awareness that will spur individuals to include your organization in their wills. Is your brand strong enough within the specific community? This is the critical question, and a tough one to answer. A companion question is whether your mission is well known and compelling enough. Without in-depth research it is difficult to ascertain these answers. However, do not discount your own personal experience. You speak to donors all the time, and you hear their stories - but do these stories transfer to the wider population? Is your organization relevant to only a certain segment of the population – e.g. a religious or educational institution? You must weigh all of these questions to decide whether a *Free Wills Program* will work for your charity.

There is also the competitive consideration. No alliance of organizations will include like-type charities unless both parties agree. However, certainly some brands are stronger than others. National health charities, for instance, track brand preference very carefully and so know their competitive strength. Nevertheless, a strong local charity with a well-defined, compelling mission may well trump a national brand in getting more of the bequests available in a *Free Wills Program*.

With all of this analysis going on, it is important to keep something in mind. The truth is, all participating charities will get results. All will receive bequests in the will. The real question is, at what ROI? The Philanthropic Alliance Group programs should deliver at an average ROI of \$0.04 to \$0.07 to future dollars or \$0.09 to \$0.13 to current dollars, for each participating charity. How will your organization do?

These ROI numbers are not the best you can achieve. Legacy programs, wherein you target existing supporters and affiliates, will operate at \$0.01 to \$0.04 to future dollars. However, *Free Wills Programs* develop revenue from new, untouched sources and do so at an impressive ROI. As well, these are completed gifts as more than 95% of individuals (U.S. research) never

remove a charity from the will. Ultimately, if your analysis passes muster, then the only way to find out results for your organization is to try it, and many organizations are going to do just that.

### Should we do it?

When the prospect of *Free Wills Programs* is dropped into a room full of gift planners in Canada, vociferous dialogue ensues. The initial response is either that it is ethically or legally wrong, or not the “right” way to do gift planning. Such response deserves careful consideration. Detailed review of CAGP and AFP codes of ethics and the Donor Bill of Rights indicate no possible ethical violation. These programs will be run with utmost transparency and accountability and at exemplary ROI. A review of provincial Law Society guidelines similarly reveals no conflicts for the legal profession and, in fact, in dialogues with many law firms across the country, the concept has been warmly received.

The bottom line is that, for some, the concept just doesn't feel right. It is different; it is new; it doesn't depend necessarily on the expertise of a gift planner; it sounds coercive even though participants are “not obligated to include a sponsoring charity in his or her will.” Mitigating these concerns is our knowledge that this methodology has been used widely for over a decade in a country with a similar legal and fund raising system. In fact, the Charity Commission in the UK (the body that regulates charities, analogous to our CRA) gives detailed instructions on the proper deployment of a *Free Wills Program*, always stressing the disclaimer: that no one is under any obligation to include a sponsoring charity in the will. The ethical and legal analysis shows no good reason why we should not try out this very new and different approach to planned giving marketing.

*Free Wills Programs* are coming to a Canadian city near you. The Philanthropic Alliance Group is embarking on a national program in 2010. Two British companies are making plans and this new and different program will be part of the

planned giving landscape in the near future. Like most change, it will challenge the status quo and maybe even rub some of us the wrong way. In the end however, it could provide a major jump forward in our philanthropic efforts to better society in Canada and around the world. It just might be the missing piece of the puzzle and deserves to be tried in Canada.

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## 2009 Donor Advised Fund Market Report

*An analysis of the overall market and trends by National Philanthropic Trust*

EDITED AND COMPILED BY  
ANDREW W. HASTINGS,  
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### About National Philanthropic Trust

National Philanthropic Trust (NPT) is an independent American charity based in Pennsylvania, dedicated to promoting and facilitating charitable giving by individuals, families, and organizations while expanding their knowledge in the field of philanthropy. Founded in 1996, NPT has been among the 100 fastest growing charities for seven straight years (2003-2009), and is one of the top 35 grant makers in the United States with \$665 million in assets under management. Since its inception, NPT has raised more than \$1.7 billion in charitable gifts, and made more than 37,000 grants to U.S. charities and charities in 26 other countries totaling \$1 billion. Led by a national board of trustees and a team of professionals with more than 200 combined years of philanthropic experience, NPT has proven expertise in the stewardship of charitable donations. NPT offers donor advised funds, supporting organizations, and special field of interest funds to help donors with the administration and investment of their philanthropic dollars and give them freedom to recommend support to

charities and causes that interest them. (From the NPT website)

### Research Process and Methodology

National Philanthropic Trust conducted the most comprehensive study of the donor advised fund market to date. During the second and third calendar quarters of 2009, NPT collected the following data from 253 organizations that administer donor advised fund programs. Sources included organizations' tax returns (990 Forms), audited financial statements, annual reports, survey responses from the sponsoring charities, and other publicly accessible sources such as *The Chronicle of Philanthropy*.

The types of organizations surveyed include:

- 32 national programs that include national public charities and commercially sponsored programs;
- 146 community foundations;
- 76 other groups that include university, faith-based, and other cause-related organizations sponsoring donor advised funds.

National Philanthropic Trust gratefully acknowledges the work of Nina Kalandadze in the collection of this data, as well as those sponsoring charities that shared their data with us.

### Summary: What the Donors Giveth, the Market Taketh Away

Despite the worst recession in over 70 years, donors increased the amount they contributed to their donor advised funds (2.2%) reaching a record \$9.1 billion. This outpouring of generosity, however, could not overcome the stock market's precipitous decline. Coupled with a substantial increase in donor grantmaking (19.4%), donor advised funds experienced their first ever year-over-year decline (-2.4%) in assets under management.

Notwithstanding the economic headwinds, the number of new donors creating donor advised funds continued to increase markedly (10.6%), reaching nearly 148,600 accounts. This suggests that as economic conditions improve donor advised funds are poised for explosive growth in the coming years.

**Table 1: Donor Advised Fund Market Overview**

Donor Advised Funds	2007	2008	% Change
Assets Under Management	\$29.3 billion	\$28.7 billion	(2.4%)
Tot. Contributions	\$8.9 billion	\$9.1 billion	2.2%
Tot. Grants	\$5.6 billion	\$6.7 billion	19.4%
Avg. Account Size	\$218,670	\$192,840	(11.8%)
Tot. Accounts	134,324	148,588	10.6%

### Financial & Professional Advisors Drive Donor Advised Fund Growth

The growth in donor advised funds is being driven predominantly by financial advisors, brokers, estate planners, accountants, and other professionals who have become educated about the benefits of this flexible and efficient model of charitable giving. The donor advised fund provides a turnkey solution. Unlike private foundations, they are easy to set up and far less costly to administer. Since the sponsoring charity manages the day-to-day administration and processes all gifts and grants, both advisors and attorneys appreciate that their clients only have to focus on what assets they would like to donate, and what charities to support. Again, unlike managing a foundation, there is no need to hold board meetings, take

minutes, file annual 990-PF tax returns, and understand the complexities of the tax code to ensure a foundation maintains compliance.

Financial advisors are integral in structuring their clients' investment and retirement portfolios, and are therefore well positioned to incorporate donor advised funds into their clients' comprehensive financial and estate plans. Because financial advisors often play such a central role in the establishment of donor advised funds, it is critical for them to continue to be educated about the ease and benefits this vehicle has to offer. Donor advised funds help financial advisors distinguish themselves from their competitors, helping financial advisors to move beyond a simple transactional relationship to one that appeals to their clients' personal values. Since

donors may name their children as successors, many financial advisors see this as an opportunity to connect with the next generation of potential clients. For these reasons, financial advisors will increasingly incorporate charitable giving vehicles, such as donor advised funds, into financial and estate planning in order to remain current with established trends in the marketplace.

### Donor Advised Funds vs. Other Charitable Options

Donor advised funds remain the fastest growing and most popular charitable vehicle. The number of donor advised funds being created, and the amount of assets they hold, are increasing at a far greater rate than all other charitable giving vehicles, as exhibited in Tables 2 and 3 below.

**Table 2: Donor Advised Fund Growth vs. Other Charitable Giving Options**  
(Number of Funds/Donors/Foundations)

	2007	2008	Pct. Change
Donor Advised Funds	134,324	148,588	10.6%
Charitable Remainder Unitrusts <sup>1</sup>	95,567	96,248	0.7%
Private Foundations <sup>2</sup>	74,470	76,704 <sup>3</sup>	3.0% <sup>3</sup>
Charitable Remainder Annuity Trusts <sup>1</sup>	20,187	19,241	(4.7%)
Charitable Lead Trusts <sup>1</sup>	6,377	6,521	2.3%
Pooled Income Funds <sup>1</sup>	1,676	1,488	(12.6%)

Another trend reported by a number of programs was the conversion of private and family foundations into donor advised funds. The most common reasons cited for individuals and families to convert their foundations include:

- Reduced administrative and operating costs;
- Increased tax benefits for future contributions;
- Ease of use, since donor advised funds can typically be managed online;

- Ability to support charities anonymously.

While DAF assets declined 2.4% this past year, this loss was modest, considering economic conditions, when compared to private foundations, which saw their assets decline by 22%.<sup>1</sup>

**Table 3: Donor Advised Fund Growth vs. Other Charitable Giving Options**  
(Dollar Value of Assets)

	2007	2008	Pct. Change
Private Foundations	\$682.22 billion <sup>2</sup>	\$579.88 billion <sup>+</sup>	(15.0%)
Charitable Remainder Unitrusts <sup>1</sup>	\$106.43 billion	\$119.20 billion	12.0%
Donor Advised Funds	\$29.3 billion	\$28.7 billion	(2.4%)
Charitable Lead Trusts <sup>1</sup>	\$18.09 billion	\$19.65 billion	8.6%
Charitable Remainder Annuity Trusts <sup>1</sup>	\$9.28 billion	\$8.93 billion	(3.8%)
Pooled Income Funds <sup>1</sup>	\$1.60 billion	\$1.46 billion	(8.8%)

### Historical Growth of Donor Advised Funds

Although donor advised funds were first established in the mid-1930s, reliable statistics have only been available since 1999. The following provides an illustration of the dramatic growth over the past five years.

Although total assets in donor advised funds fell for the first time (see Table 5 below), this was due to unprecedented factors:

- significant decline in stock market values;
- a record increase in grantmaking to \$6.7 billion

When one considers the continued growth in the number of donor advised funds the long-term prospects look exceptionally strong. We anticipate that as the economy and stock market performance improve, donor advised fund assets will return to their historically robust levels.

Donor advised funds have solidified themselves as the most popular charitable giving vehicle in terms of the number of funds/donors (see Table 2). More than 148,500 donor advised funds have been created, which is more than double the number of private foundations and exceeds the total number of private foundations, charitable remainder unitrusts, charitable remainder annuity trusts, charitable gift annuities, and pooled income funds.

Over the past five years the number of new funds has experienced a cumulative annual growth rate of 61.6%.

Donors were very active in their grantmaking. While they increased contributions to their funds modestly, they substantially increased their grantmaking by more than 19% to a record \$6.7 billion. We speculate that because of the challenging economic conditions, donors used their donor advised funds in place of their checkbooks and other direct donations to support their favorite charitable causes.

### Donor Advised Fund Market Segment Growth

A variety of organizations sponsor donor advised funds. These include national programs, which are made up of public charities (such as National Philanthropic Trust), and commercially sponsored programs, which are created as an extension of financial services firms. In addition, community foundations, faith-based institutions, universities, and other charitable institutions sponsor donor advised funds.

#### National/Commercially Sponsored Programs

The fastest growing segment is the national donor advised fund programs (currently comprising 32 institutions, such as National Philanthropic Trust, Fidelity Charitable Gift Fund, Vanguard Charitable Endowment Fund, et. al.). This group emerged, as per NPT's projection last year, as the largest market

segment in assets under management. The National/Commercially Sponsored programs also received the most contributions and served the most donors. National programs showed the fastest rates of growth in every category (assets, new funds, contributions, grants, average fund size).

#### Community Foundations

Community foundations, which comprise the most mature and prevalent market segment with 146 institutions surveyed, experienced the largest decline in assets – dropping from \$12.7 billion to \$11.6 billion, a decline of 8.5%. Although they brought in new donors, their 3.7% growth was the slowest among all groups. Interestingly, they saw the largest increase in contributions – up 15.4% - - and their donors were also the most generous as they increased their grantmaking by 33.2%. Community foundations retain the largest average fund size of all market segments.

#### Faith-Based/University/Other Programs

Faith-Based/University/Other Programs assets were down 5.4% (\$5.3 billion), and their contributions fell 11.2%. Like the two other groups, they increased the number of accounts – in this case by 11.2%. Faith-based and other charitable sponsors, such as universities and cause-related programs, trailed in most categories, but surprisingly serviced almost the same number of donors as community foundations.

The growth of national programs versus that of community foundations and other programs was most pronounced in the amounts of their incoming contributions and the number of their funds. The national/commercially sponsored programs raised more than the two other market segments combined, and their percentage increase in contributions was 35.7% versus 5.1% for community foundations, and 28.1% for faith-based and other programs.

Community foundation donor advised funds, on average, tend to be larger than funds in other market segments. It is NPT's opinion that this is due to two factors: fund minimums, and age of funds. Some national programs have reduced their fund

opening minimums to as little as \$5,000, whereas many community foundation minimums remain at \$25,000 and above. Also, because assets in donor advised funds are invested and grow tax-free, compounding of investment gains (particularly during the strong market growth in the 1980s and early 1990s) provided long-standing funds to grow accordingly. While the majority of community foundations were established in the 1980s, a number have existed and offered donor advised funds throughout the 1950s, 1960s, and 1970s. In contrast, almost every national/commercially sponsored program was created after 1996.

With the overall decline in assets it is not surprising that the average account size declined for all market segments. Even with this decline, the average size of a donor advised fund is \$192,840, which exceeds the average 401(k) plan (\$137,430)<sup>5</sup> and the average 529 education savings plan (\$12,316).<sup>6</sup>

#### Market Projections: 2009-2011

Donor advised funds showed remarkable resilience in the face of the worst economy since the Great Depression. When one considers the precipitous decline in overall income, GDP, real estate values, etc., the fact that overall assets remained almost the same - and contributions actually increased - we expect the future of donor advised funds to be exceptionally promising.

We stand by last year's statement that due to the severe economic downturn we anticipate charitable giving in general, and contributions to donor advised funds in particular, could decline (in inflation-adjusted dollars) in the near term. If history is any guide, philanthropy is a lagging economic indicator. Charitable contributions are discretionary, and we expect that individuals may continue to cut back on their charitable donations in 2009 and will not increase their giving until their confidence in the economy and stock market is restored. This would indicate a rebound occurring no earlier than 2010, and possibly not until 2011.

Despite the economic challenges, individuals will continue to experience events in their lives that will necessitate gifts to charity, and donor advised funds are well positioned as the charitable giving vehicle of choice for high-net-worth individuals. Some of these life events include:

- Retirement - which may lead executives to exercise the sale of highly appreciated restricted securities or closely held stock;
- Sale of family business - which may lead owners of companies to make gifts of closely held stock to offset capital gains;
- Death - which may lead decedents with taxable estates to make gifts in their wills and trusts, creating charitable legacies for generations.

Because of the challenges in the markets, uncertainties in federal and state tax policies, and the impending retirement of the Baby Boomers, it is NPT's contention that financial advisors and estate planners will continue to play a critical role in the future growth of donor advised funds. Donor advised funds will need to be strategically incorporated into financial and estate planning to insure that the broad range of clients' needs are best being met. Therefore, it is imperative for financial advisors to keep abreast of the full range of solutions that donor advised funds can offer. If that happens, NPT believes that the fastest growing segment in the donor advised fund market will remain the national programs, such as National Philanthropic Trust for the foreseeable future.

For more information, visit [www.nptrust.org](http://www.nptrust.org). National Philanthropic Trust 888.878.7900

1. Internal Revenue Service, IRS Statistics of Income Division, October 2009.
2. Number of Grantmaking Foundations 1975 to 2007, *The Foundation Center*, 2009. Includes total number of independent, corporate, and operating foundations.
3. Estimate is a projection based on five year average growth of private foundations (3.0%) from data collected by *The Foundation Center*.
4. Estimate based on several surveys and reports published by *Indiana University Center on Philanthropy* (Foundation Value Statements in Times of Economic Distress,

28% decline), *The Chronicle of Philanthropy* (February 12, 2009), Pension and Investments (June 16, 2009). Projecting an average 15% decline.

5. *Investment Company Institute*, What Does Consistent Participation in 401(k) Plans Generate?, July 2009. Survey of 21.8 million participants at year-end 2007. In 2007, the average account size of a donor advised fund was \$218,679.
6. *College Savings Plan*, as reported in the *Los Angeles Times*, Study Up On How To Spend 529 Funds For College, August 10, 2008.

## The Basics - examining the fundamentals of gift planning

BY JOHN WEBSTER HOCHSTADT

### 1. Governance and authority

Whether a gift planner assumes an established position or is charged with a start-up, s/he will almost invariably be playing catch-up from Day One. This condition imposes a number of challenges, and frequently results in the failure to ascertain the policy and legal authority by which the planner closes and accepts many gifts.

How many of us have read through the articles of incorporation, letters patent, or other establishing documents for the charity we serve? I asked to see these documents in a national charity with international ties, and no one in the executive suite knew what I was talking about.

While the gift planner may reasonably assume the charity has a legal basis for existing, the same cannot be said for signing authority to commit the charity to contracts and obligations.

This is not a trivial issue, as both the gift planner and the Board could find themselves liable, absent clear and explicit written authority for the gift planner and for the gifts she or he plans.

If such authority is on file, the prudent planner will table it at the next Board meeting, to remind all concerned that a) s/he has the stated authority; and b) said authority flows directly from the explicit action of the Board.

Lacking written policy or authority, the planner should consult the CEO, President, or ED and consider how best to establish it. Such establishment is essential for a professional and successful program, and in no event should signing authority for legally-established gift vehicles vest with the Board. This would handcuff the gift planner, and relegate the position to a clerical or support role.

Much preferable would be a draft policy developed from best practices, drawing on professional associations and charities with mature gift planning programs. This policy should be tabled by the senior executive, not the gift planner, and said executive will ensure support for its adoption before it reaches a Board meeting.

The only constraints on the planner's authority, if any, should be justified and reasonable. The planner should have signing authority on all types of gifts established at law in Canada, as well as an adequate budget to engage professional advisors as required for specific gifts. Having a retired advisor on the Board is no substitute for current professional input, and in fact can result in serious errors.

With clear and explicit authority, the gift planner can get down to the business of helping donors and prospects see themselves as part of the solutions offered by the charity.

*John Webster Hochstadt*  
(webster@jrtwave.com) is the Editor of *Gift Planning in Canada*.

## IN BRIEF

### Janet Gadeski now Group Publisher for Hilborn newsletters

Janet Gadeski, editor of *Canadian Fundraising & Philanthropy* since mid-2008, will become Group Publisher in charge of the newsletters published by The Hilborn Group Ltd, effective January 1, 2010. In that role she will be responsible for overall direction and market development for both the monthly journal *Gift Planning in Canada* and *Canadian*

*Fundraising & Philanthropy*, published twice monthly for almost 20 years.

Janet will continue as editor of *Canadian Fundraising & Philanthropy*, and John Webster Hochstadt, now in his fifth year as editor of *Gift Planning in Canada*, will continue in his role.

Janet's two decades of experience in fund raising and nonprofit management range from a modest public radio station to major symphony orchestras. The study of music drew her from her home town of Calgary to the United States, where she began her career as a church musician, music teacher, and classical music announcer with a 3,000 watt (that's a whopping 30 light bulbs) public radio station.

Her first taste of fund raising was more irritating than inspiring ("Just \$100 more and we can return to our special broadcast.") Seeking more sophisticated fund development skills, she earned an MBA and an MA in Arts Management from Southern Methodist University in Dallas, Texas. There, during a student placement with the Dallas Symphony, she watched in awe as the orchestra's simultaneous campaigns for its annual appeal, its endowment fund, and a new hall all surpassed their targets.

After returning to Canada, she worked in fund raising with the Toronto Symphony and general management with a number of organizations including the Association of Canadian Choral Conductors, Amici (a chamber ensemble of Toronto Symphony musicians), the Music Educators National Conference, and Metropolitan United Church. As Founding President and CEO of The United Church of Canada Foundation, she helped to create a national foundation for the denomination and developed a low-cost, socially responsible investment program for its congregations.

Janet began writing for *Canadian FundRaiser* in 2003, focusing on endowment development, investment and marketing. She became editor in July, 2008, and last summer planned and managed its redesign and name change to *Canadian Fundraising & Philanthropy*.

# THE LAST WORD

## Gobble, Gobble – Turkey Leftovers

BY MARILYN KERFOOT

The Turkey Challenge issued last fall by Ann Rosenfield and Mary McPherson has been a great addition to GPIC. I hope they continue to raise ethical concerns in future issues; it is important that we apply our lofty ideals to the reality of day to day practice to ensure that we all keep "walking the talk".

I was particularly drawn to their example of endowment funds that were collapsed by a board of directors contrary to the spirit in which those gifts had been solicited and given. In my experience, the majority of endowed gifts are made through bequests. Unfortunately, charitable organizations don't always accord deceased donors the same respect and concern as living donors. It's easy to understand why this happens, but that understanding doesn't make the behaviour any more ethical.

I have a couple of comments related to the article *GPIC Ethics Challenge – Time to Talk Turkey* (October 2009). The first comment is a somewhat technical one and I make it wearing my lawyer's hat. Ann and Mary referred to a donor's 'legal designate', a term that appears in Imagine Canada's Ethical Code. Paragraph C3 of the Code states:

*All restricted or designated donations shall be used for the purposes for which they were given unless the charity has obtained legal authorization to use them for other purposes. Alternative uses will be discussed with the donor or with the **donor's legal designate**. If the donor is deceased or legally incompetent and the charity is unable to contact a **legal designate**, the donation shall be used in a manner that is as consis-*

*tent as possible with the donor's original intent. If necessary, the charity will apply to the courts or the appropriate regulatory body to obtain legal authorization to use the donation for other purposes. (Emphasis added.)*

It would be interesting to know exactly what Imagine Canada means by 'legal designate' because, in my view, all legal designates are not necessarily created equal.

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### *forever is a long time*

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For example, one can argue that an attorney acting under a general enduring power of attorney does have the right to speak for a mentally incompetent donor about potential changes to a restricted gift previously made by that donor. In law, a general power of attorney gives the donee (the attorney) the authority to make financial and legal decisions for the donor with only a few exceptions, such as making or changing the donor's will. However, in my opinion, this authority does not extend to a legal representative appointed to administer a deceased donor's estate (i.e. an executor, estate trustee, etc.) unless such authority has been granted specifically in the will or by court order.

An executor (I use this word because it is still the official term in my home province of British Columbia) is bound to administer the deceased's will according to its terms. S/he has no right to exercise discretion unless authorized by the will or by law (including legislation or judicial precedent). I know of no law (in B.C.

at least) that authorizes an executor to amend either gift agreements entered into by the donor while alive or gift terms contained in the donor's will.

I had occasion to reflect on this point recently when contacted by a colleague from another charity that was considering – guess what? – accepting an endowed gift in a will with the hope of using the capital for current funding. She was looking to me for my opinion and mentioned that she had spoken to the executors and the estate lawyer to see if she could get their blessing.

My response was immediate and definite: if the charity chooses to accept the gift, it is legally obligated to respect all conditions attached to the gift in the will. Neither the executors nor the estate lawyer can release the charitable beneficiary from that obligation.

I appreciate that charities may be tempted to dip into endowed capital during these tough economic times. Perhaps charities should be rethinking the benefits of 'permanent' endowments. I recently heard a nationally known and respected charity lawyer say "forever is a long time". She may be right, but that doesn't change either the legal or ethical obligations that charities have to honour endowments established by donors in good faith.

In their article, Ann and Mary state that "[A]ltering endowment policies after agreements have been made will most certainly negatively affect long term relationships with current and prospective endowment donors." I hope

they are right. However, my guess is that the directors of the organization described in the Turkey Challenge did what they did because they were confident they could get away with it.

Many deceased donors leave no family behind who can monitor the way in which a charity handles its estate gifts. In fact, it is relatively easy for a charity to abuse its position of trust with bequests because of this lack of oversight. Certainly, in British Columbia there is no regulatory body that actively monitors charitable activity. Technically this role belongs to the Attorney General but that is all it is – a technicality. Nor does Canada Revenue Agency's income tax mandate provide a rationale for it to audit activity in this area.

All of this brings us back to the various ethical codes that are intended to guide the actions of charities and their staffs. Choosing whether to follow these codes is voluntary. Fear of negative public reaction acts as a deterrent for those who need one when it comes to dealing with gifts from living donors. We can only hope that the vast majority of organizations and fundraisers will also live up to the ethical standards our sector is trying to set when it comes to deceased donors and estate gifts.

*Marilyn Kerfoot (mkerfoot@telus.net) is a gift planning consultant working in Vancouver, BC. She has been a teacher and mentor through, among others, CAGP's Banff Course, BCIT's Fundraising Management Program, BC's Continuing Legal Education Society and the ADVOCIS Planning School. Marilyn is a member of GPIC's Editorial Advisory Board.*

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