Presentation Transcript

May 14, 2020 – Webinar Donor Advised Funds and Their Critics

The Effective Philanthropy Learning Initiative at Stanford PACS hosted an online webinar with Q&A. Law, business, graduate, and undergraduate students shared their learnings, research, and recommendations from the winter Policy Lab practicum on donor advised funds led by Stanford Law Professors Joseph Bankman and Paul Brest, and Visiting Scholar Daniel Hemel.

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Values-Based Investing

ALYSSA EPSTEIN: Hi, my name's Alyssa Epstein. I'm a second year law student. I'm going to be talking about ESG and impact investing today.

So values-based investing is an increasingly popular trend inside and outside of DAFs. We're going to be discussing two types of values-based investing. Environmental, social and governance investing, which is ESG investing, which is essentially investing in publicly-traded securities that meet certain ethical criteria. And impact investing, which is private investing in socially-conscious companies or projects at or below market rates.

ESG investing is often advertised as being able to achieve both market rate risk-adjusted returns and social impact. Its proponents argue that it decreases the cost of capital for good companies at the expense of bad companies. However, under normal efficient market assumptions, it is impossible to alter the cost of capital for companies on secondary markets. Unlike ESG investing, impact investing is primarily conducted on private markets. Impact investments can be equity or debt to older companies or new ones or made to advance particular projects. Private markets are less liquid and less efficient, so arbitrageurs take longer to identify and correct skewed prices.

Impact investors in the private market also act as arbitrageurs, themselves. They can expend resources to evaluate the true value and risks of privately-held, socially-responsible companies, and identify opportunities to reduce the cost of capital to those companies at non-concessionary rates. Impact investments have long played a role in the charitable sector through the use of program-related investments, PRIs, at foundations. A PRI might be a low-interest loan to a small business owned by disadvantaged members of a marginalized group or a high-risk investment in low-income housing.

Both ESG and impact investments have become increasingly available to DAFs. ESG portfolios are available at all of the national DAF sponsors, many community foundations, and some single-issue sponsors. Several of the national DAF sponsors, for example, Fidelity, Schwab, and Vanguard, all offer more than one ESG pool to any DAF account housed within them. More ESG options seem to be available to large donors with accounts at these institutions. So the ESG pools at these institutions tend to have higher fees than their non-ESG counterparts. But they are becoming more and more popular for donors. In 2019, Fidelity had $1.1 billion allocated to values-based investment options.

Impact investing options are also available at some DAF sponsors, but these options are less widely available. Community foundations like the Chicago Community Trust and the Silicon Valley Community Foundation offer funds distributing small loans to individuals and non-profits in their areas. National Philanthropic Trust offers a social impact portfolio with some direct private investments to all accounts. Fidelity, Schwab, and Vanguard, on the other hand, restrict impact investments to larger donors, making recoverable grants or quasi PRIs and other private investments available at certain high thresholds only. Quasi PRIs are also available at some community foundations, like Silicon Valley Community Foundation.

The proliferation of ESG and impact investing options has several effects. ESG options allow investors who care about having clean hands for reputational or moral reasons to accomplish this within their charitable accounts. ESG options can also contribute to a wider advocacy movement, like Divestment, which pairs financial decision making with broader social awareness of a cause. While ESG at DAFs can play a positive role, it is important that sponsors make clear and donors realize that these investments will not, by themselves, reduce social impact and are maybe riskier or more expensive than the non-ESG alternatives.

Impact investments, on the other hand, offer the prospect of magnifying the effects of charitable donations within DAF accounts without harming the eventual grant to charity. The hyped fees and concessionary rates may reduce these prospects. Since huge sums of charitable dollars are now housed within DAFs, impact investments could assuage concerns about the timing of the payout of money from DAFs. Moreover, DAFs could be a good venue for quasi PRI activity. Since PRIs tend to be high risk, large staffs can make many more of them than a foundation by pooling money from many accounts and offsetting risk in the aggregate.

To summarize, the combination of values-based investing strategies and donor-advised funds is an exciting one, with the potential to increase the social value of DAF-bound charitable dollars. While these options are available and expanding, DAFs should focus primarily on growing their impact investment options to maximize this potential.