5 Myths About Using Donor Advised Funds for Impact Investing

Donor advised funds (DAFs) have seen strong growth over the past five years – and now represent nearly $160 billion in charitable assets across over 1 million DAF accounts. This is happening at a time where client interest in ESG and impact investing is also on the rise, leading many national DAF providers and community foundations to incorporate investment options which create positive social and environmental change. Despite the evolution of these platforms, several myths about a donor's ability to use DAFs for impact investing continue to be perpetuated in wealth advisory and philanthropic circles. These five seem to be the most prevalent.

Myth #1 - Large national DAF providers and community foundations do not offer private debt or equity impact investment options.

Truth – In fact, some of the largest national DAF providers (including Fidelity Charitable and National Philanthropic Trust) provide private debt and equity impact investments to a sub-set of their donors. As for community foundations, Chicago Community Trust is one example of an organization that has implemented a menu of local impact investing opportunities for its donors. In addition, several additional multi-billion-dollar DAF providers, including leading community foundations, are actively developing similar programs.

Myth #2 – The number of impact opportunities available to DAF account holders is limited.

Truth – Many leading providers offer multiple liquid, thematic pooled vehicles (e.g., environmental stewardship, gender equity, financial inclusion, etc.) that are comprised primarily of ESG mutual funds and ETFs. These pools are generally available to all DAF account holders.

Additionally, most of the DAF providers we work with allow donors to allocate to recoverable grants. These are grants given to nonprofit organizations for charitable purposes whereby the nonprofit agrees to return some or all of the capital based on the performance of the program. Recoverable grants are highly impactful, and when successful the returned capital can be used to pursue additional charitable purposes. Vanguard Charitable is an example of a leading national DAF provider offering a number of pre-approved recoverable grant opportunities to a select group of clients.

Myth #3 – It is only possible to make donor-identified private debt and equity impact investments through a specialist DAF.

Truth – While it was generally true in the past that donor-sourced private funds and direct investments were difficult (if not impossible) to transact except through a specialized DAF provider, it is no longer the case. Requirements vary, but the ability for sophisticated donors to recommend transactions in private market opportunities has become much more commonplace. Depending on the DAF provider, often the donor must retain a financial advisor, and in some cases provide a detailed due diligence report in addition to standard fund documents for approval. Special fees may be assessed for these types of investments.

Myth #4 - Impact investments in DAFs offer below-market rate returns.

Truth – This myth doesn't only apply to DAFs! Impact investments cover a wide spectrum of themes, asset classes, and opportunities, and as such, expected financial returns run the gamut from competitive to below market when compared to their non-impact oriented counterparts. As with any type of investment, returns for impact focused investments are largely dependent on the underlying asset classes chosen. Investors can choose to trade some level of return in exchange for more meaningful social and environmental outcomes. Or, they can pursue both returns and impact through opportunities such as impact focused private equity funds, which target returns comparable to top-performing non-impact PE funds.

Myth #5 - Using DAFs for illiquid impact investing is at odds with their charitable purpose.

Truth – DAFs offer donors many compelling benefits, including convenience, cost efficiency, and flexibility, which is why they have become some of the fastest growing philanthropic vehicles. Much like private foundations, DAFs are formed to support the critical work of charitable organizations. However, in the interim period between a donor's contribution to a DAF and directing grants to charities, how the assets in the account are invested can drive positive change. Donors can recommend investments in renewable energy technology, fund promising entrepreneurs who don't have access to traditional financing, and provide access to clean water for communities in need. These are just a few of the catalytic investments that are fully aligned with the philanthropic purpose of DAFs.

In summary, the DAF industry has moved concertedly in recent years to offer innovative solutions that satisfy growing donor demand for impact investing. Advisors and their values-conscious clients with DAFs may be pleasantly surprised at new options now being offered by their existing providers or feel more emboldened to demand investment choices reflecting the change they want to see in the world.

This piece was originally published in Investment News.