

## ■ Creating the Legacy

### The Next Wave

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In 1975, the SEC deregulated brokerage commissions and set the stage for Charles Schwab & Co. to create the discount brokerage business model. By unbundling the sale of advice from execution, Schwab fundamentally changed the wealth management business. Today, the intertwined worlds of philanthropy and finance are undergoing a similar shift that is transforming the wealth management industry.

Using a model similar to the full service brokerage business, community foundations have long bundled philanthropic advice with execution. In 1992, the Fidelity Charitable Gift Fund—in a comparable move—unbundled philanthropic advice from execution. By eliminating advice on which nonprofits to support, it was able to offer a low-cost product that competed with community foundations.

This seismic shift is just one indicator of the way the lines between wealth management and philanthropy are blurring. Today we are in the early stages of making philanthropy a core wealth management service.

Over the past 30 years, the wealth management industry has been radically reconfigured to serve the needs of the Baby Boomer generation. For much of that time, Boomers themselves focused on the process of saving for retirement. The Center on Wealth and Philanthropy at Boston College predicts that the next 40 years will see a \$41 trillion wealth transfer between generations—the largest transfer of wealth in history. Over \$6 trillion of this fortune is expected to go to charities.

Even while this shift in priorities marches forward, some wealth managers remain stubbornly focused on helping clients retain their wealth. The business is structured to encourage advisors to discourage philanthropy, and many financial professionals lack the tools needed to assist their clients with charitable giving.

In many cases, advisors simply hand off the responsibility of dealing with the client's philanthropic impulses. While collaborating with lawyers, community foundations, CPAs and nonprofit planned giving officers might seem like a good solution, the fact is that investment management of philanthropic assets has specialized needs.

Interest in philanthropy among high-net-worth individuals has been growing for some time. But it was events of 2006 that truly introduced the modern approach to philanthropy into the consciousness of the affluent. In that year, Bill Gates announced he would be stepping down from his full time role at Microsoft to work on the Bill and Melinda Gates Foundation. Warren Buffett quickly followed with the announcement that he would give the bulk of his wealth to the Gates Foundation. This event was the tipping point in what I call the "Second Great Wave of Philanthropy."

This phrase describes the resurgent interest in philanthropy that follows in the footsteps of Andrew Carnegie and John D. Rockefeller, who created the First Wave. While Carnegie and Rockefeller did much of their giving posthumously and thought of it separately from their business life, the Second Great Wave is characterized by the trend of giving while living. Modern philanthropy follows the leads of people like Gates, who

decided to quit business to focus on philanthropy, and Buffett, who decided not to wait until his death, but to give away the vast bulk of his fortune now.

But the importance of Gates/Buffett is not simply the amount of assets in play. Instead, the Gates/Buffett announcement will come to be seen as a clarion call that encouraged people in all walks of life to embrace “giving while living” and ended the traditional decision to give to charity only at the end of one’s life.

But apart from “doing good,” both Andrew Forrest, Australia’s richest person, and Buffett cited another trend: The desire not to harm their children by plying them with too much wealth. Buffett’s mantra is to give your children “enough so they can do anything they want, but not so much that they can do nothing.”

One of the major concerns of today’s high-net-worth families is the worry that too much wealth will spoil their children. Today many families are seeking to give their children the “right” amount of wealth. There is plenty of evidence such as that presented in the book *Philanthropy, Heirs & Values*, by Roy Williams and Vic Preisser, (2005, Robert D. Reed Publishers) demonstrating that the best way to pass assets on in a way that preserves the wealth but does not spoil the children, is for the entire family to engage in philanthropy together.

The result is to shift philanthropy away from being a concern primarily of estate planners, who, since most giving was in the form of bequests, traditionally played the role of philanthropic advisor. “Giving while living,” on the other hand, shifts the philanthropic advisory role squarely onto the shoulders of wealth managers. And so we see that philanthropy is a core element of wealth management in a post-Gates/Buffett world.

Why, then, have some wealth managers been so slow to respond to their clients’ growing interest in philanthropy? The primary issue is that large wealth management firms see philanthropy as a secondary customer service offering rather than a primary question of asset allocation. These still view philanthropy as akin to the touchy-feely family office/concierge service that some very high-end wealth managers offer. At the same time, major donors are not accustomed to paying for philanthropic advice. These two facts combine to create an environment where wealth managers view philanthropic consulting as a cost center with no associated revenue.

In a world where most families with investable net worth above \$10 million give \$50,000 or more per year to charity, clients are being deeply underserved. They are paying far more in taxes than they should, and they are missing out on the opportunity for their giving to have far more impact. In the coming decades, failure to offer philanthropic advising will be akin to a wealth manager professing ignorance of retirement planning.

However, simply understanding private foundations, donor advised funds and charitable trusts will not be enough. At least some wealth managers already have this expertise. But simply helping clients set up these vehicles is nothing more than tax planning. True philanthropic planning must embrace the growing convergence between financial products and giving opportunities and help their clients navigate the philanthropic landscape.

### Mission Related Investing

Mission related investing (MRI) is the term used to describe investments made by philanthropic entities in the pursuit of both financial and social returns. Unlike traditional socially responsible investing that relies on “negative screening”—the avoidance of public companies that do not pass certain social criteria—MRI implies proactively seeking investment opportunities that produce a blend of financial returns and social impact that

are in line with the philanthropy's mission. Still an emergent issue, MRI is characterized by limited deal flow, especially in deals that have minimums low enough to allow widespread participation. But MRI brings philanthropic advising directly into the domain of the wealth manager.

In the late 1990s, the board of the F.B. Heron Foundation posed the question, "Should a private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?" Traditionally, foundations have erected a firewall between the investment side of the house and the program side. F.B. Heron was asking, "What about the 95% of our assets that are not given away each year?" The answer they found was mission-related investing, toward which they now dedicate 24% of their endowment.

MRI opportunities have been available in the debt arena for some time. Community reinvestment bonds are debt backed by loans made to build affordable housing or other community development projects. Banks have been required to make these sorts of loans since the Community Reinvestment Act of 1977. However, philanthropists are now exploring the full range of MRI, including equity investments. Heron makes grants to nonprofits seeking to revitalize inner city and rural communities. But according to the foundation, they also "invest in private equity funds that provide needed equity for commercial real estate projects in these communities (often in cooperation with community-based groups) and financing for businesses seeking to expand in or relocate to these communities."

The interest in MRI is spurring product creation that over time should make MRI investing more accessible to private investors. San Francisco's Good Capital is a venture capital fund that invests in nonprofits and for-profit entities with a social mission. Their goal is to provide positive but below market-rate financial returns and strong social impact. The Bay Area Equity Fund, managed by JPMorgan, is a venture capital fund that strives for full market-rate returns while investing in companies that generate high quality jobs in low and middle-income neighborhoods of the San Francisco Bay Area. (For more on MRI please see *WM* July/August 2008, page 84, "Goodwill Profits.")

One of the problems of MRI's equity side is the fact that a donor/investor cannot take a true equity stake in a nonprofit. Since nonprofit accounting has no entry equivalent to equity, all incoming money must be booked as revenue. But an effort is underway to change this. Nonprofit Finance Fund, which has long financed nonprofits via debt products, has recently launched NFF Capital Partners. This project, run by Capital One founding executive George Overholser, has developed the SEGUE accounting system, which "provides philanthropic investors with a clear and auditable record of the organization's progress towards self-sustaining operations, along with a clear record of how much growth capital is consumed along the way." SEGUE units are often referred to as "philanthropic equity."

Just as today's wealth manager creates portfolios of assets that fit the financial risk and return goals of their clients, philanthropic wealth managers will need to help their clients navigate the rapidly evolving MRI field. Matching financial and social risk/return expectations to each client will be a necessary role for wealth advisors hoping to provide clients with best-in-class service.

Clients understand the role of each advisor and can identify their own needs and match them to the appropriate advisor.

To whom will your clients turn for advice on which philanthropic vehicle to create? Who will help a client family define its philanthropic mission statement? Who will analyze the financial characteristics of a MRI opportunity? Will the same person consider the social implications of such an investment? Philanthropy is still an immature industry.

Philanthropy-minded clients need a concierge who understands the philanthropic landscape and can point them to the appropriate people and resources.

Just as a traditional client might ask their wealth manager for assistance in evaluating a mortgage or learning more about alternative investments, philanthropic clients' needs are not limited to the management of their investment portfolio. The wealth manager who strives to become a philanthropic concierge must build a broad network of contacts within philanthropy and know where to turn when their client asks for help.

Philanthropic investing has another characteristic that makes the role of philanthropic concierge even more important than its counterpart in traditional wealth management. In philanthropy, the social return that giving creates accrues to society at large and not just to the individual client. This means that true philanthropic concierges will benefit their clients by connecting them with similar clients and be able to identify co-funding or collaborative opportunities across their client base and ultimately throughout the philanthropic ecosystem.

The Second Great Wave of Philanthropy is going to transform both wealth management and traditional philanthropy. We must be aware that as much as financial professionals can add tremendous value to philanthropic clients, philanthropy requires much more than business knowledge. Wealth managers who recognize the value they can provide to philanthropic clients will discover a whole new frontier to explore. Like any frontier, the landscape is difficult, but the adventure is worth it.

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