PHILANTHROPIC FOUNDATIONS IN CANADA

LANDSCAPES, INDIGENOUS PERSPECTIVES AND PATHWAYS TO CHANGE

Edited by

Peter R Elson

Sylvain A. Lefèvre

Jean-Marc Fontan

University of Victoria

UQÀM | Université du Québec à Montréal

Social Sciences and Humanities Research Council of Canada

Conseil de recherches en sciences humaines du Canada

Canada

This research was supported by the Social Sciences and Humanities Research Council of Canada.

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Dedicated to our dear
friend and colleague
Jack Quarter

1942–2019

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Part one

Chapter four

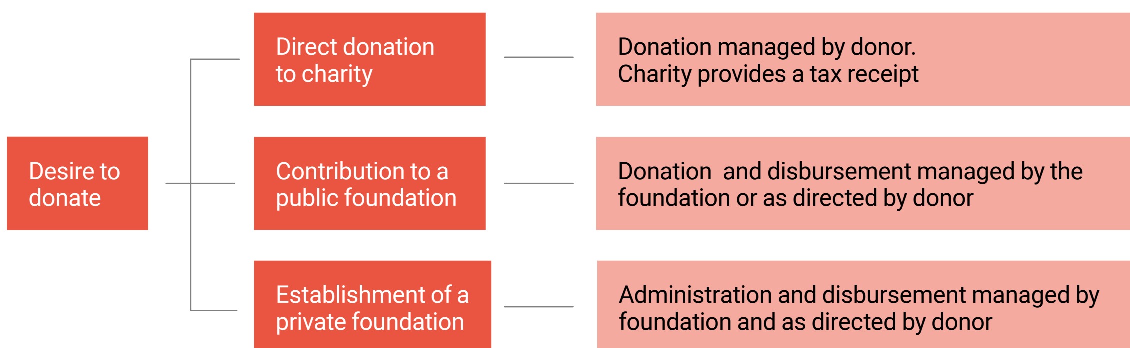
Donor-advised funds and charitable foundations in Canada

Carla Funk

The entire Canadian economy faces upheaval as the "baby boomers", that large demographic bubble of people born in the two decades following the Second World War, shift into retirement, old age, end of life – and trigger a massive wealth transfer. This wealth transfer has been estimated to be in the order of $750 billion (Parkinson *et al.*, 2017; Tal, 2016). This paper will explore in some detail the repercussions of this substantial wealth transfer, which has only just started and which is about to accelerate rapidly. It will explore the impact of this wealth transfer on charitable foundations in Canada in general, and on donor-advised funds in particular.

In Canada, end-of-life wealth distributions have two main options: funds can be distributed to individuals, or to a registered charity. A third option, distributing funds to taxes, is not strictly an option, since there is some tax liability on both these options. Making a charitable donation has long been available as an estate-planning tool. Charitable donations support worthy causes and divert monies that might be subject to tax. As Figure 1 illustrates, a direct donation to a charity is the only option that imposes no long-term administrative cost to the donor. This option assumes that the donor is prepared to invest their own time, and is interested in doing so, in selecting a given charity or charities, and is also prepared to pay a transactional fee to a professional advisor, should they be making tax-savvy donations such as gifts of appreciated stock or ecologically sensitive land. Transaction or administrative costs increase in the case of either the donor-advised fund or private foundation option.

Figure 1 – Donation options



As registered charities, Canadian foundations benefit from the donation of these wealth disbursements from individuals, just as they themselves disburse grants to charitable organizations in the form of grants. Donor-advised funds, a specific sub-set within public foundations, have increasingly become a charitable giving vehicle of choice for donors in the United States (Levine, 2018), and this trend is showing similar signs of growth in Canada (Barhat, 2010; Funk, 2018; Sjogren & Bezaire, 2018).

The use of donor-advised funds has simplified and streamlined the process of giving. Some professional wealth advisors, such as those affiliated with banks, are assisting clients to create these funds under their financial institution's charitable giving foundations, referred to here as "privately sponsored public foundations". Others choose to work with community foundations and other kinds of public foundation. Table 1 provides examples of various types of public foundations in Canada.

The type of foundation advisors work with has implications on their own bottom line. Funds that are directed to a community foundation or other charities leave the "books" of the financial advisors and by doing so have compensation implications for that advisor. Financial advisors are often financially rewarded on the overall size of their investment portfolio; when the portfolio shrinks as a result of charitable giving, the advisor's income shrinks accordingly.

Funds that are directed to a donor-advised fund within their affiliated privately sponsored public foundation, however, reward the advisor with an immediate commission and annual "trailing commissions" on these monies. Trailing commissions are the commission investors pay each year that they own an investment; the fee is paid upon purchase and every year after (Paladin Registry, n.d.).

With financial institutions delving further into the charitable giving arena, this chapter explores financial advisors' use of donor-advised funds as a strategic philanthropic planning tool, and the long-term implications of these funds for the future of foundations.

Table 1 – Canadian public foundations: categories, characteristics and examples

Public foundation type	Characteristics	Example
Community public foundation	Dedicated to philanthropic social improvement primarily in a given place	The Winnipeg Foundation http://www.wpgfdn.org/ also see Community Foundations of Canada http:// communityfoundations.ca/
Religious public foundation	Dedicated to the philanthropic guiding principles of particular religious belief	Abundance Canada(formerly The Mennonite Foundation of Canada) https://abundance.ca/
Intermediary public foundation	Promoting giving in Canada generally	Gift Funds Canada https://giftfunds.com/
Single-cause public foundation	Promotion of giving for a single cause	Canadian Breast Cancer Foundation http://www.cbcf.org
Single-purpose public foundation	Promotion of giving for a single cause, and to a particular institution	Hospital for Sick Children's Hospital Foundation https://www. sickkidsfoundation.com/
Privately sponsored dedicated public foundation	Financial institution or private firm's dedicated affiliated charitable giving foundations	Aqueduct Foundation (exclusively offers donor-advised funds, affiliated with Scotia Wealth Management) http://www. aqueductfoundation.ca/
Privately sponsored collective public foundation	Financial institutions collectively sponsor a charitable public foundation	Benefaction Foundation (an independent, non-exclusive foundation that facilitates donor-advised funding for several financial institutions or firms such as CIBC Private Wealth Management, CIBC Wood Gundy, Richardson GMP, and Assante Wealth Management) http://benefaction.ca/

Donor-advised funds

If philanthropic giving were a spectrum, a donor-advised fund would be situated somewhere between a donor writing a cheque directly to a charity and a donor creating a private foundation for philanthropic purposes (Borzykowski, 2011; McCaffery, 2006, p. 25). It is essentially a segregated, or a separately identified, fund within a supporting public foundation, whose purpose is to make grants to other charitable organizations (Barhat, 2010). According to one such supporting foundation, "Once a donor-advised fund is created, the donor's gift is then invested in order to provide perpetual annual funds to the donor's charities of choice from the income of this investment. This allows the donor's selected charities to realize not only immediate benefits, but also annual benefits well into the future" (Canadian Medical Foundation, n.d., para. 6).

Unlike the named fund described above, which is designated to a particular charity, donor-advised funds allow donors to be flexible about which charity or charities the fund supports. After a donor makes a contribution to the supporting public foundation (and gains a charitable tax receipt) that organization has legal control of the contribution. However, the donor maintains advisory privileges for the distribution of funds and, in some cases, for the investment of assets in the account (Blades & Burrows, 2012; Levine, 2018).

Community foundations have been making use of donor-advised funds as a philanthropic giving tool for decades. As of the end of 2017, almost 50 years after the first donor-advised fund was created, about one-third of the individual funds the Vancouver Foundation administered were donor advised. Vancouver Foundation held 1,885 funds: 673 were donor-advised funds and 684 were charitable agency funds. The remaining 528 funds were classified as designated, corporate agency funds and "others" (C Fong, personal communication, June 28, 2018). All of the individual funds are collectively invested in their Consolidated Trust Fund and Socially Responsible Investment Fund and have a market value of $1.1 billion. With a market value of $236 million, donor-advised funds represent approximately 22% of that total market value (C Fong, personal communication, June 28, 2018).

Cindy Lindsay, director of learning at Community Foundations Canada, indicates that, while this percentage varies from community foundation to community foundation, in general donor-advised funds represent approximately 30–35% of the total market value of Canada's community foundations; this percentage has remained consistent for decades (C Lindsay, personal communication, August 10, 2018).

Advantages of donor-advised funds

There are six distinct advantages in using donor-advised funds over creating a private family foundation. First, they are seen as cost-effective, easy to establish and flexible, and enable a donor to "give on (their) own terms" (CanadaGives, n.d., para. 1).

As an example, Vancouver Foundation charges an annual fund administration fee of 0.70%. This recovers the investment management fee charged by the fund managers (on average 0.60% per annum on their Consolidated Trust Fund and 0.30% on their Socially Responsible Investment Fund) (C Fong, personal communication, June 28, 2018). In comparison, private foundations can be costly to initiate, especially if they involve complicated direct charitable activities or if foreign charitable activities are involved. A simple private foundation can be established for a little as $5,000 CDN (Blumberg, 2016), but the ongoing decision-making, administration and governance of a private foundation can carry on for generations and entail a lot of work (Bouw, 2018).

Second, donor-advised funds provide a long-term strategy to coordinate and streamline a client's annual charitable contributions. They are a convenient alternative to having to go through the legal and administrative hassle, and expense, of creating a private foundation. Once given, the donor's money belongs to the administering fund, which then disburses donations or grants on behalf of the donor. This does entail some loss of control. For example, donors cannot make legally binding pledges for future contributions to a charity since the administering foundation now owns the money (Fritz, 2018). Succession and inheritance represent another potential loss of control. While donors can specify whom the account will go to after their death, inheritance can't be prescribed indefinitely and eventually the funds go into a general pool of money at the administering fund (*ibid.*).

A third advantage ascribed to donor-advised funds is that they are a simple and effective tool for investment advisors to use to talk to their clients about philanthropy (McCaffery, 2006, p. 25). In Canada, one of the reasons financial advisors hesitate to speak with their clients about philanthropy has been identified as their lack of comfort and knowledge with the topic. Quite simply, professional advisors are reluctant to raise a topic that they don't know much about (CAGP, 2016, 5:59; Funk, 2018). Presumably, were the donor-advised fund process simple for an advisor to explain to a client, and an efficient way to put a philanthropic plan in place, more financial advisors would be encouraged to speak with their clients about philanthropy.

Fourth, financial advisors have an added incentive to embrace donor-advised funds as a charitable vehicle if their financial institutions or firms have created sponsoring charitable foundations, which, in this paper/article/report, are collectively referred to as "privately sponsored public foundations". These foundations provide a platform for facilitating donor-advised funds for advisors' clients and are either dedicated platforms for a single, specific affiliated financial

institution, or are collectively sponsored by a variety of financial institutions. See Table 1 and Table 2 for examples of "privately sponsored" donor-advised fund foundations in Canada.

A further advantage to the use of a donor-advised fund over the establishment of a private foundation is the relatively low threshold for entry. In the United States most programs require a commitment of only $5,000 USD (Fritz, 2018). In Canada the figure tends to be somewhat higher. For example the Toronto Foundation requires $25,000 CDN over two years (Toronto Foundation, 2016), and the SickKids Foundation of Toronto requires a minimum commitment of $100,000 CDN payable over five years (SickKids Foundation, n.d.), while The Winnipeg Foundation requires a minimum of $20,000 CDN to create a donor-advised fund (The Winnipeg Foundation, n.d.). These are still substantial sums, but they are much smaller than the dollar amounts typically invested when establishing a private foundation.

Finally, an advantage implicit in the donor-advised fund arrangement, whether within a community or privately sponsored foundation, is privacy for the donor. Joshua Thorne (manager, philanthropic advisory services, Scotia Private Client Group) notes that "For some clients the number one selling feature of donor-advised funds is the ability to make significant charitable gifts without letting either their family or the rest of the world know that they are the philanthropist behind that [donation]" (Barhat, 2010, para. 13). Privacy provides double-barrelled advantage to the donor by "eliminating pressure from over-solicitation [for donations from charities] and the disclosure of detailed financial information required for a [private] family foundation" (CanadaGives, n.d., para. 3).

Table 2 – Examples of *The Globe and Mail* donor-advised-fund foundations in Canada (2018)

Privately sponsored foundation	Affiliation	Total assets (000)
The Charitable Gift Funds Canada Foundation	RBC Dominion Securities	$384,011
Private Giving Foundation	TD Wealth (Waterhouse)	$297,265
Aqueduct Foundation	Scotia Wealth Management	$196,563
Strategic Charitable Giving Foundation (collectively sponsored)	Investors Group	$221,375
Benefaction	various, including CIBC Private Wealth/Wood Gundy, Richardson GMP, Assante Wealth Management	$31,671

Source: *The Globe and Mail*, 2018

Private Giving Foundation, the first privately sponsored donor-advised fund program in Canada, was created in 2004 by TD Waterhouse (Investment Executive, 2004). In 2006 Mackenzie Investments followed suit, becoming the first mutual fund company in Canada to launch a donor-advised fund (Offman, 2015). Since that time more privately sponsored public foundations have been created. "Canadian commercial financial institutions have eagerly entered the space, providing programs that invest the money with their own managers and sometimes continue to pay the client's advisor a trailing commission" (McCaffery, 2006, p. 29).

Given the advantages of donor-advised funds as a strategic philanthropic tool, the topic of trailing commissions and other financial incentives is worth examining in the context of the influence of financial advisors on foundations in Canada.

Financial incentives for advisors

What kind of incentives are in place to encourage private financial advisors to employ donor-advised funds? At a conference speech in 2016, Brad Offman, then Vice-President Strategic Philanthropy at Mackenzie Financial Corporation, provided an example of a hypothetical client investing $100,000 into a privately sponsored donor-advised fund: as a result of this transaction a financial advisor could expect to earn approximately $5,000 immediately as commission, and to continue earning an annual $1,000 trailing commission thereafter (CAGP, 2016, pp. 4–32). For those advisors with high-net-worth clients exhibiting charitable giving habits and intentions, these commissions could prove highly lucrative. If we were to use these as benchmarks, we could estimate the commission and continued trailing commissions on a $2 million gift as $100,000 (commission) and $20,000 (annual trailing commission) and, on a $5 million gift, as $250,000 and $50,000 respectively. These commissions could place the advisor in a conflicted position; they create a powerful incentive for financial advisors to direct charitably minded clients to create donor-advised funds within privately sponsored public foundations rather than towards any of the various other strategic charitable giving options available, including community foundations. Whether in practice advisors act with bias is difficult to ascertain, but the situation does illustrate the potential for conflict of interest and raises ethical questions that are examined later in this chapter.

Do donor-advised funds spell the end of private foundations?

Given the multiple advantages of the donor-advised fund, is there a danger that their use by public foundations will push out the more costly (and, ironically, less private) private foundations?

So far private foundations are holding their own, in numbers at least. Both public and private foundations increased rapidly from 1994 to 2014: the number of public foundations increased by 69% to 5,100, while in the same period private foundations increased 76% to 5,300 (Imagine Canada & Philanthropic Foundations Canada, 2014). In 2015 Canada was reported to have a total

of 10,743 foundations. Of these, 47% were public foundations and 53% were private (Philanthropic Foundations Canada, 2017b). In terms of total assets, public foundations account for $30.4 billion of the total $69.7 billion held by foundations in Canada, with private foundations carrying a greater asset volume at $39.3 billion. A new trend for the Canadian philanthropic sector has been the appearance of a large number of very large private foundations with assets over the billion dollar mark (Philanthropic Foundations Canada, 2017a, p. 3). This data suggests that, for the very wealthy at least, the private foundation is still the philanthropic vehicle of choice.

So, if they are not affecting private foundations, is the increase in use of donor-advised funds having an impact on public foundations in Canada?

Donor-advised funds and public foundations

Donor-advised funds were traditionally offered through community foundations, but this changed in 2004 when TD Waterhouse launched the first commercial donor-advised fund program in Canada. Since that time many Canadian financial institutions have moved into this space with the creation of privately sponsored public foundations offering donor-advised funds (Barhat, 2010; Funk, 2018). Unfortunately, the Canadian Revenue Agency T3010 form for reporting charitable activity does not make a distinction between donor-advised funds and other donations, which makes it difficult to both measure growth in dollar terms and also clearly identify trends in this area. Data for donor-advised funds in the United States are more readily available through their charitable reporting process, and this aids the process of tracking American trends. As donor-advised fund usage increases in this country, we can reasonably expect to foreshadow a similar experience in Canada by examining well-documented trends in the United States.

Because donor-advised funds were so successful in the United States, and because they offer financial advisors powerful financial incentives, it is generally thought that these sponsoring foundations would gain rapid traction in Canada.

A deep dive into murky waters

For the uninitiated, the path of donor-advised funds can be convoluted and murky. Understanding who is responsible for their administration, governance and distribution requires insider knowledge. Here we turn to philanthropy professional Brad Offman, of Spire Philanthropy, for expertise in classifying these funds. Table 3 illustrates Offman's advice to classify

donor-advised funds using their distribution channels. The term "distribution" represents the sales, marketing and promotion of donor-advised funds.

While helpful in classifying the organization responsible for distribution, these organizations are not necessarily the same as the governing body, or those responsible for the administration of the fund.

Table 3 – Donor-advised fund distribution channels

Distribution channel	Example
Community foundations	Winnipeg Foundation, Toronto Foundation, Vancouver Foundation
Banks	Royal Bank of Canada, Scotia Trust, Toronto Dominion
Large financial services	Mackenzie, Raymond James, Investors Group
Small financial services	Jarislowski, CGOV
Other	CHiMP, SickKids, United Way

Sub-classification of distribution, governance and administration is necessary in order to follow the funding channels. Offman provides an example: the distribution provided by Investors Group is governed by Strategic Charitable Giving Foundation and administered by its sister company, Mackenzie Investments.

Of the five banks in Canada, all have donor-advised fund distribution programs but only two administer these internally; the remaining three use external firms to manage their programs.

These various pathways from client–donor to a particular implementing charity can be difficult to follow. Donors, financial advisors, and charitable professionals alike may be forgiven for finding the donor-advised fund pathway murkier and less understandable than the actual process of setting up such a fund.

Growth of donor-advised funds

Use of donor-advised funds started earlier in the United States than in Canada. The first donor-advised fund there was created in 1931 by William Barstow at the New York Community Trust (New York Community Trust, n.d.). Trends and growth of the use of this charitable giving vehicle have been rigorously examined for over a decade. The independent public charity, National Philanthropic Trust has produced an annual report on donor-advised funds for the past thirteen years. The numbers show a rate of growth of 12.7% in 2018, growth that was reflected in all key metrics (number of individual donor-advised funds, total grant dollars from them,

total contributions to them, and total charitable assets) for seven consecutive years (National Philanthropic Trust, 2019).

The growth in dollar amounts for these funds across the United States has been remarkable. "Contributions to donor-advised funds in 2016 totalled $23.27 billion … surpassing the 2015 (contributions) of $21.62 billion" and "charitable assets under management in all donor-advised funds totalled $85.15 billion in 2016" (National Philanthropic Trust, 2017, section 6).

Donor-advised funds started in the 1930s, but it was only in the 1990s that the United States witnessed large leaps in their growth. After languishing as the "stepchildren of philanthropy", the sudden success of donor-advised funds is attributed to investor and businessman Edward (Ned) Johnson. Johnson petitioned the IRS to create a charitable vehicle for the mutual fund company Fidelity Investments, and in a landmark ruling in 1991 received approval to create the Fidelity Charitable Gift Fund (Metcalf, 2018; Shakely, 2015). Greater donor control had been successfully advanced, and the advantages at the time were many:

> → Now [advisors] could offer clients a philanthropic vehicle that cost nothing to establish and that didn't need IRS approval. They also had the same financial incentive to serve advised-fund donors as they had to serve other clients. What's more because investment fees are quantity-driven, Fidelity Charitable could charge fees that were lower – often much lower – than those of any community foundation.
>
> **Shakely, 2015, para. 13**

Fidelity Charitable Gift Trust, through advertising and direct marketing by their financial advisors, was highly successful. It was not long before Charles Schwab, Vanguard and other financial companies followed suit – by 2012 the top three donor-advised fund foundations were all privately sponsored public foundations: Vanguard Charitable Endowment Program had total assets of $2.3 billion, Schwab Charitable Fund assets of $3.05 billion, and Fidelity Charitable Gift Fund had a total of $5.57 billion, beating long-established religious foundations and community foundations such as the Chicago Community Trust and the New York Community Trusts (Epstein, 2012).

Today, Fidelity Charitable is "one of the country's [USA] largest grantmaking organizations, issuing more than 930,000 individual grants totalling $3.8 billion in fiscal year 2016–17" (Fidelity Charitable, 2017, p. 6). In that same fiscal year, total assets of Fidelity Charitable rose approximately $5.1 billion, from $16.0 billion to a total asset value of $21.2 billion (Fidelity Charitable, 2017, p. 25). In order to appreciate the growth of philanthropy through

donor-advised funds, consider this: donor-advised funds currently make up half of America's biggest charities, and four of the top ten charities are privately sponsored public foundations (Metcalf, 2018).

Given the meteoric growth of Fidelity Charitable and other similar foundations in the United States, it is small wonder that Canadian financial institutions and firms have followed suit in creating similar privately sponsored public foundations to facilitate philanthropic donor-advised funds. It is estimated that a total of $3.5 billion is held in donor-advised funds in Canada. This number includes privately sponsored public, community and other public foundations that offer the service of donor-advised funds (Sjogren & Bezaire, 2018).

The total donor-advised-funds assets in Canada is dwarfed by the American counterparts: the $3.5 billion total assets of all donor-advised funds in Canada represents less than the $3.8 billion that was *granted out* to charities by a single privately sponsored public foundation in the United States: Fidelity Charitable. Philanthropy is big business in the American financial industry; with our baby-boomer demographic shift and resultant intergenerational wealth transfer occurring here, Canada is just beginning to show signs of the same.

Competition? Or increased philanthropy?

So, does the rise of philanthropy on the backs of financial advisors constitute an opportunity or a threat? Will donor-advised funds affiliated with financial firms push aside Canadian community foundations in terms of attracting strategic charitable wealth funds? Brad Offman, Founder and Principal of Spire Philanthropy, describes the American experience:

> → In the United States, the relationship between commercial firms and community foundations was not a particularly healthy one. Community foundations mobilized to improve their practices in order to compete in a world where donors had the ability to access instant information disseminated by corporations with considerable resources. Furthermore, commercial firms failed to recognize community foundations as important stakeholders in the philanthropic landscape. The unhealthy tension between commercial and community philanthropy undermined the resources of both sides and created a market characterized not by philanthropic values but by traditional cutthroat competition.
>
> **Offman, 2015, para. 6**

While some community foundations might have been threatened by the changing landscape, others embraced the attention that philanthropy and donor-advised funds were receiving. Jack Shakely, president emeritus of the California Community Foundation, describes how this foundation used the situation to their benefit:

> → In the mid-1990s, Fidelity launched a huge advertising campaign ... [that] very effectively explained the advantages of donor-advised funds. The Fidelity campaign was so effective, in fact, that I developed a campaign of my own on its coat-tails: I simply extolled the added benefits that come with local management of a donor-advised-fund.
>
> **Shakely, 2015, para. 14**

In Shakely's experience, the rise in the use by privately sponsored public foundations of donor-advised funds has been of net benefit to philanthropy in general:

> → Entities like Fidelity Charitable have the financial incentive and the marketing might to reach a vast constituency of would-be donors. The growth of such funds represents the greatest marketing phenomenon in the recent history of charitable giving: for the first time ever, philanthropy has a sales force. And philanthropy as a whole has benefited from it.
>
> **Shakely, 2015, para. 7**

Data is not readily available through the regulatory reporting system in Canada to study the effect advisor compensation has had on the funnelling of funds to community foundations as opposed to privately sponsored public foundations. It is, however, an important question.

There will always be those that gain and those that lose in a changed landscape of this kind, but the American experience indicates that Canadian community foundations and privately sponsored public foundations should find ways to work together, rather than compete, in order to expand philanthropy in general. Donor-advised funds represent the potential for a new and dynamic growth of charitable fund development. This is an opportunity for commercial firms, which are predicted to continue to launch more programs and, by doing so, further penetrate the Canadian philanthropic landscape. Equally, this is potentially an opportunity for community foundations, which are predicted to experience an era of unprecedented growth through donor-advised fund management (Offman, 2015).

Controversy over warehousing charitable funds

In spite of the multiple advantages attributed to the charitable vehicle of donor-advised funds, and despite their consistent growth, not everyone in the United States is equally enamoured of their use. Boston College Law School's Professor, Ray D Madoff, fears that the use of donor-advised funds means a detour of funds away from immediate charitable use (Madoff, 2011). Her concern rests with the rise of activity by large financial institutions such as Fidelity, Schwab and Goldman Sachs, which, through the creation of affiliated privately sponsored public foundations, hold, invest, and distribute dollars for charitable purposes. Madoff is concerned that these funds "generate significant management and investment fees for the institutions that house them, which have little incentive to speed up the distribution of resources to the charitable sector" (*ibid.*, para. 3).

Unlike regulations for donor-advised funds in Canada, donor-advised funds in the United States are under no obligation to make minimum annual distributions. Nonprofit consultant Alan Cantor echoes the general concern about the increased use of donor-advised funds within privately sponsored public foundations, stating that this "accelerating trend of warehousing philanthropic dollars is a deeply troubling trend for American philanthropy" (Cantor, 2014, para. 2).

Despite Madoff and Cantor's fear that donor-advised funders will sit on their philanthropic assets indefinitely, American data to date shows no signs that such warehousing of charitable funds is taking place. In fact, the contrary is true: while there have been large leaps in contributions to donor-advised funds in the past years, the percentage payouts from these funds have been equally generous. National Philanthropy Trust reports that "grants from donor-advised funds to charitable organizations reached a new high at $23.42 billion. This is an 18.9 per cent increase from a revised 2017 total of $19.70 billion" (Heisman, 2019, sec. 5).

Regardless of the data, highly visible exceptions to the aggregate data have recently brought the question of warehousing of charitable funds to the fore. A *New York Times* article on donor-advised funds with the provocative title "How Tech Billionaires Hack Their Taxes With a Philanthropic Loophole" details the increasing lack of transparency of philanthropy (Gelles, 2018). The article focuses on a 2014 donor-advised-fund contribution of GoPro stocks valued at $500 million by GoPro founder and billionaire Nicholas Woodman, thereby creating the Jill and Nicholas Woodman Foundation. Four years later, there is little evidence of pay-out to the community by the Foundation – only a grant to the Bonny Doon Art, Wine and Brew Festival, as a benefit to an elementary school in California (*ibid.*, para. 5). In fact, since this is a donor-advised fund, in the United States, no pay-outs are required.

In this case the benefit of this large donor-advised fund to society is difficult to see, but the benefit to Woodman is clear. Through this donation Woodman avoided paying capital gains on the $500 million (a savings estimated to be in the tens of millions). In addition, Woodman likely

saved more millions by claiming a charitable tax deduction, and will probably continue to reduce his personal tax bill in future years. The article sums up the situation: "Mr Woodman achieved this enticing combination of tax efficiency and secrecy by using a donor-advised fund – a sort of charitable checking account with serious tax benefits and little or no accountability" (*ibid.*, para. 8).

Canada has prevented potential "warehousing" of charitable dollars by imposing disbursement quotas (Blumberg, 2010, para.2). In contrast to the American system, the Canadian Revenue Agency regulations stipulate that a foundation must disburse at least 3.5% of the fund's average value of assets in the previous 24 months each year (Canada Revenue Agency, 2017). The "3.5% rate is roughly equal to the historical real rate of return, which is the rate of return after inflation. Prior to 2002, the rate was 4.5%" (Burrows, 2013, para. 7). Perhaps this regulation was imposed in recognition that the US regulation, which allows the receipt of a charitable receipt for donating to a vehicle with no payout requirements, makes little public-policy sense (Cantor, 2014; Gelles, 2018).

The Canadian *minimum regulated rate* of disbursement (3.5%) for all registered charities is much lower than the *actual rate* of disbursement for donor-advised funds (20.4 %) reported in the United States. Critics, however, warn that these numbers can be skewed to give the illusion that meaningful philanthropic activity has taken place where there is none (Gelles, 2018, para. 34). This illusion is created when one privately sponsored public foundation trades donor-advised funds with another – for example, Vanguard Charitable might shift $15 million donor-advised funds to Fidelity Charitable. Privately sponsored public foundation representatives indicate that this is simply a case of wealthy donors adjusting their accounts, but sceptics see a system ripe for abuse: "Donors may wait for years to engage in meaningful philanthropic activity, or decide to simply leave the fund for their children to manage" (*ibid.*, para. 31).

Critics of the American system are alarmed that donors can realize a tax deduction by contributing to a donor-advised fund without actually contributing funds to an operating charity. The Canadian system is not perfect, either: "due to the minimum assets requirement [$100,000], the 3.5% disbursement quota affects only a minority of larger Canadian charities" (Burrows, 2013). Since the disbursement quota is calculated on the basis of a charity's entire annual expenditures for charitable purposes, and is not linked to investment alone, most charities that fundraise may receive and spend much more than the equivalent of 3.5% of its investment assets.

This amount is then added to a disbursement quota surplus, which can be carried forward for up to five years (*ibid.*). In effect, “the 3.5% is not an onerous requirement for charities that have multiple income streams and do not rely on investment payouts alone to support their charitable activities. Most public charities now have disbursement quota surpluses, although there are exceptions” (*ibid.*, p. 2). It is important to note also that, since the 3.5% quota applies to the average value of assets within a foundation, some individual funds within a foundation may not make donations to any registered charities.

This is certainly a cause for concern in the United States, where it is observed that the numbers are deceiving: “While the overall payout rate at an organization that manages DAFs [donor-advised funds] may be substantial, the numbers could be warped by a few donors who give away huge sums, while the majority of donors give away virtually nothing at all” (Gelles, 2018, para. 35).

Given the debate in the United States on this matter, Canadians might wish to consider whether the 3.5% disbursement regulation goes far enough to alleviate concerns of warehousing of charitable dollars in Canada. Canada does not track disbursement of donor-advised funds specifically and so, while it would be interesting to make comparisons, it is difficult to ascertain donor-advised fund disbursements in general, let alone distinguish between disbursements from privately sponsored public foundations and those from other public foundations or track disbursements from one privately sponsored public foundation to another. If the American example holds true for this country, there is increasing cause for vigilance about the warehousing of philanthropic funds in Canada as the use of donor-advised funds becomes an increasingly popular giving vehicle here. However, without Canadian-specific data to examine donor-advised fund activity here, there is little opportunity to accurately address this possibility.

While warehousing may not be deemed cause for immediate concern, the question of “independence of interest” has created considerable controversy in the United States and is worthy of scrutiny in the Canadian context. Detractors fear that the commercialization of philanthropy will be distorted to reflect the financial advisor’s self-interest.

Independence of interest in establishing donor-advised funds

Cantor bemoans the "inexorable takeover of the charitable sector by Wall Street", noting that, despite protestations from these sponsoring organizations that they are not commercially interested:

> → [n]early all donor-advised fund dollars are invested in the mutual fund of the affiliated financial firm and, given the constant cross-selling between the for-profit and nonprofit entities, that notion of independence is little more than a legal fig leaf
>
> **Cantor, 2014, para. 9**

A recent qualitative investigation of the value proposition of the inclusion of philanthropy in the business practices of professional advisors in Canada highlights similar implications, noting the potential for conflict of interest in the process of establishing a donor-advised-fund (Funk, 2018). When a client seeks assistance with strategic charitable giving, some advice is laden with self-interest. An ethical advisor looking out for the best interests of their client will present various options, which might include creating a private foundation, donating directly to charity, or donating to a community foundation *in addition* to the option of creating a donor-advised fund within a privately sponsored public foundation.

Clients need to be aware – should an advisor recommend establishing a donor-advised fund within privately sponsored public foundations – that this is not a completely unbiased conversation. Monies that otherwise would be lost from the client's managed portfolio to a charity or to a community foundation are maintained within the advisor's "books" if the client chooses to create a donor-advised fund under the auspices of an affiliated sponsoring firm. In this case the advisor is likely to be compensated through "trailing commissions", as noted earlier, at a rate of approximately 1% annually. One financial advisor candidly described donor-advised funds as "the ultimate revenue generator" for the financial advisor (*ibid.*).

Alternatively, when a client expresses interest in dedicating part of their portfolio to be donated directly to a charity, it is not in the immediate best interest of the advisor, since in this case those funds would leave their "books"; the managed fund portfolio for that client would be depleted by this move, which would represent a decline in an advisor's income. It is in the best interest of the financial advisor to keep the funds under their management to ensure that they would be compensated. Dissuading clients from making any charitable contributions at all is

certainly one option, and the use of donor-advised funds is certainly preferably to that kind of client–advisor conversation.

Not all client–advisor situations constitute self-interest. In some cases, such as when a client has sought out a values-based firm with a strong commitment to ethical investing, the client-as-donor might find comfort in the knowledge that their advisor's long-term commitment to a particular investing model will continue on in their philanthropic portfolio, with the understanding that the advisor will be using the same ethical and value-based approach (*ibid.*).

In other cases, an advisor may have a strong relationship of trust with a client, built over decades of effective investment advice and wealth management. Donor-advised funds provide that client with a comfortable belief that their charitable contributions will be similarly dealt with should they commit donations to an in-house foundation under that same investment management. This client would naturally expect to rely on the same level of effectiveness from their professional advisor in dealing with their philanthropic goals – for this reason financial advisors are advised to gain a solid understanding of the philanthropic sector, in order to speak comfortably on the topic of philanthropy and be equipped to offer clients a full suite of financial advice that includes strategic charitable giving (Funk, 2018; Sjogren & Bezaire, 2018).

Ultimately, "donor(s) should be wary of the financial advisor that insists that strategic charitable giving plans be directed exclusively to [privately sponsored public] foundations, since this is clearly the option most beneficial to that advisor, and is not necessarily in the best interest to the charity or to the donor's charitable intent" (Funk, 2018, p. 17). Ethics come into play when a client's advisor does not clearly inform them of possible self-interest, when an advisor does not inform the client of options that might not provide the advisor with compensation but which more clearly represent the client's charitable interests (such as giving directly to a charity), or when an advisor refuses to execute their client's charitable strategies unless funds are directed to the sponsoring foundation.

The potential for unscrupulous financial advisors acting in self-interest rather than in the best interests of their clients is very real and can only be combated by ensuring transparent transfer of funds in the sector, through the provision of clear information to and by all advisors, and through the education of donors. In Canada, are donors explicitly aware of the affiliation between the privately sponsored public charitable foundation and the commercial financial institution providing their financial management services? There are likely to be requirements of disclosure to this effect when committing funds to a charitable foundation, but this fact is not easily discernible to anyone outside the financial sector seeking to unravel the tangled web of charitable fund options.

Are privately sponsored foundations the right choice?

Another important question when considering donor-advised funds is whether privately sponsored charitable foundations are as well-equipped as community foundations to disburse funds. Grant-giving requires specialized and sophisticated skill sets that might not immediately be apparent to either donors or financial advisors. This harks back to the concerns of Ostrander (2007) that, when donors increased control, recipients' control was diminished and in the process valuable on-the-ground knowledge would be ignored or lost.

Community foundations in Canada have been honing those skills for nearly one hundred years – establishing the philanthropic networks and relationships required to build, support and develop resilient communities. Community Foundations of Canada describes some of the activities that are required to disburse funds in a meaningful manner: "We connect people with causes that inspire them. We animate civic engagement and dialogue. And we invest in talent, impact and innovation with a focus on tackling some of the most persistent social challenges facing our communities, our country and the world" (Community Foundations of Canada, n.d.). Kate McCaffery of Advisor's Edge agrees that community foundations possess worthy qualities: "Those running the (community foundation) have specialized knowledge of their given charitable sectors, which can sometimes be leveraged to provide very personalized service to donor clients" (McCaffery, 2006, p. 31).

If financial institutions with privately sponsored public foundations for the purpose of facilitating donor-advised funds are primarily motivated by maintaining management of client portfolios and providing personal tax planning for their clients, how well do they perform in these specialized, community development tasks? Why would a donor not simply choose to gain the same tax benefits and create a donor-advised fund directly within their local community foundation? Concerns about values-based and ethical investing, or continuing with the management of a trusted advisor might be good reasons; yet these are being addressed in some larger community foundations through increased flexibility and responsiveness on the management of those donor-advised funds.

Cindy Lindsay (personal communication, 2018), learning director of Community Foundations Canada, indicates that, depending on the size of the community foundation and the size of the gift, there are options for what they call a "third party advisor", which would enable the creation of a donor-advised fund within the auspices of a community foundation and yet be managed by the donor's professional advisor of choice. These arrangements are made cautiously, however, and they are reserved for large donations that start at $500,000 or $1 million minimum, depending on the community foundation in question.

Lindsay notes that some community foundations in Canada are concerned about donor-advised funds that are housed at privately sponsored public foundations; they are worried that these are enabling the wealthy to gain tax advantages without following through on their philanthropic commitment. Others, though, are not at all concerned, and she explains that variability in reactions is a result of how "savvy" local professional advisors are about philanthropy. Advisors may realize that in certain cases a client shows little charitable intent and has a greater focus on the tax break donor-advised funds bring to the table. These clients might be better served by the privately sponsored public foundation; yet they sometimes approach the community foundations seeking the competitive rate of fees that a large commercial financial institution is offering. "Donors that seek tax loopholes are not necessarily about philanthropic intent. However, 'charitable intent' is what community foundations do: we gather as many dollars as we possibly can in order to funnel funds back into the community. We are not particularly hoping to attract a client that has no interest in creating community good, and is only focused on personal gain" (C Lindsay, personal communication, 2018).

An added concern about privately sponsored public foundations is in the case of "orphan funds", when a donor dies without leaving direction for the complete distribution of the fund. For those public foundations with a clear purpose or cause, this does not pose a problem – monies are easily disbursed in alignment with donor intent. However, "when funds are left to organizations whose only business is operating these funds, like those with financial firms, it seems more problematic. Charity is not their focus, and how these 'orphan' funds will eventually be used is less clear" (Levine, 2018).

More data on donor-advised funds in Canada is required

In Canada, is financial advisor influence directing more funds to sponsoring foundations? If privately sponsored public foundations have no intention of developing community development skills, have we simply created a well-paid intermediary within this institutional entity?

Is this a positive influence, generating more aggregate dollars to charity that might not otherwise have been donated – is the philanthropic pie getting bigger as a result of the influence of financial advisors? Or is the pie perhaps unchanged: are philanthropic funds simply being diverted from community foundations and towards privately sponsored public foundations? Or are community foundations holding their own in the unchanged pie – are direct donations to charities the losers in this drive for philanthropic dollars?

The implication of these questions is that much about the use of donor-advised funds remains obscure. Canada lacks the data required to critically examine the impact of this charitable giving vehicle in the philanthropic sector. In the United States, some say community foundations have been losing market share to privately sponsored public foundations (Levine, 2018) while others argue that aggressive marketing by these foundations has "encouraged a new set of donors to enter the field" (Shakely, 2015, para. 19).

In private conversation, financial advisors suggest that without personal incentives the majority of advisors would not consider engaging their clients in a conversation about philanthropy, and so the privately sponsored public foundations are indeed encouraging conversations about philanthropy and promoting the concept of Canadians' giving. Better sources of data and further study are required in both countries in order to verify these assertions (Funk, 2018; Heist & Vance-McMullen, 2019).

Expect upheaval

Privately sponsored public foundations and the use of donor-advised funds have seismically shifted philanthropic giving in the United States over the past three decades. Given the demographic shift occurring in Canada, and the intergenerational wealth transfer that is obliged to occur as the baby boomer demographic bubble ages out, we can expect a similar shift in Canada as well.

If the American example is an accurate foreshadow of the Canadian experience, not everyone is going to come out of this upheaval unscathed. Advisors have access to channels of capital that charities don't have. Donors rely on good advice, and it is perhaps inevitable that they would rely on the advice of the individuals and institutions that carried them through the period of their wealth accumulation for their philanthropic advice. Financial advisors have the potential to drive more philanthropic dollars into the charitable system, to enlarge the philanthropic pie to benefit more Canadians. Community foundations are at risk of losing charitable funds to privately sponsored public foundations unless they embrace the concept and find ways to accommodate both donors and advisors.

Community foundations are still the experts on charity, community development, and the community's needs. Religious foundations will always attract donors who share common values and concepts of generosity. Foundations with specific causes will attract those donors passionate about the impact of their dollar in a very specific manner. All of these foundations can offer the donor the same tax benefits, flexibility, ease of donor experience, and privacy afforded by the in-house foundations.

In Canada, with the added benefit of hindsight through examination of the American experience of these charitable vehicles, and by learning from those experiences, it would be prudent to put

in place measures for ensuring that the Canadian philanthropic system remains proactive about disclosure and transparency. The vast wealth this philanthropic vehicle represents, the unanswered questions raised about increased donor control, and the vested interest of a highly organized and professional financial machinery focused on the creation and growth of donor-advised funds all point to an urgency for their rigorous review.

As Canada's wealthy baby-boomers approach the two inevitable occurrences in life, death and taxes, there is an opportunity to embrace the best of the American experience, and to learn from the worst of philanthropy in that country. In Canada we embrace the generosity and philanthropic intent of our citizens, and encourage those acts through significant tax incentives. At the same time, it is critical to ensure that the tax benefits accrued by the wealthy are legitimized through benefit to those that are actively engaged in helping Canadians towards building a stronger and more resilient Canada.

Three key takeaways

1

With an impending massive transfer of wealth from baby boomers to the next generation, donor-advised funds are poised to radically alter the face of philanthropy in Canada.

2

Philanthropic resources are increasingly shifting into the hands of commercial financial institutions through the brokerage of donor-advised funds, spelling potential opportunities and threats for foundations.

3

Donors gain greater control through the use of donor-advised funds on the one hand, and lose it in the long term on the other. While it is clear that financial professionals stand to gain, it is not clear whether there is a net benefit to Canadian society.

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