Courtesy of

RESTRICTED STOCK INFORMATION

INCREASING DONATIONS USING "FOR-PROFIT" FINANCIAL ENGINEERING

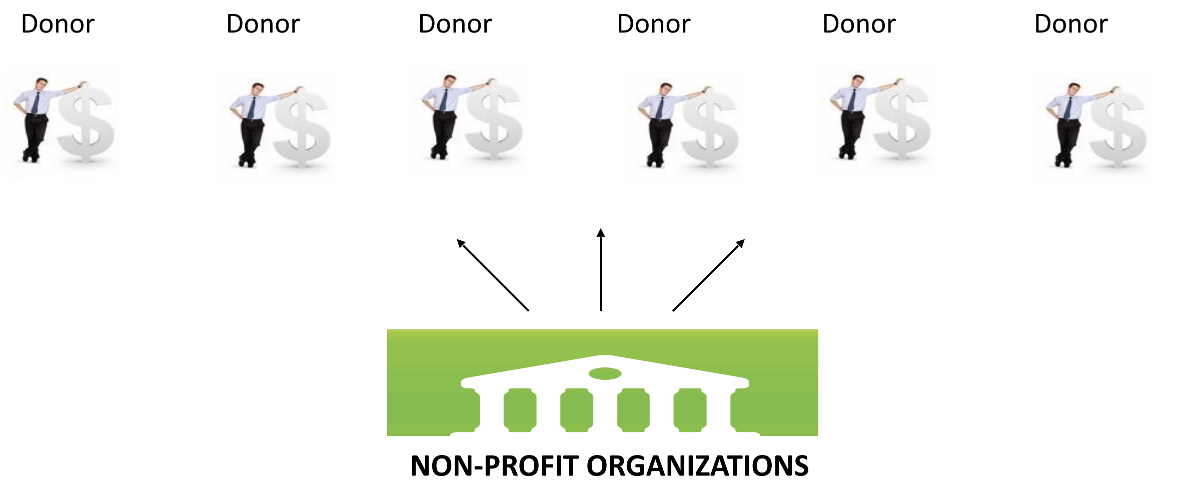
2017
William Miller

EXECUTIVE SUMMARY

The history of non-profit giving in the United States is long, storied and unprecedented in scope in the modern world. In addition, throughout the last decade financial and legal products such as annuities, insurances, specialized trusts, etc. have been utilized as augmentation "vehicles" in programs designed to address both the donative and estate planning objectives of donors. While these products represent positive strides, they don't address the drawbacks associated with the vast majority of funding strategies employed by non-profit organizations. These drawbacks are centered on a simple fact that non-profits seem unable to produce sufficient economic benefits for their donors in order to attract a large portion of a donor's net worth. Instead, most organizations are left with garnering support based mostly on the intangible benefits of offering a donor the feeling of having achieved social, spiritual and economic good with his or her donation.

Unfortunately, many non-profit organizations fail to understand that part of the problem is centered on how they differ from the donor in the perception of the process of asking for donations.

To illustrate this point, in the first example on the next page, we attempt to show how the non-profit organization perceives donors as "sources of money" that need to be farmed in order to survive. Looking outward, with their needs at the center of the equation, the non-profit organization assumes that donors want to give and that the deciding factor in generating a donation is whether or not the non-profit organization's "mission" is attractive.



Of course, donors have a completely different viewpoint of the process. While they recognize the good that non-profits accomplish, the donor's problem is twofold.

First, even donors with substantial capital resources recognize that giving money away without replenishing their principal will eventually lead to a point that the donor ends up with no money. Second, the process of choosing which non-profit organization to support can be daunting. From their perspective there appears to be an unending number of groups looking for their money. The diagram on the following page attempts to illustrate this point.

Below is a sampling of just a few of the U.S. non-profit organizations looking for financial support. In addition to the many national organizations, there are also thousands of local groups seeking contributions.

National Church College Alumni Association SPCA UNICEF CARE Children's Defense Fund World Vision American Lung Association Arthritis Foundation Farm Aid YMCA Easter Seals Africare United Way American Red Cross USO March of Dimes Food Banks	Disabled American Veterans American Heart Association National Alliance to End Homelessness American Humane Society Make-a-Wish Foundation Habitat for Humanity Juvenile Diabetes Foundation Project Hope Toys for Tots PBS (Public Broadcasting) Farm Aid Special Olympics MS Foundation 4H Fisher House

Again, to a donor, the process of which non-profit organization to support can be difficult at best. For example, every donation decision necessitates the donor narrowing the field of potential candidates through a laborious investigation process that requires a commitment of time and energy. Further, every donation must be evaluated based on the size and frequency of the donation in relation to funds available. Make a wrong decision and the donor will not only lose his or her ability to make future donations, but just as importantly, will jeopardize personal financial stability. While non-profit organizations justify their inability to attract donations with statements regarding the poor economy, a lack of marketing funds, too much competition, and/or other excuses, we believe the real problem goes much deeper. Donors don't see non-profit organizations as a solution to any of their financial needs. Consider this simple question. Look at the diagram below and ask yourself, "What would you do with the majority of your money if you were an individual with moderate to high net-worth?"

CHOICES

NON-PROFIT ORGANIZATIONS

BENEFITS OFFERED

Limited Tax Benefits
Good Feelings

FOR-PROFIT SECULAR ORGANIZATIONS*

BENEFITS OFFERED

Return of Principal
Safety of Principal
Growth Potential
Income Potential
Flexibility
Ability to Fund Personal Needs

**Includes: Banks, Brokerage Firms, Investment Advisory Firms, Mutual Fund Companies, Hedge Funds, Venture Capital Funds, Real Estate Brokers, Insurance Companies, Credit Unions, Pension Companies, Private Investment Partnerships, etc.*

Conclusion

We believe the answer to the quandary that plagues all non-profits – how to become more attractive to potential contributors – can be found by looking aggressively toward the secular investment community. There, ideas, concepts and investment vehicles abound that have the capacity to enable a non-profit organization to create compelling programs that provide economic benefits on par with secular investments. By offering competitive donor benefits the non-profit organization enhances their capacity to increase the size and consistency of donations.

HOW THIS REPORT CAME INTO BEING

A few years back, using the same blueprint we had developed when exploring new business opportunities in our for-profit ventures, One-Forty-Four Plus (144+) LLC set out to gain a greater understanding of the unique characteristics of the nonprofit arena. This included focusing our efforts on information gathering and preplanning, both critical elements of a successful endeavor. Our initial goals included: (a) gaining a greater comprehension of how non-profit organizations operate, (b) determining if secular concepts could indeed be applied toward non-profit fund-raising programs, and (c) establishing what would be required to implement the programs that were conceived.

Our Initial Findings – More than just a few Roadblocks

While our journey continued over the months that followed, our first contacts with non-profit organizations raised a number of issues we had not anticipated. For example:

Almost without exception there was a dark cloud of skepticism that seemed to hang over every discussion. At first, this puzzled us. We were baffled that there would be any resistance to <u>exploring ideas</u>, especially considering the critical need for donations and the fact that we as an organization and as individuals were not asking for anything in return. However, as we studied this phenomenon in greater detail we eventually found the reason for such large-scale cynicism. Virtually everyone we talked to was acutely aware of some nonprofit scam. From corrupt televangelists to the massive Ponzi schemes perpetrated by New Era and Bernie Madoff, the nonprofit world was extremely distrustful of any idea that had not been tried by others over and over again. As a result, we ended up spending a substantial amount of time attempting to overcome fears that, while justified, were unwarranted in our case.

Another group of obstacles occurred when we began to present sophisticated financial ideas that were commonplace in the for-profit world but were practically unheard of in the non-profit sector. There was an old adage that seemed to fit. "How does one know that you know an area, if they don't have your knowledge?" We found ourselves in much the same position as someone trying to explain how a 747-jumbo jet sitting on the ground gets airborne to someone who has never heard of or seen an airplane. Until you see it happen you can't imagine how such a heavy piece of metal could ever get off the ground.

We also discovered difficulties based on the inherent operational structure of most non-profits. For example, a nonprofit's management hierarchy is dissimilar to for-profit businesses. Instead of a flow chart that starts at the top, with a group of Executive Officers who make final decisions on behalf of the company without outside interference, in the non-profit world there was almost always a complex structure where the decision-making process begins with a "Director, who then must seek approval from a Board of Directors, who operate by "committee." While this type of structure doesn't create a problem in a non-profit's day-to-day activities, it did create a plethora of problems for us, especially as it related to trying to get a diverse group of administrators, Board members, and other interested parties to agree on any course of action. Rather than deal with one or two individuals, we constantly had to interact with 10 to 20 individuals, many whom lacked knowledge or were unwilling to be patient during the educational process.

There were other problems as well. Some organizations believed that anything associated with the financial world was somehow at odds with the mission of non-profits. It was also apparent that many Boards were highly political; to a point where one individual saying "yes" to a suggestion would automatically trigger a "no" by someone else who simply took an opposing point of view regardless of the merits of a proposal. Finally, as with most bureaucracies, those making the decisions inherently knew that their jobs were safe if they simply said "no" and maintained the status quo. The thought process was "why jeopardize a Board position" that in many cases is worn like a badge of honor and produces benefits beyond the nonprofit organization, by taking risks. It is much easier to just show up at a meeting, pontificate on the agenda items, and socialize with fellow board members. Of course, in the for-profit business world, taking measured risks are what lead to growth and advantages over competition.

Summary

Eventually we were able to answer many of the concerns mentioned above. It just took longer than we had hoped. However, along the way we found out that it is possible to change the dynamic of how non-profits raise funds. We also found that secular concepts are flexible enough to be used in developing solid donation programs, and finally, that there are ways of reaching more potential donors for larger donations.

Therefore, while you read and decipher the following material, keep in mind that despite an occasional negative overtone due to what we had to go through, this report should provide a positive impetus to explore the possibilities of the new dynamic we hoped to achieve – increasing donations through financial engineering.

The Authors

SECTION I

DICUSSION OF A CONCEPT APPLICATION

BACKGROUND

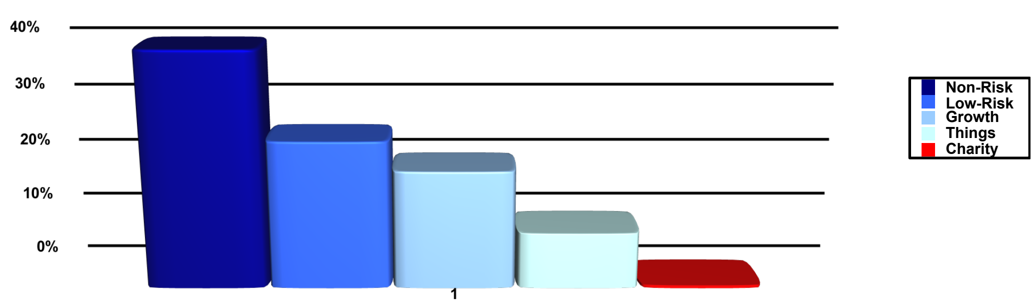
In a secular world, if an organization wishes to raise money it must provide something tangible in return. It doesn't matter if the organization or group seeking funds is a bank, financial institution, private company, or public corporation. If the entity asks for dollars, it either provides a means to return some or all of the principal (usually with interest) or it provides a growth or profit sharing factor. While this precept is obvious, it is also obvious, as we discussed earlier, that non-profit organizations seeking donations or financial support tend to do something quite different. They ask for money without providing any tangible economic benefit other than occasional tax relief that can be exhausted. As a result, many consider donating money as less than attractive.

The chart on the next page represents a middle-of-the-road asset allocation model for a conservative wealthy individual. It shows the majority of disposable income generated is placed in non-risk to low-risk categories as well as areas that produce growth or enhance quality of life. It also illustrates that of the 100% available for asset allocation, usually a very small percentage of a person's total net worth ends up being earmarked to the general category of charitable gift giving. Of course we recognize that the percentage allocated to each area differs between individuals and there are no absolutes. However, what we are confident in saying is that the percentage of disposable income allocated to a given area is usually in direct proportion to the amount of economic benefit derived.

In presenting the diagram below, we attempt to show that individuals judge a combination of factors prior to "investing" including: risk to principal; the potential to generate income or growth; or in the case of cars, planes, boats, and other "things," the amount of fun that can be derived from an expenditure. Since few non-profit organizations provide economic incentives or fun in return for a donation, the amount designated by a potential contributor for a non-profit endeavor usually ends up being minuscule in relation to the individual's overall net worth.

ASSET ALLOCATION CHART

PERCENT OF DISPOSABLE INCOME



There are additional problems as well. As we attempted to show in one of the previous diagrams, seldom is there just one organization competing for a donor's attention. National and local non-profit charities, churches, political organizations, special interest groups and others all market their causes to donors. Unless there is a "hook" (an approach geared toward a specific donor desire) the chances that any one organization will garner all of a donor's allocated funds are slim.

Finally, and perhaps the biggest problem of all, non-profit gift giving and fund raising has grown into a cloistered industry in which ideas are sought and developed inward rather than outward. Financial engineering (see definition below) has practically disappeared from the non-profit fund raising arena. It has been replaced by stagnate concepts promoted by those who tend to parrot the ideas generated by others in the same field.

> *Note: Financial engineering is a process that utilizes existing financial instruments to create a new and enhanced product of some type. Just about any combination of financial instruments and products can be used in financial engineering. The process may involve a simple union between two products, or make use of several different products to create a new product that provides benefits that none of the other instruments could manage on their own.*

In order for conditions to change, non-profits need to begin to explore ways of increasing donations by looking to the secular world of finance.

In this study we hoped to locate various methods that would provide a host of economic benefits for donors, including:

1. A way to return and/or preserve a donor's principal
2. Allow multiple methods of donation payments (cash, Restricted Stock, low-basis stock, and even certain real estate properties)

Our core premise centered on the belief that there are programs and methods that can increase the size of donations while providing all the moral, social, and spiritual benefits that come from supporting non-profit organizations. As a result, a donation can become less of a "give-away" and more of an "investment."

A NEW METHODOLOGY

In determining possibilities, we began by financially engineering two or more investment vehicles into a combination package that when applied toward a non-profit donation could offer solid economic benefits for the donor. For example, it is possible to create a package where a nonprofit investor can receive a Return of Principal in a relatively short period of time backed by debt instruments while at the same time receiving a growth component based upon an underlying index such as the Standard and Poor 500 ETF (Exchange Traded Fund).

These types of packages (sometimes referred to as Structured Products, Market Linked Notes, Market CD's, and other names) are commonplace in the investment world.

> *Note: Today, variations of these products are the largest and fastest growing segment of the financial market. As part of the $24 trillion fixed income market, they are used by major financial institutions, pension and profit sharing plans, non-profit organizations, Individual Retirement Accounts (IRAs) and others who require safety first and growth second.*

In conclusion, by looking at the structure of various investment vehicles available in the secular world, and making a few minor alterations, viable programs can be initiated that enable donors to receive economic benefits while still providing gift-giving support to worthy nonprofit organizations.

BENEFITS TO DONORS

One of the ways to determine the value of a given program is to consider the benefits it creates for donors. We believe it is safe to say that the greater the benefits, the greater the ability to attract donors. While the only program we discussed in any length was a program centered on the use of a preservation of principal customized Structured Product, it still showed the potential to offer donors a number of benefits not normally available with other donation programs. For example:

- **Programs Can Be Produced That Provide Competitive Economic Benefits**

  With just the <u>one</u> proposed methodology, contributors would be able to provide financial assistance to the non-profit organization while still receiving economic benefits competitive to secular investments, including a return of principal, growth, flexibility, and potential tax benefits.

- **Programs Can Be Produced That Offer Complete Flexibility**

  Flexibility is something few donation programs offer. However, in many of the programs we reviewed flexibility was a cornerstone of the package. For example, some programs allowed the donor to receive all or a portion of his principal back in a relatively short period of time. At the time the donor was about to receive their distribution, they would have the flexibility to receive a full distribution, or if more advantageous a partial distribution, or finally, no distribution at all. To those donors who didn't need the return of principal, the non-profit organization would then receive an amount equal to the value of the original donation.

- **Programs Can Be Produced That Cover Unforeseen Future Events**

  Many programs can be developed in which the donor maintains recourse in the event of an emergency or in the event that economic conditions change in the future. With any other donor program, once the money is given to the non-profit organization, it is lost. The donor can't go back and ask for a refund. However, with the customized programs, the value of the contribution might not be lost and could be recoverable.

- **The Usual Benefits of Making a Donation not Diminished**

  In addition to all the above benefits, the donor still receives the usual social, spiritual and economic good that comes from supporting the non-profit organization.

BENEFITS TO NON-PROFIT ORGANIZATIONS

- **The Sources for Future Donations are not Diminished**

  Perhaps more than any other fact, non-profit organizations should understand that with most of the programs we have suggested, a donation made today does not deplete the source of future donations.

  For example, normally when a donation is given, the source of the donation (the donor) must either replenish what was given away or micro-manage the remaining resources so principal is not diminished to a point where there is nothing left. By providing a return of principal, access to future donations are more likely because the initial donation did not reduce the donor's financial capacity to give, as he or she would receive back a dollar amount equal to or greater than the original contribution. This also opens up a number of alternatives such as the possibility of creating a "legacy" gift that provides funding in perpetuity.

- **The Amount Available for Donations is Increased**

As discussed earlier in this report, the amount designated for non-profit gift giving can be quite small in relation to an individual's overall net worth. However, by changing the dynamic of a non-profit contribution to that of a competitive investment, the actual dollar amount available to a non-profit organization may be significantly increased. Instead of mining the 1% or less that is usually earmarked by donors for non-profit purposes, a non-profit organization would be able to go after the approximate 90% of the investor's net worth allocated for safe, semi-safe, and growth areas usually held by secular organizations (banks, brokerage companies, investment advisory firms, etc). This can be accomplished because the benefits offered by the non-profit organization can be equal to or greater than those offered by secular organizations.

- **Paperwork is Simple and Easy to Coordinate**

  The paperwork for most programs we reviewed can be developed quickly and is simple to coordinate.

- **No Liability Issues for the Non-Profit Organization**

  All the elements of a given program can be set up as mathematically certain transactions that are coordinated by a major financial institution who assumes liability for implementation of the program. In addition, since the main elements of most of the programs we reviewed center on debt instruments, there are little to no risk issues to deal with.

- **Immediate Release of Funds**

  Virtually every program we reviewed enabled the funds earmarked for the nonprofit organization to be available immediately. Unlike life insurance policies, certain trusts, and annuities that require the non-profit to wait for a donation to mature, there was no waiting period before the donation was triggered.

SECTION II

RESTRICTED STOCK

AN UNTAPPED RESOURCE FOR DONATIONS

In addition to how investment vehicles are combined, enabling donors to make contributions with alternatives to cash is another area to be considered. For example, securities such as Rule 144/45 Restricted Stock, that may have severe limitations as to liquidity and/or unwanted tax consequences if sold, may have substantial benefits when used in a non-profit gift giving transaction. In addition, Restricted Stock typically represents a single large concentrated position of wealth, in many cases substantially greater than the other assets that make up an individual's remaining net worth. Current estimates peg the Restricted Stock marketplace to be in excess of $5 trillion dollars. Finally, there is a solid track record of utilizing Restricted Stock for donative purposes and such donations are commonplace among many large non-profit institutions, albeit without much creativity – a point we will address later.

Background Related to Restricted Stock

Although virtually every non-profit organization is familiar with the process of asking for cash donations, only a few understand how illiquid assets can be used for donative purposes.

Note: Illiquid assets, for our purposes, include Restricted Stock and low basis stock in publicly traded companies. We define Restricted Stock (RS) as stock held by owners, officers, senior management, or other insiders of publicly traded companies. Our use of the term is limited strictly to stock of public companies that have "gone public" via a public registration process known as an Initial Public Offering (IPO). Such stock is commonly referred to as "Rule 144 Restricted Stock." Excluded from our definition is stock held in private companies (which is also sometimes referred to as "restricted stock"). We also exclude "restricted stock options" (RSOs) in the discussion as most RSOs are restricted only by the underlying company, not as a result of federal securities laws. While not discussed in this report "Low Basis Stock" is defined as stock that has a low cost base in relation to its current value. Like Restricted Stock low basis shares potentially expose the stockholder to significant federal income tax as a result of a sale of stock.

Perhaps the most difficult illiquid asset to understand, but also the most beneficial, is Rule 144 Restricted Stock. The reasons become evident once the creation of such stock and the restrictions imposed on its marketability are understood.

How Rule 144 Restricted Stock is Generally Created

While not true in all circumstances, generally Rule 144 Restricted Stock results from a formal process in which a private company issues stock for the first time to the general public through an Initial Public Offering (IPO). Since this is the easiest way to explain the characteristics of Restricted Stock, its benefits and drawbacks, and finally how it can be used as a donation, we'll focus on these events to explain how Restricted Stock comes into being.

Most IPO offerings begin with the original owners of the privately held company giving up a portion of their pre-IPO stock to the general public in return for needed capital. The percentage of shares the original owners typically release to the public can be quite small, ranging from as little as 10 to 20%. This still leaves the original owners with the majority of shares, approaching 80 to 90% or more. Further, the amount of new capital raised can be massive in relation to the value of the company prior to the IPO and especially in relation to the amount the original owners of the company may have put up to capitalize the company at its inception.

Historical Note: Before there were regulations regarding IPOs, the disparity between what an original owner and the public paid for a stock and its subsequent valuation in the marketplace caused a problem. Unscrupulous businessmen would take a company public simply so they could raise a significant amount of money and then, quickly after the offering, sell their shares against the public marketplace. In many cases it didn't matter that the sales triggered a decline in the price of the stock, as even a small percentage of stock sold at the beginning would economically justify the practice. After all, in their eyes they had paid virtually nothing for the stock. This practice, called "dumping," obviously hurt the small investor who had put up money in good faith. However, prior to the Great Depression stocks generally had moved up with such regularity that no one seemed to mind. In fact, stocks were so widely purchased that it was even possible to buy stocks on 10% margin; e.g., one had only to deposit $1 for every $10 worth of stock purchased. However, things changed dramatically after the stock market crash of 1929. Finally, in 1933 Congress recognized problems relating to the securities markets and as part of sweeping changes, enacted a series of laws designed to regulate the securities industry. The Securities Act of 1933 and the Securities Act of 1934 (the "Act" or "Acts") promulgated new rules governing brokers, brokerage firms, mutual funds, and the process of raising capital from potential investors. Rule 144 of the Act *specifically addresses the process of how owners can liquidate their securities, and eliminates the practice of dumping.*

Regulatory Considerations

Generally, Rule 144 states that control persons and insiders cannot sell any of their shares for at least six months after the IPO. This restriction allows the stock to stabilize before persons in control of the company or privy to inside information begin any liquidation process. After the six-month wait, such Restricted Stock owners have further limitations. They can sell only 1% of the total shares outstanding in any quarter. The 1% per quarter limitation is non-cumulative so that the sale of less than 1% in one quarter does not increase the amount that can be sold in a subsequent quarter.

Note: In some circumstances there may be additional limitations based on volume and trading activity.

By imposing these limitations, Rule 144 prevents a company's control person or insider from "dumping" shares, which could have a negative impact on the price of the publicly traded stock. Further, because Rule 144 Restricted Stock owners may have inside knowledge of the underlying company, they are also prevented from executing any form of pre-sale in anticipation of news. Restrictive pre-sales include such transactions as the purchase of put options, the sale of calls, the use of option "collars" and Variable Prepaid Forward Contracts ("VPFCs") or programs based on borrowing that use Restricted Stock for collateral. Therefore, despite the enormous wealth of many Restricted Stock owners, many might be considered "cash poor."

We should also point out that even years after an IPO, where the original owners may have long ago liquidated their shares, does not always diminish the amount of Restricted Stock that may be available for donative purposes. For example, anytime someone is in a position to know the inside working of a public company, such as the senior management, their families, key employees, and others, their stock is also restricted under the same regulations. In fact, even if the insider purchased shares in the open market before becoming an "affiliate" of the company, his or her shares would become restricted after they assumed the position of a control person.

The Problems Faced by Owners of Restricted Stock

Virtually all owners of Restricted Stock are shackled by the stock's lack of liquidity. Despite sometimes being a major portion of an individual's overall net worth, Restricted Stock holdings are practically useless until sold under Rule 144. For the most part owners will deposit the stock in a safety deposit box or hold the securities at a brokerage firm until they decide to sell their allotted 1% per quarter.

Using Restricted Stock as a Non-profit Contribution

What more than a few in the non-profit world have come to realize is that Restricted Stock is an ideal vehicle when making a donation. A Restricted Stock donation program allows the owner of stock to make a donation to the non-profit organization, utilizing the full value of the stock for purposes of a donation. Since most owners have an extremely low-cost base, there are significant tax benefits that can be offered. This is why some large institutions, mainly colleges and universities, have full-fledged Restricted Stock departments. It enables them to go after donors who might not otherwise be interested in donating to their organization.

Another important fact to understand is that when Restricted Stock is contributed, it doesn't require the non-profit to hold or manage the stock. One of the benefits of being a non-profit is that 144 Restricted Stock can be sold by the non-profit immediately upon receipt, thereby converting what was once an illiquid asset to cash.

Since a Restricted Stock donation has so many benefits to the contributor (even without our added creativity) we have been surprised at how little this area is understood and even more amazed that fund raisers have failed to ask a potential donor if he or she owns Restricted Stock that the non-profit would be willing to accept as a means of payment.

Variations of 144 Restricted Stock Programs

Despite the obvious benefits of a straight forward Restricted Stock donation, we believe many non-profits have missed the mark. Just because the non-profit accepts Restricted Stock as a means of payment for a donation, the non-profit is still asking for a donation and providing no economic benefit in return, other than the limited tax benefits that are easily exhausted. Further, when markets declined in 2008, Restricted Stock holders became resistant to giving up stock when prices were so low. This had a huge impact on the non-profit Restricted Stock departments as they did not offer a program that would provide upside market participation to offset the diminished value of stock at the time. Therefore, owners of such stock simply made the decision to hold off making any non-profit donations until the stock recovered in price, which meant, of course, that Restricted Stock donations dried up.

Coupling the Restricted Stock Donation with the Non-profit Structured Product Type of Program

If one couples what we discussed in creating "return of principal" donation programs that provide tangible economic benefits with what has been discussed about Restricted Stock a unique picture begins to emerge.

- Contributors are able to provide financial assistance to the non-profit organization with a security they paid virtually nothing for, that has little or no income value and is illiquid and difficult to sell. Best of all, in "x" number of years they can get back as much as a 100% return of principal (equal to the value of their initial capital contribution) not in stock, but in cash. There is no out-of-pocket cost, risk to principal, or drawbacks that come from the loss of "use of money."
- Since hybrid non-profit products can be created <u>for the donor</u> from the proceeds of a Restricted Stock sale, a decline in the value of the stock has no impact on the amount that will be returned to the donor. The stock could fall to zero and the donor would still receive cash equal to the value of the stock at the time of the initial contribution. This may be especially important during periods where markets or stocks are close to all time highs. Many owners of RS are all too familiar with what can happen to the value of their stocks during declining markets or when companies or industries collapse.
- One of the biggest concerns a donor may have when contributing stock in his or her company has to do with opportunities lost should the underlying stock <u>rise</u> in price, an especially important consideration in today's marketplace. Of course, with a customized non-profit Structured Product there is a stock or market component already built into the package. This provision provides upside potential, with no downside risk, and negates the argument that by making a Restricted Stock donation the donor gives up future value derived from holding their stock in an advancing market.

  Another attractive feature that can be offered is a provision that allows the donor to select whether he wants the growth component to be based on the contributed stock, or a general stock market component based on an index such as the Standard and Poor 500 Index. This diversification element is especially important to those who are concerned with having all their "eggs in one basket."
- A Restricted Stock program, just like a cash-based program, can offer complete flexibility to the donor. For example, at the time the donor is about to receive their distribution, they

would have the flexibility to receive a full distribution, or if more advantageous a partial distribution, or finally, no distribution at all. In addition, should the donor wish to expand his or her gift giving, it can be done without incurring taxes resulting from having sold the stock.

Note: One of the issues that surfaced centered on what happens when a Restricted Stock owner, who has not paid taxes on gains, contributes Restricted Stock knowing that he or she will receive a dollar value equal to the contribution at some point in the future. Will the IRS look at the transaction as a constructive sale, in which case taxes would be due at the time of the contribution, or would the taxes be due at the time the final distribution was made?

Our answer is it doesn't much matter either way. Even if the worst-case scenario were to occur, where the taxes are due at the beginning, the maximum tax would be 23.8% based on current long-term capital gains. Keep in mind that if the taxes are paid, the portion of the contribution that ends up being given to the non-profit (30% in some of our models) would end up creating a tax write-off of 30% that could be used to offset this tax bite from the Restricted Stock sale. Therefore, even with a less than positive event, having to pay taxes on the sale up front, the donor would receive the benefits of: (a) freezing the value of his or her holdings at the time of the contribution, which means there would be no risk of the principal declining due to market conditions; (b) upside potential as if the stock were not contributed (remember the derivative component); and (c) a better net gain than if the donor held the securities and sold them at a later date without the benefit of a non-profit donation tax write-off.

Finally, in some of the programs we have reviewed, the recipient of the donation could put in motion a program that would, return principal, pay the constructive sale taxes, and provide upside potential, all the while providing the charitable organization with support. The only difference is that the donor would not be able to write off the full amount of the donation on taxes; something we feel would not be as important because of the future flexibility that can be offered.

Note: Due to tax regulations charitable organizations cannot offer a return of principal and a tax write off. Typically, the donor can only receive one or the other. Under all conditions the amount of the write off can only equal what is actually given to the charitable organization.

- The donor maintains recourse in the event of an emergency or in the event that economic conditions have changed in the future. With any other donor program, once the money is given to the non-profit organization, it is lost. The donor can't go back and ask for a refund. With many of the programs we reviewed, the value of the contribution is not lost and is fully recoverable.
- Goodwill that comes from making a sizable donation to a non-profit organization should not be underestimated. It has benefits for the individual, and ramifications to the underlying company who approves the donation with the owner's Restricted Stock.

Benefits to Non-profit Organizations

As with the "Return of Principal" cash donation program discussed earlier, many of the benefits to the non-profit organization that accepts Restricted Stock are similar. However, with a Restricted Stock Donation program there is one additional key benefit:

- Normally it is extremely difficult to find cash donors willing to contribute large sums for non-profit organization projects. Few individuals are in possession of such amounts, and even fewer are willing to consider making a sizeable donation that may deplete available capital. There are, however, many individuals who possess Restricted Stock and even more who would consider the "Return of Principal" structure to be attractive. It comes down to the difference between asking someone for after-tax dollars, that are needed for day-to-day purposes, versus asking someone to "use" a pre-tax asset with a zero cost base that is illiquid, has numerous restrictions, is subject to market declines, and is just sitting in a safety deposit box providing no benefits to anyone.

SECTION III

COMMONLY ASKED QUESTIONS

QUALIFICATIONS

While we have attempted to be as clear and forthright in our answers as possible, please keep in mind that there will always be areas that require further clarification. Also, it is impossible to answer everything in a single document, especially when there are volumes of data related to each subject.

- **The concepts you have proposed seem "too good to be true."**

  There is an old adage that most of us have heard: *"If something seems too good to be true, it probably is."* While it is wise to use this statement as a reminder to be cautious, we would also like to point out that the statement does not say "If something seems too good to be true, it <u>never</u> is."

  If you are going to give consideration to the statement, "it seems too good to be true," perhaps you should also consider that exploring these concepts does not cost any money. Either you will find that the concepts are faulty, in which case you don't have to do anything; or you will find out that the concepts are real, in which case you can choose what to do next.

- **Are these concepts new?**

  No, they are not new. Every concept described in this report has been done before – although almost exclusively in the for-profit world.

- **Why haven't these concepts been utilized by the non-profit world?**

  We believe that biggest reason comes down to a simple fact – the industry is cloistered. For example, when an industry first comes into existence individuals will tend to look to any area for ideas. However, as it matures it begins to attract "specialists" who are educated or trained only in that specific industry or discipline. The pattern of developing a concept internally and then tweaking the ideas over and over without regard to concepts or strategies that may be available from other industries eventually leads to a decline in creativity. In the non-profit gift giving world this means finding out what everyone else in the industry is doing and copying the ideas.

  There may be a few other reasons as well.

  Non-profit organizations typically operate differently than for-profit businesses. Administrators are hired under a different set of criteria and seldom have rigid performance requirements tied to their employment. As we alluded to previously, one is less likely to be fired by maintaining the status quo (even if he or she is less than successful) than attempting to make changes that might not go well but might also solve problems. It is very similar to politics.

Additionally, it is rare that an administrator will be aggressive on his own. Most of the time, Boards of Directors are the only ones who can effectuate real change, and seldom do they agree unilaterally to do so. Instead, the same fears that cripple administrators crop into their thinking. The decision-making mentality is centered on how not to lose versus how to win.

Also, many organizations that support non-profits are slow to embrace new ideas, and without their approval, many non-profits will not act. A vicious circle begins when the non-profit administrator wants to initiate a new idea but has to seek approval from a bureaucratic Board, who then seeks opinions from outside advisors – who normally resist change. Since the advisors don't like approving anything that hasn't been done before, they take the safe route and recommend rejection. Since the Boards feel decisions are too risky without advisor approval, they also reject the idea. And, finally, without Board approval the administrators will not act. Over time, everyone learns – don't take chances and/or wait until everyone else in the industry is doing what was proposed, so that no one can be judged as reckless.

Finally, as you can probably tell by now, while the concepts themselves are fairly simple and there is a wealth of information available that anyone can review, these are not ideas commonplace in the non-profit world. In order to even get to the implementation stage there is a fairly lengthy process that is required. Unless there is a commitment to learn, investigate, prove, and plan, nothing will occur.

- **How come we've never heard of Restricted Stock or using such securities for a donation?**

  We can't tell you why someone hasn't heard of Restricted Stock or using Restricted Stock as a donative tool. What we can tell you is that there are many large institutions in the non-profit world that do have Restricted Stock donation programs and have raised large sums as a result. Just within the educational world, Harvard, the University of Southern California, Penn University, Notre Dame, and a host of other major colleges too numerous to mention have well defined Restricted Stock departments. Look up "Restricted Stock donations" on the Internet. You might be surprised.

- **Do these concepts require the non-profit organization to manage money or become an investment advisor?**

  None of the strategies discussed require the non-profit organization to manage money or become an investment advisor, any more than using an insurance product in a donative plan requires the non-profit organization to be licensed to sell insurance.

- **How does such a small group of individuals come up with viable ideas when major institutions, with thousands of employees, have not even scratched the surface of offering fund raising solutions for the non-profit world?**

  We believe there are three primary reasons.

  First, major financial institutions are busy with the business at hand and seldom have time to brainstorm new ideas, especially for unrelated industries. Like any organization that grows into a large institution, they tend to become bureaucratic in nature and the creation of new ideas becomes less important than the maintenance of current business.

  Second, most large organizations will tend to pursue areas that produce the largest profits. It is the reason so many brokerage firms promote mutual funds when there are better vehicles available. In looking at many of the concepts we found attractive, we noticed the commissions and fee structures of the underlying products were relatively low in comparison to other products marketed by the large financial institutions. Asking secular companies to relinquish areas of high profit potential in favor of areas that require substantial development expenditures while producing low profit margins, is asking for more than most are willing to do. Add to that the difficulty of getting non-profits to act on any new proposals and it becomes clear most secular companies simply don't have an interest in pursuing ideas and programs for entities that produce little profits or are difficult to penetrate.

Finally, if one goes back in history, many innovative ideas have come from individuals, not big corporations. For example, the greatest leap in computer growth came about from ideas by a small group of Harvard University students working out of their dorm rooms, not the biggest corporations of the time – Xerox, IBM, Univac, or Honeywell. (Hint: the same group eventually founded Microsoft.) In another example, in 1973, the Chicago Board of Options Exchange was founded by a small group of businessmen – not Merrill Lynch, Prudential Bache, Paine Webber, or Dean Witter – the big financial giants of the time. Option activities, which were scoffed at by virtually every large institution at inception, now represent nearly 1/3 of all trading activity.

In conclusion, while it would seem logical that big organizations would be looking to develop programs for non-profit organizations, more often than not the best ideas will tend to come from individuals or small organizations that are unencumbered with maintaining a large business enterprise and have the time and motivation to explore new ideas.

- **Non-profit organizations do not operate like for-profit business entities. What problems did you uncover and how do you anticipate overcoming the obstacles?**

  As mentioned earlier, one of the most surprising obstacles we found centered on how difficult it was to work through the operational structure of many non-profit organizations. Because of the inherent bureaucracy we were usually required to make a series of general presentations to a large group of individuals (such as Board or committee members), many of whom were neither qualified to make a judgment of the concepts due to their specific lack of financial knowledge, or who had preconceived notions as to whether or not something was even worth pursuing.

  This process was further exasperated when Board or committee members had been appointed based upon aspects other than their financial knowledge; i.e., individuals who had influence in the community, gave large contributions, or were recognized for their moral authority. In addition, most non-profit organizations we interviewed failed to recognize a very simple but important point – that being a lawyer, accountant, doctor, successful business owner, wealthy individual, or large-scale donor, does not automatically mean the individual has any real financial experience. In other words, just because someone is an expert in one field does not make them an expert in another. Look closely and you will also find that the vast majority of these individuals hire outside advisors.

  Finally, in those cases where progress was positive, the non-profit organization's leadership had clear vision, greater control over the bureaucratic elements of the organization, and was more progressive by nature. In those areas where we had the most difficulty, there were a myriad of reasons for delays, ranging from political infighting amongst Board members, misguided edicts, a lack of strong leadership willing to fight for the ideas, the interference of key employees who saw us as a threat to their jobs, and finally, entrenched outside advisors that saw us as competition and a threat to their business.

- **Our organization has limited financial expertise. As a result, we rely heavily on outside financial and fund-raising experts to assist us in money matters. What is wrong with this?**

  The answer is there is nothing wrong with using advisors when others within the organization lack the experience. Most non-profit organizations rely on outside advisors. While a seemingly logical solution, a number of problems still need to be addressed.

For example, related to the use of a financial advisor, one of our early test cases was an educational institution in which the President of the institution raved about their advisor. We were told the individual was well schooled in high finance, had been a tremendous asset to the college, and was someone we should get to know. Unfortunately, after a short time we found the advisor was neither skilled nor knowledgeable. During a recent market decline, for example, the advisor not only lost money for the college but had a greater percentage loss than the benchmark averages. Further the advisor did not understand the principles of hedging and/or protection, which would have reduced such losses, nor was there any comprehension of the more sophisticated strategies that are commonplace in the financial world. The advisor's range of expertise was no greater than that of a low-level advisor. However, the advisor was extremely gregarious, had known the President of the institution on a personal level for a number of years, and finally, had been in the financial business for a significant period of time - with all the usual credentials related to education and licensing. To the President, who had little or no financial knowledge himself, the advisor appeared to be experienced, knowledgeable, and professional. Coupled with the personal relationship that had developed over the years, it was practically impossible for the President to make a rational judgment on the skills of his advisor. So the answer to the first part of this question – what is wrong with using an outside financial advisor – is nothing, as long as you have accurately determined the person's level of skill.

As far as relying on an outside advisor for fund raising ideas, the biggest problem goes back to the cloistered argument previously discussed. A specialist in one area does not always follow concepts in another area. For example, look up the phrases "non-profit gift giving," "fund raising for non-profit organizations," "increasing donations," "donating Restricted Stock" or a host of other industry terms on the Internet and you will find thousands of sites devoted to each area. What you will not see is any discussion of financial engineering or investment products used by the secular financial community that, once understood, might be applicable to developing programs to increase non-profit gift giving. What you will see is an overwhelming number of advisory companies or individuals with ideas on how to get a donor to give up his or her assets for little in return. You'll see essays or special fund-raising drives that attempt to sell donors on the need to tithe, give-away deals in which donations entitle a donor to a special gift, and event promotions as diverse as flamingo flocking, bake sales, art shows, auctions, and a multitude of other ideas that have little attractiveness to high-net-worth donors.

If all else fails and you are not able to judge the veracity of your advisor, we suggest getting a second opinion. While this is time-consuming and may feel like you are being disloyal, it does allow you to sit in the middle and hear comments from each side.

- **It seems that the Structured Products and similar vehicles described earlier, in addition to be being a tool to increase donations, would also be a useful tool for non-profits when managing their own investment portfolios. Why haven't our advisors discussed these vehicles with us?**

  Most advisors in the non-profit world have been trained in the use of asset allocation models in which a mixture of bonds, stocks, mutual funds, and other well-worn investment vehicles are used to manage money. Due to their training and backgrounds, this is what they are comfortable selling. In addition, choosing a mixture of mutual funds and/or picking stocks as part of an asset allocation model has a long history in the industry. It appears to the uninitiated as a sensible approach and doesn't require a lengthy educational process. In virtually every case the non-profit organizations we approached used advisors promoting the asset allocation model.

- **What are the liabilities issues with regards to the non-profit organization that uses or promotes these potential programs?**

Because of the up-front and mathematical certainty of the transactions there are no liability issues for the non-profit organization. Similar to creating a trust agreement to produce a legacy gift, all the parties know in advance all the caveats of whatever agreement is formed, before any funds change hands. Further all transactions can be verified by legal counsel and are executed by major financial institutions that have the responsibility of ensuring compliance.