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North Carolina Rewrites Rules for Charity Endowments and Other Restricted Funds

Despite recent dramatic dips in fund values, charities may now tap into endowment funds, thanks to the 2009 North Carolina General Assembly. Until very recently, state law had effectively barred the use of any endowment that had declined below its original value. Now, however, the new North Carolina Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides more liberal rules for endowments and other funds that are subject to donor-imposed restrictions.

Increased Spending Authority

UPMIFA does away with the previous inflexible, bright-line limit on spending from endowments. That limit could have cut off a vital source of support for charities in bad economic times. Prior law allowed a charity to spend endowment income and principal growth for its stated purposes. In all events, however, the charity had to preserve the "historic dollar value" (that is, the original aggregate value of all gifts to the endowment fund). If expenditures, investment performance or a general economic downturn caused the endowment value to fall below its historic dollar value, prior law prevented the charity from using any of its endowment principal, regardless of how severe the need might be. Some accounting firms even took the position that a charity in that situation also could not use endowment income; instead, they advised that income be reinvested in the fund to rebuild the principal value. In contrast, UPMIFA does not set any absolute limit on spending endowment principal. Rather it permits a charity to use as much of an endowment – income or principal – as the board determines is prudent under the circumstances.

Clearer Standards for Board Action

Preserving the purchasing power of the fund – the principal reason for the former historic dollar value limit – is now only one of the factors the board should consider in determining whether, and how much, to spend. UPMIFA lists other factors the board should consider in making spending decisions: (1) the charity's overall purposes and those of the specific fund, (2) general economic conditions, (3) possible effects of inflation or deflation, (4) expected total return (income and growth), (5) the charity's other resources and (6) its investment policy. UPMIFA provides similar criteria for determining whether a particular investment is prudent and generally outlines the duties of charity directors with respect to investments.

Greater Protection for Board Decisions

The UPMIFA rules permit the board to delegate investment decisions to third parties so long as the board acts prudently in selecting the agent, establishes the scope of delegation and monitors the agent's performance. They also confirm that the prudence of decisions about investments and expenditures will be judged on the basis of (1) the facts and circumstances then existing and not by hindsight, and (2) the portfolio as a whole and not individual investments viewed in isolation.

New Ways to Modify Restrictions

UPMIFA gives charities new ways to modify or remove outdated donor restrictions on an endowment or other fund. Of course, a charity and its donors may agree at any time to modify restrictions that the donors have imposed. If donor-imposed restrictions have become obsolete or impracticable or if they impair administration of the fund, the charity may also ask the superior court to modify them, allowing the Attorney General to be heard. Now, however, UPMIFA also allows a charity to modify restrictions on funds worth less than $100,000 that are more than 10 years old, without seeking court approval, so long as it first notifies the Attorney General that it intends to do so, and the Attorney General does not object within 60 days after being notified of the proposed modification. Any modification of a restricted fund must be generally consistent with the charitable purpose of the original gift.

Applicability

UPMIFA generally governs all restricted funds a charity holds for its own benefit, regardless of when they were created, unless the charity and the donor specifically agree otherwise in the documents that created the funds. UPMIFA confirms a charity's discretion to use assets that the board has set aside on its own motion, i.e., so-called "quasi-endowment" or "board-designated" funds. The board may change or remove restrictions on those funds unless donors have contributed to a fund in reliance on the existing terms or other binding restrictions on the fund do not permit the board to change those terms.

Charities should carefully review their restricted funds and endowments in light of UPMIFA to confirm the breadth of the board's discretion over investments and expenditures, the board's corresponding duties and responsibilities, and the proper structure of future restricted gifts.