NONPROFIT ORGANIZATIONS ARTICLE

ROBINSON BRADSHAW & HINSON

APRIL 2009

North Carolina Adopts New, Flexible Approach to Endowment Spending

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(As published in the Spring 2009 edition of NCNG Network News)

On March 19, 2009, the Uniform Management of Institutional Funds Act (UMIFA) was repealed and the Uniform Prudent Management of Institutional Funds Act (UPMIFA) became law in North Carolina. With this change, North Carolina joins a majority of states enacting UPMIFA to modernize the standards for management and investment of nonprofit endowment funds. The adoption of UPMIFA was timely as recent economic challenges had significantly limited the ability of many nonprofits in North Carolina to access critically needed endowment funds.

UPMIFA applies to funds that, under the terms of a gift agreement, are not wholly expendable by the nonprofit on a current basis (i.e., "endowment funds"). UPMIFA establishes a "prudence" standard for the management of endowment funds. It enables a nonprofit's governing body to approve any expenditure that it deems to be prudent, including certain expenditures that would invade the corpus of an endowment fund. UPMIFA's prudence standard replaces UMIFA's "historic dollar value" standard, which prevented nonprofits from spending from underwater endowment funds (i.e., funds with asset values below the principal amount of the original gift, plus any subsequent contributions). Given current market conditions, many endowment funds were substantially under water when UPMIFA was adopted last month.

The key to UPMIFA's new, flexible spending rule is the governing board's interpretation of "prudence." UPMIFA identifies seven factors that must be considered in the governing board's decision to appropriate for expenditure or accumulate endowment fund assets:

- duration and preservation of the fund,
- purposes of the nonprofit and the fund,
- general economic conditions,
- possible effect of inflation or deflation,
- expected total return from investing,
- other resources of the nonprofit, and
- the nonprofit's investment policy.

Similarly, UPMIFA requires that the governing board "manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." It sets forth eight factors that must be considered: general economic conditions, possible effect of inflation or deflation, the expected tax consequences (if any) of investment decisions or strategies, the role of each asset within the nonprofit's overall investment portfolio, expected total return from investing, other resources available to the nonprofit, duration and preservation of the fund, and any special relationship of the fund's assets to the nonprofit. UPMIFA also specifically states that nonprofits generally are required to diversify their assets.

Best Practices for UPMIFA Compliance

* Review and retain documentation related to all "endowment" funds
* Generally avoid classification of assets as permanently restricted endowment funds (i.e., retain board discretion)
* Adopt and comply with board investment and spending policies
* Exercise board oversight in engaging investment advisors
* Ensure that board meeting minutes document "prudence"

Keep in mind, UPMIFA does not override donor restrictions on the management of endowment funds. That is, a gift agreement creating an endowment fund held by a nonprofit may include specific restrictions on the fund's management, thereby overriding UPMIFA's flexible prudence standard. Similarly, UPMIFA does not relieve endowments that are classified as private foundations from complying with the Internal Revenue Service mandatory minimum distribution rules.

In addition, UPMIFA permits nonprofits under certain circumstances to release or modify donor restrictions on old and small endowment funds (i.e., at least ten years old and not more than $100,000) without first seeking donor or court approval. UPMIFA requires only that the nonprofit seeking to release or modify such restrictions provide 60 days' notice to the Attorney General. Other restrictions may be released with court approval.

Finally, UPMIFA expressly permits nonprofits to delegate management and investment functions to professional advisors and others, provided that the nonprofit uses prudence in selecting the agent, establishing the scope of the delegation, and monitoring the agent's performance and compliance with the terms of the delegation.

UPMIFA provides much needed flexibility to nonprofits in North Carolina holding endowment funds that have been hard hit by market declines, many of which are facing increased demands for services while adapting to decreased revenue from donors and other sources. The new UPMIFA "prudence" standard applicable to management and investment of endowment funds undoubtedly will advance the interests of our state's nonprofits and the constituents they serve.