Memorandum

To: UMIFA Drafting Committee, Advisors, and Observers

From: Susan Gary, Reporter

Date: October 25, 2005

Re: Fall Drafting Committee Meeting

At our Fall Meeting we have the following issues to discuss:

Section 2(3) – Definition of Gift Instrument

At the annual meeting a Commissioner noted that the definition of gift instrument seems to include solicitations only if a fund results from the solicitation. A charity may solicit money for a scholarship fund or building fund that already exists, and the solicitation should serve as the gift instrument for the donor who responds and makes a contribution to the existing fund. Please review a possible change in the draft.

Section 4 – Endowment Spending

<u>Historic dollar value.</u> Should we return to the concept of historic dollar value?

> For many funds the concept is meaningless, but for some funds the accident of the date of a gift means that a fund will be frozen for years. Donor intent on the concept of hdv is not at all clear, given that hdv is a default rule that applies when a donor did not clearly articulate intent. Observers who advise donors have provided us with input that suggests that donors have various intents with respect to spending. It can be argued that the new, more restrictive spending rule under UMIFA (200-), even without hdv, may be closer to donor intent than the rule under UMIFA (1972).

<u>Retroactive application of the spending rule.</u> Should the spending rule apply to all funds, whenever donors made contributions?

> Some observers have suggested making the application of the spending rule in UMIFA (200-) prospective only. Doing so would mean that charities with funds created before the adoption of UMIFA (200-) would operate under two sets of rules. Charities and lawyers have commented that this would be unworkable, especially for small charities or small funds. When I described this issue at a recent meeting of ACTEC's Charitable Planning Committee (lawyers who represent both charities and donors) the reaction to retroactive application was vehement opposition from those who spoke to me about the issue.

If we consider not applying our changes retroactively, we need to decide whether to put both rules in the new Act. We should consider whether we simply want the spending rule of UMIFA (1972) to apply to all contributions made before the effective date of UMIFA (200-) or whether we want to apply the concept of hdv but require a charity making distributions after the effective date of the revised statute to follow the more restrictive prudence standard that governs spending decisions in (UMIFA 200-). We should also address directly whether a charity operating under UMIFA (1972) for old contributions can continue to distribute interest and dividend income when a fund's value is below hdv. As we know, a disadvantage of UMIFA (1972) has been that in recent years charities with underwater funds have invested for ordinary income rather than for long-term gain, potentially depleting further the value of the funds. I suppose that if we decide that the hdv rule should apply retroactively even though it is a rule of construction, then the rest of the spending rule should be the 1972 rule as well.

<u>Presumption of imprudence.</u> Should we include in the Act without brackets, in the Act with brackets, or in the Comments, a presumption of imprudence for spending above 7% of the value of an endowment fund in any one year?

During the NCCUSL 2005 Annual Meeting, a straw vote indicated that a majority of Commissioners present thought the 7% presumption should not be included in the statute, at least without brackets. Some Commissioners talked about the possibility of including the presumption in the Act but without a fixed percentage and then providing in the Act that the Attorney General or some state agency would set the percentage and revise it periodically.

The lawyers I talked with at ACTEC were comfortable with the 7% presumption.

A number of problems arise when the presumption is applied to an endowment fund that is created for a limited period of time rather than as a perpetual fund. For example, if a charity creates a building fund to be spent within 10 years, the fund will be an endowment fund under the definition in UMIFA (200-). The charity will likely spend little or nothing in the early years and then substantially more than 7% during construction. Could we apply the presumption only to perpetual funds? We would have to define what we mean. The concept would be to exclude any fund that is created for a term of years or created in order to complete a specified project but is not created to last in perpetuity. I suspect that finding language that would limit the presumption in this way may be difficult, but if we could do it, we could solve at least some of the problems the 7% rule creates.

<u>Notifying Attorney General if spending exceeds 5%.</u> A Commissioner suggested that we include a requirement that if a charity intends to spend more than 5% in one year the charity must notify the Attorney General. We would have to determine when notification would occur, how long the AG would have to respond so that the charity could go ahead

with spending, and which date would be used to determine the value of the fund. It could be that spending would be under 5% when the charity made the decision to spend but then at the end of the year if the value of the fund dropped unexpectedly, the amount already spent could be in excess of 5%. Someone else suggested that the notice be given to the district attorney or county attorney for the county in which the charity was organized.

Section 6 – Modification

Notification of donor. Should the Act require a charity to notify donors in connection with equitable deviation, cy pres, or small, old fund modification?

> Trust law does not require charities to notify donors in connection with applications to the court for equitable deviation or cy pres. If we include donor notification in UMIFA we are creating two different rules for charities and that creates obvious problems. I have included language in the Comments explaining this.
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> With respect to small, old funds, donor notification would not be inconsistent with other law because no other law exists, but donor notification seems particularly unnecessary when a fund is at least 20 years old. A charity is likely to notify a donor who can be found but requiring the expenditure of time and resources to track down donors seems unnecessary. I have included further explanation in the Comments.

Other Issues

Coverage of UMIFA. Should charitable trusts with corporate trustees be included in the coverage of UMIFA (1972)?

> Many people have commented that one set of rules should govern the management of charitable funds, regardless of the organizational structure of the charity. The bank trustees will likely opposed inclusion of those trusts within UMIFA.

Accounting rules. Is there anything we can do to ensure better reporting with respect to endowment funds?

> The accounting rules set forth by FASB create problems for charities with endowment funds. To the extent possible (and we cannot change the FASB rules), we should try to improve the reporting related to endowment funds so that charities and their donors have a better picture of the financial circumstances being reported.

Donor standing. Should UMIFA provide for donor standing?

A number of comments from NCCUSL Commissioners suggest continuing dissatisfaction with the lack of standing for a donor whose gift has been misspent. Other Commissioners expressed concern that standing could increase harassment of charities by family members of the original donor. The Drafting Committee concluded that UMIFA was not the right place to create standing. Do we want to reconsider?

Name for UMIFA (200-)

Someone at the Annual Meeting or perhaps at our Committee meeting held on Saturday before the Annual Meeting had a suggestion for a new name, but I cannot find it in my notes.