Protecting Your Endowment Gift

FIDUCIARY TRUST™ CHARITABLE

Philanthropy Insights

Establishing an endowment gift to support a nonprofit cause that is important to you can be an excellent way to have a lasting impact. However, given that endowments are long term in nature, circumstances can change with the receiving nonprofit down the road that could put your generous gift at risk. Therefore, it is important to understand the potential hazards of endowment gifts, and consider options to mitigate them before funding one.

The Reality

While we all like to believe that the nonprofits we support will be around for the long term, the reality is that thousands of nonprofits fail or are restructured every year, including some large ones that have been around for a century or longer. While in many cases restricted endowment funds held at a nonprofit that is dissolving may be protected from creditors, the funds you contributed are typically given to another nonprofit with a similar purpose. While this conversion process usually requires approval from the state attorney general's office, and you as the donor may be consulted in the process, you may have limited flexibility to significantly change the purpose of the funds, unless you employ an approach described below.

In addition to failures, nonprofit organizations' priorities can change over time, creating a misalignment of interests. For example, you could endow a fund to be used for equipment for a particular collegiate sports team. But what happens to your endowment fund if the school discontinues the sport? While you may have some influence over where the funds are redirected, the school has control of the funds and your options are invariably limited.

Learn More:

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Protecting Your Interests

One way to protect your philanthropic interests is to establish an endowment outside the nonprofit that would benefit from it, with terms that provide flexibility to redirect the funds should the nonprofit not be able to fulfill the intended purpose of the endowment. While there are a couple of different vehicles that you could use with this approach, the process of engaging the beneficiary nonprofit, such as a school, community service nonprofit, religious institution, or other nonprofit, would be similar:

Process for Establishing an Endowment Gift

1. Identify Your Priorities and Interests
2. Understand the Beneficiary Nonprofit's Needs
3. Agree Upon Plan for Use of the Endowment Income
4. Establish Clear Nonprofit Performance Standards
5. Fund the Endowment Outside the Beneficiary Nonprofit
6. Measure Results and Release Funds as Appropriate
7. Switch to Alternate Giving Plans if the Metrics Are Not Achieved

Establishing an Independent Endowment Fund

To enable you to accomplish your charitable objectives, it can be valuable to use a charitable giving vehicle that is adaptable to the changes that may occur in the future and provides you with a voice in how the use of funds will be adapted. It is also important to have access to expertise to ensure matters are handled appropriately.

There are two principal vehicles that we believe can be valuable in these situations: a flexible "endowment" fund and a private foundation. Below we describe the advantages and tradeoffs of each.

The Fiduciary Flexible Endowment Fund™

Recognizing this endowment need among donors, Fiduciary Trust Charitable (FT Charitable) has established a special Fiduciary Flexible Endowment Fund™. With this approach, your endowment gift would be placed in a fund at FT Charitable to benefit the nonprofit you designate on an established grant schedule. This schedule could be income only, a percentage of the fund annually, or some other approach you request. Should the nonprofit not meet the standards you establish, then FT Charitable would redirect the funds to another charitable purpose based on the criteria you dictate when you set up the fund. Should you so desire, FT Charitable could consult with you or someone you designate as it determines the new charitable recipient(s) of the funds.

The advantages of the Flexible Endowment Fund™ are simplicity, a typically lower cost (relative to a private foundation), and built-in fiduciary oversight from Fiduciary Trust Charitable. A disadvantage is that you do not have legal control of the assets, although you could be consulted should there be a need to redirect the funds.

What is an Endowment?

There are several different types of endowments, each with important characteristics. The common feature of all endowments is that they represent funds set aside to finance activities of one or more nonprofits, typically on a long-term basis.

Below, we explore the four primary types of endowments. The first two, restricted endowments and term endowments, are most relevant for the use of a Fiduciary Flexible Endowment Fund™ or a private foundation

- **Restricted Endowments:** Assets that have been set aside with earnings to be used to fund long-term, specific activities of a nonprofit, as defined by the donor. The principal, including realized capital gains, is retained in the endowment in perpetuity.

- **Term Endowments:** An endowment in which the principal is not retained in perpetuity. It is released to a nonprofit after a specific event occurs or after a defined time period.

- **Unrestricted Endowments:** Similar to a restricted endowment as it is long term in nature and the principal is retained in perpetuity. The difference is that the income from the endowment can be used for any purpose by the nonprofit.

- **Quasi-Endowments:** Principal assets set aside by a nonprofit's board of directors upon which there is an intent to only expend the earnings, while leaving the principal intact. However, the nonprofit's board has the discretion to expend the principal if necessary.

A Private Foundation

A private foundation is another option for protecting your endowment interests. Unless you already have a private foundation that can be modified for an endowment gift purpose, you would need to establish a new one. The key steps include creating the trust instrument (which defines the structure and terms of the foundation), naming trustees, applying for tax-exempt status, and contributing funds. Once the funds are in the foundation, the trustees could distribute regular grants to the nonprofit you are supporting on the schedule you agree upon with the beneficiary nonprofit.

Foundation trustees need to ensure ongoing compliance with trust laws that change over time

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The primary benefit of a foundation is that the foundation trustees, which could include you, the donor, have full legal control of the assets and grant decision process. The disadvantages are the expense to establish and maintain the foundation (including a 1.39% tax on net investment income), tax filing requirements, a 5% annual distribution requirement, less favorable personal income tax deduction limits on contributions as well as the ongoing time required for administrative work. In addition, foundation trustees have fiduciary risk and need to stay abreast of and ensuring ongoing compliance with foundation laws that typically change over time. However, hiring a firm that is experienced in trust and foundation administration can relieve much of the administrative burden.

Moving Forward

Your endowment gift can have a significant impact on helping a nonprofit serve the needs of its community now and far into the future. Before funding an endowment, it is important to consult with experts to help ensure your gift has maximum impact and your interests are protected. This includes ensuring you have a thorough process for establishing the endowment gift, the steps of which were described earlier. We can assist with this process, and we also partner with philanthropic consultants to help ensure your objectives are met. Please reach out to us if you would like to discuss your philanthropic giving priorities. ■

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