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**UNIFORM  
PRUDENT  
MANAGEMENT  
OF INSTITUTIONAL  
FUNDS ACT**

*Diversity of Thought*

*Uniformity of Law*

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

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# UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT  
IN ALL THE STATES

at its

ANNUAL CONFERENCE  
MEETING IN ITS ONE-HUNDRED-AND-FIFTEENTH YEAR  
HILTON HEAD, SOUTH CAROLINA

July 7-14, 2006

*WITH PREFATORY NOTE AND COMMENTS*

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By

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

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October 10, 2006

## **A SUMMARY**

At its annual meeting in July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and recommended it for enactment by the legislatures of the various states. UPMIFA is designed to replace the existing Uniform Management of Institutional Funds Act (UMIFA), which was approved by NCCUSL in 1972 and has since been enacted in 47 states. UMIFA was a pioneering statute, providing uniform and fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as "endowments" to those institutions. Those rules supported two general principles: 1) that assets would be invested prudently in diversified investments that sought growth as well as income, and 2) that appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable institution. These two principles have been the twin lodestars of asset management for endowments since UMIFA became the law of the land in nearly all U.S. jurisdictions.

UPMIFA continues these fundamental principles as a needed upgrade of UMIFA. Both investment in assets and expenditure for charitable purposes have grown exponentially in the 35 years since UMIFA was drafted; asset management theory and practice have also advanced. UPMIFA, as an up-date and successor to UMIFA, establishes an even sounder and more unified basis for charitable fund management than UMIFA has done.

### **INVESTMENT**

In 1972, UMIFA represented a revolutionary advance over prevailing practices which imposed upon endowments the limited investment opportunities available for managing trust assets – even endowments not organized as trusts. By stating the first prudent investor rule in statutory law, UMIFA allowed endowments to invest in any kind of assets, to pool endowment funds for investment purposes, and to delegate investment management to other persons (*e.g.*, professional investment advisors), as long as the governing board of the charitable institution exercised ordinary business care and prudence in making these decisions. A range of factors guided the exercise of prudence.

UPMIFA incorporates the experience gained in the last 35 years under UMIFA by providing even stronger guidance for investment management and enumerating a more exact set of rules for investing in a prudent manner. It requires investment "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." It requires prudence in incurring investment costs, authorizing "only costs that are appropriate and reasonable." Factors to be considered in investing are expanded to include, for example, the effects of inflation. UPMIFA emphasizes that investment decisions must be made in relation to the overall resources of the institution and its charitable purposes. No investment decision may be made in isolation, but must be made in light of the fund's entire portfolio, and as a part of an investment strategy "having risk and return objectives reasonably suited to the fund and to the institution." A charitable institution must diversify assets as an affirmative obligation unless "special circumstances" dictate otherwise. Assets must be reviewed within a reasonable time

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after they come into the possession of the institution in order to conform them to the investment strategy and objectives of the fund. Investment experts, whether in-house or hired for the purpose, are held to a standard of care consistent with that expertise.

UMIFA initiated the era of modern portfolio management for charitable institutions. UPMIFA provides the standards and guidelines that subsequent experience tells us are the most appropriate for the purpose. Charitable institutions will have more precise standards to guide them. Courts will have more precise standards with which to measure prudence in the event of a challenge. The result should be more money for programs supported by charitable funds, including endowments.

## **EXPENDITURE**

UMIFA initiated the concept of total return expenditure of endowment assets for charitable program purposes, expressly permitting prudent expenditure of both appreciation and income and replacing the old trust law concept that only income (*e.g.*, interest and dividends) could be spent. Thus, asset growth and income could be appropriated for program purposes, subject to the rule that a fund could not be spent below "historic dollar value."

UPMIFA builds upon UMIFA's rule on appreciation, but it eliminates the concept of "historic dollar value." UPMIFA, instead, provides better guidance on prudence and makes the need for a floor on spending unnecessary. UPMIFA states that the institution "may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes and duration for which the endowment fund is established." Seven criteria guide the institution in its yearly expenditure decisions: "1) duration and preservation of the endowment fund; 2) the purposes of the institution and the endowment fund; 3) general economic conditions; 4) effect of inflation or deflation; 5) the expected total return from income and the appreciation of investments; 6) other resources of the institution; and, 7) the investment policy of the institution." These standards mirror the standards that apply to investment decision-making, thus unifying both investment and expenditure decisions more concretely.

UPMIFA includes an optional provision that allows states to enact another kind of safeguard against excessive expenditure. If a state does not want to rely solely upon the rule of prudence provided in UPMIFA, the state may adopt a provision that creates a rebuttable presumption of imprudence if an institution expends an amount greater than seven percent of fair market value of a fund, calculated in an averaging formula over three years. While the seven percent rule is likely not to be necessary, it is available for those states that may be uncomfortable with the general standards.

## **RELEASE OR MODIFICATION OF RESTRICTIONS**

UPMIFA recognizes and protects donor intent more broadly than UMIFA did, in part by providing a more comprehensive treatment of the modification of restrictions on charitable funds. Sometimes a restriction imposed by a donor becomes impracticable or wasteful or may impair the management of a fund. The donor may consent to release the restriction, if the donor is still alive and able to do so, but if the donor is not available the charity can ask for court approval of a modification of the restriction. The trust law doctrines of *cy pres* (modifying a purpose restriction) and *deviation* (modifying a management restriction) probably already apply to charitable funds held by nonprofit corporations. UPMIFA makes this clear. Under UMIFA,

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the only option with respect to a restriction was release of the restriction. UPMIFA instead authorizes a modification that a court determines to be in accordance with the donor's probable intention. If the charity asks for court approval of a modification, the charity must notify the state's chief charitable regulator and the regulator may participate in the proceeding.

UPMIFA adds a new provision that allows a charity to modify a restriction on a small (less than \$25,000) and old (over 20 years old) fund without going to court. If a restriction has become impracticable or wasteful, the charity may notify the state charitable regulator, wait 60 days, and then, unless the regulator objects, modify the restriction in a manner consistent with the charitable purposes expressed in any documents that were part of the original gift.

## **CONCLUSION**

UPMIFA reflects and incorporates the 35 years of experience that has accumulated under the original UMIFA. Rather than changing institutional investment or expenditure practices, it brings them up to date and unifies them across a broad range of charitable funds. The better charitable institutions manage investments and prudently control expenditures, the more money they should have for program purposes.

A Few Facts About  
UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

**PURPOSE:** This act, like its predecessor the Uniform Management of Institutional Funds Act of 1972, provides statutory guidelines for management, investment, and expenditures of endowment funds held by charitable institutions. The new act expressly provides for diversification of assets, pooling of assets, and total return investment, to implement whole portfolio management, bringing the law governing charitable institutions in line with modern investment and expenditure practice.

**ORIGIN:** Completed by the Uniform Law Commissioners in 2006.

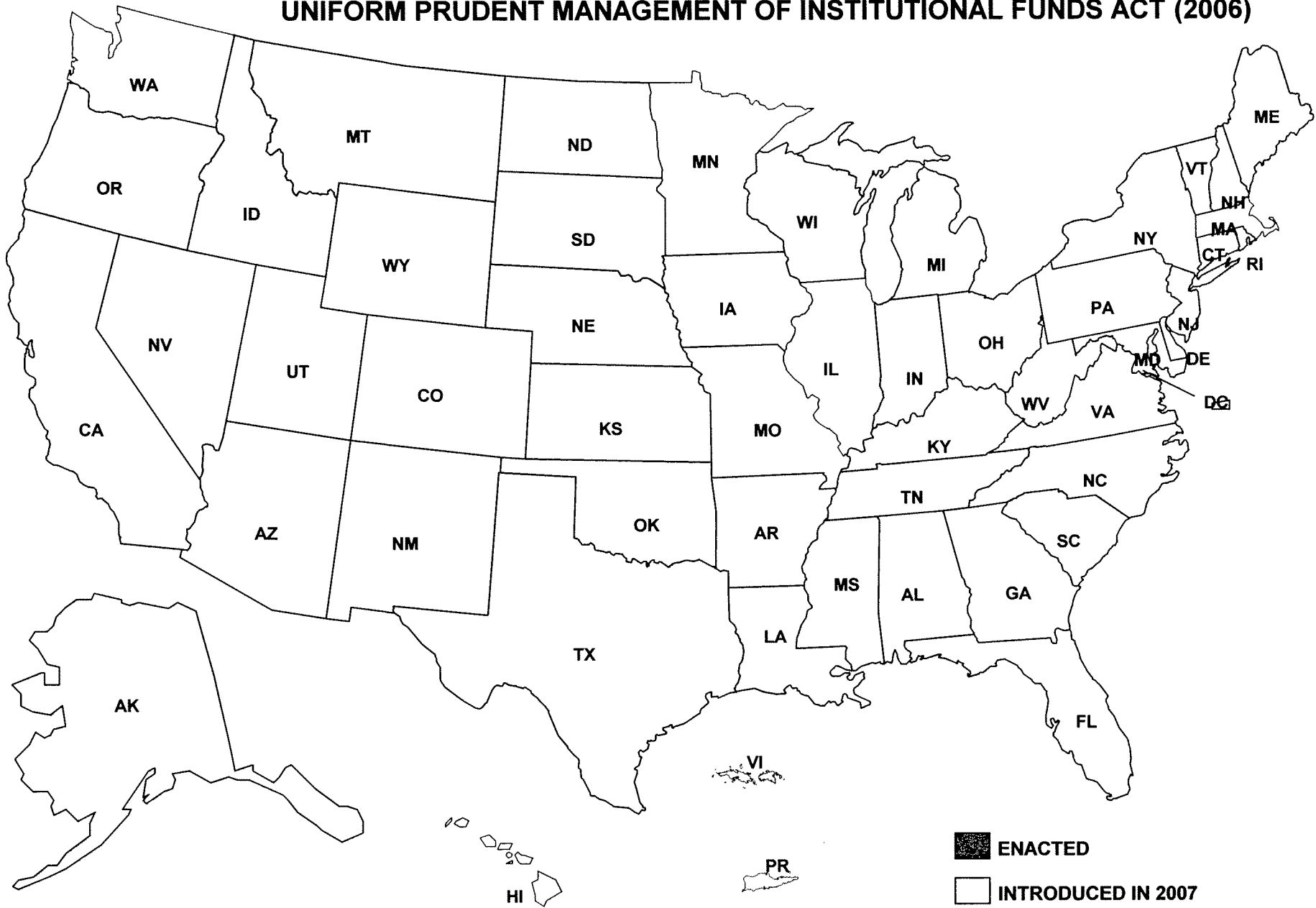
**STATE  
ADOPTIONS:**

2007	Connecticut	Oklahoma
<b>INTRODUCTIONS:</b>	Idaho	South Dakota
	Indiana	Tennessee
	Montana	Texas
	Nebraska	US Virgin Islands
	Nevada	Utah

For any further information regarding the Uniform Prudent Management of Institutional Funds Act (2006), please contact John McCabe or Katie Robinson at 312-915-0195.

(2/9/07)

# UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT (2006)



February 9, 2007

## HIGHLIGHTS

- **Investment freedom.** Portfolio managers are not limited in the kinds of assets that may be sought for the portfolio. (Broader than UMIFA)
- **Costs.** Costs must be managed prudently in relationship to the assets, the purposes of the institution and the skills available to the institution. (Not addressed in UMIFA)
- **Expenditure of funds.** Total return expenditure is expressly authorized under comprehensive prudent standards relating to the whole economics situation of the charitable institution. (UMIFA does not address this standard)
- **Historic dollar value abolished.** UPMIFA abolishes the historic dollar value limitation on expenditure in UMIFA.
- **Seven percent rule.** States may adopt an optional rule that presumes expenditure exceeding 7% of total return is imprudent. (Not addressed in UMIFA)
- **Release of restrictions for small institutional funds.** These is a new procedure for releasing restrictions on small institutional funds (less than \$25,000) held for a long period of time (20 years), requiring only notice to the Attorney General 60 days in advance of the release. (Not addressed in UMIFA)
- **Application.** UPMIFA applies to funds held in any form, including nonprofit corporate form, except charitable trusts, with a commercial or individual trustee. (UMIFA applies only to endowments held by a charitable institution for its own account.)

## **WHY STATES SHOULD ADOPT THE ACT**

This 2006 Uniform Prudent Management of Institutional Funds Act replaces and updates the 1972 Uniform Management of Institutional Funds Act. Its rules govern investment of the funds of charitable organizations and total return expenditure of those funds. It establishes a prudent management investment regime derived from the Uniform Prudent Investor Act (which applies only to trusts) and a prudent total return expenditure based upon performance of the portfolio held by a charitable institution. It also provides for delegation of authority for investment to outside agents and reformation of donor restrictions (cy pres) on funds when these are so outdated that the original objective can no longer be honored.

States should adopt the Uniform Prudent Management of Institutional Funds Act:

1. To make sure that the best investment practices govern the actual investment of institutional funds.
2. To withdraw obsolete rules governing prudent total return expenditure and provide a modern rule of prudence consistent with the rules that govern investment.
3. To eliminate differences in investment and expenditure rules that apply to different types of nonprofit organizations. The same rules govern all under UPMIFA.
4. To encourage growth of institutional funds while eliminating investment risks that threaten principal.
5. To assure that there are adequate assets in any institutional fund to meet program needs.
6. To make the law governing institutional funds uniform in every state.

**UMIFA Become UPMIFA <sup>1</sup>**  
**By Susan Gary <sup>2</sup>**

The Uniform Management of Institutional Funds Act (UMIFA) guides charities on the management and investment of funds, provides rules on spending from endowment funds, and permits the release of restrictions on the use and management of charitable funds. The Act has been adopted in 47 states and the District of Columbia. It has been successful, but portions of it are out-of-date, and the National Conference of Commissioners on Uniform State Laws (the Uniform Law Commission) at its annual meeting on July 13, 2006, approved a revised version: the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

In 1972, when the Uniform Law Commission promulgated UMIFA, a great deal of uncertainty existed about the standards that governed directors of charities operating as nonprofit corporations. Trust law provided guidance, but trust law at that time restricted investment decision making in a number of ways. Trustees analyzed risk on an asset-by-asset basis, rather than across the portfolio. Trust law did not permit delegation of investment authority, so involving investment advisors caused concern. Trust accounting rules defined income and principal in a way that affected both spending and investing. If a charity could spend only "income" under trust law rules, the trust law definition of income limited investment options. UMIFA created a new set of rules that made total-return investing possible for charities organized as nonprofit corporations.

In the period since 1972, trust law has caught up with UMIFA in many respects. The Uniform Prudent Investor Act (UPIA), a trust law statute now adopted in 44 states, provides modern guidance for the prudence standard fiduciaries should follow in making investment decisions. Although the comments to UPIA suggest that the standards articulated in that statute also apply to charities organized as nonprofit corporations, making the standard explicitly applicable to all charities makes sense. With this and other changes in mind, the Uniform Law Commission decided to update UMIFA.

Four years in the making, UPMIFA updates the prudence standard that applies to the management and investment of charitable funds. UPMIFA also modernizes the rules governing

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<sup>2</sup> Susan N. Gary is a professor at the University of Oregon School of Law, Eugene, the reporter for UPMIFA, and co-chair of the Uniform Acts for Probate and Trust Law Committee.

expenditures from endowment funds, both to provide better guidance on spending from endowment funds and to give institutions the ability to cope more easily with fluctuations in the value of the endowment. Finally, UPMIFA adopts provisions governing the release and modification of restrictions on charitable funds to permit more efficient management of these funds. UPMIFA applies, as did UMIFA, to charities organized as nonprofit corporations and to charities organized as trusts, but only to those trusts that have a charity as a trustee.

### **Prudent Investing**

The standard for investing and managing charitable funds is one of prudence. Although the law applicable to private trusts and to business corporations may hold trustees and directors to different standards of care, the standard of care for those managing a charity should be the same for all charities, regardless of the organizational form.

UPMIFA's articulation of the prudence standard reflects the merging of the trust and corporate standards when applied to managers of charitable funds. The statute takes language from both the Revised Model Nonprofit Corporation Act (RMNCA) and UPIA. The RMNCA states that a manager must act "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." This language derives from the business standard, but "similar circumstances" refers to the fact that the funds are managed for charitable purposes and not business purposes. UPMIFA uses language from the RMNCA and then follows this general direction with specific factors that a manager should consider. These factors derive from UPIA and are consistent with good practice under current law.

The prudence standard in UPMIFA requires managers to meet their fiduciary duty of care, the duty to minimize costs, and the duty to investigate with respect to investment decision making. In addition, UPMIFA directs managers of charities to consider general economic conditions, to make decisions on a portfolio basis, to allocate risk and return across the portfolio, and to consider the needs of the charity both to make distributions and to preserve capital. A charity can pool funds for purposes of management and investment, and in some situations doing so can yield better investment results. Managers are reminded that donor intent controls, so a charity must follow any specific donor directions for investment and management of assets. Of course, this emphasis on donor intent does not mean that a donor should control the management of a charity.

Prudence is a standard that evolves over time, and UPMIFA is simply updating the statutory language to provide good direction about the role of prudence in investment and management. The guidance should be helpful to charities and comports with current best practices.

### **Endowment Spending**

The big change UPMIFA brings comes in the rules on spending from endowment funds, defined as funds that cannot be wholly expended on a current basis. These rules apply to donor-restricted funds and not to board-restricted funds. Money set aside by a board of directors as an

"endowment" is a board-restricted fund; money contributed by a donor with the intent that the money be held as an endowment is a donor-restricted fund. If a charity raises money for its endowment, and donors contribute with the understanding that the charity will hold their contributions in the endowment, then these rules apply to that fund. Donor intent in this regard will depend on the applicable "gift instrument," the documents that define the terms of the gift. The gift instrument may be a letter from the donor accompanying the gift, a solicitation from the charity to which the donor responds, or a gift agreement entered into by the donor and the charity.

UMIFA's spending rule has been critically important to the successful functioning of the investment guidance the statute provides. Endowments are typically described as funds that maintain principal and distribute income. The difficulty lies in determining what constitutes principal and income. Before UMIFA arrived on the scene, charities organized as nonprofit corporations assumed that trust accounting rules applied to them. Those rules defined income to exclude capital gains. Thus, a direction to "spend only income" meant that a charity might skew its investment decisions to produce more trust accounting income, to the detriment of the long-term health of a fund.

Rather than trying to define income and principal, the drafters of UMIFA devised a spending rule that seemed a better fit for charities. UMIFA uses the term historic dollar value (HDV) to mean the value of contributions made to an endowment fund, without increases or decreases because of investment results, inflation, or anything else. Under UMIFA, a charity can spend from an endowment fund the amount of appreciation above HDV the charity deems prudent, after considering the charity's purposes, but can never spend below HDV. The prudence standard in UMIFA limits spending above HDV because a charity can spend only the amounts the directors determine to be prudent. The statute provides minimal guidance, however, and focuses on the needs of the charity rather than on the purpose of the particular fund. Fortunately, despite the limited statutory guidance, most charities have developed spending rules that comply with UMIFA and also limit spending in ways that preserve the purchasing power of the endowment funds they manage.

UPMIFA no longer uses the term "historic dollar value" and no longer restricts spending to amounts above HDV. Under UPMIFA, a charity can spend the amount the charity deems prudent after considering the donor's intent that the endowment fund continue permanently, the purposes of the fund (and not just of the charity as under UMIFA), and relevant economic factors. The intention of the change is not to permit unrestricted spending from an endowment fund. UPMIFA applies a more carefully articulated prudence standard than that used in UMIFA to guide the process of making decisions about spending. UPMIFA emphasizes the perpetuation of the purchasing power of the fund, not just of the original dollars contributed to the fund. Although the Act does not require that a specified amount be set aside as principal, the Act assumes that a charity will preserve "principal" by maintaining the purchasing power of amounts contributed and will spend "income" by making a distribution each year using a reasonable

spending rate. UPMIFA encourages charities to establish a spending policy that will be responsive to short-term fluctuations in the value of the fund.

Any donor restrictions agreed to by a charity will control the management of an endowment fund. If a donor wants to create an endowment fund that can spend only 4% each year, and if the charity agrees to the restriction, the restriction will govern spending from the fund. If, however, the donor restricts the fund by indicating that the charity should "pay only income" or "hold the fund as an endowment," then a rule of construction in UPMIFA will treat the fund as an endowment fund subject to the UPMIFA rules on spending. The Act assumes that a donor who gives to an endowment fund wants the charity to use modern investment strategies to generate enough funds to distribute while maintaining the long-term viability of the fund. UPMIFA gives effect to the presumed intent of the donor.

UPMIFA will apply to charitable funds created both before and after enactment. Some people have expressed concern that the change in the endowment spending rules will affect donor intent. The rule of construction in UPMIFA gives meaning to a donor's direction to "pay only the income" from an endowment. A constructional rule resolves an ambiguity, in this case because the words used by a donor do not convey a specific meaning. Changing a statutory constructional rule does not change the underlying intent and, instead, changes the way an ambiguity is resolved. The change should better effectuate the intent of the donors. The committee that drafted UPMIFA concluded that the new rules provide better protection for donors and for charities. The committee also noted that unless UPMIFA applies retroactively, charities will face unwieldy and costly administrative burdens. Without retroactive application, a charity would have to maintain two sets of records for every endowment fund created before enactment that receives contributions after enactment.

Because of concerns expressed by some constituencies about the removal of HDV as a floor for spending, the committee agreed to draft two optional provisions for legislatures to consider. The Act should function well without these optional provisions, but some states may prefer to include one or both of them. The first optional provision appears in brackets in the text of the Act. The provision, section 4(d), creates a rebuttable presumption of imprudence for spending more than 7% of the value of an endowment fund in one year. The value of the fund is determined based on a three-year rolling average. Seven percent is a high number and is not intended as a safe harbor. The number was made high enough to allow some fluctuation in a year when a charity needs to spend more and to allow for some changes in economic conditions.

Those in favor of the presumption argue that the presumption provides a useful guideline for charities and for those who supervise charities. The presumption may also curb a charity's temptation to spend its endowment funds too quickly. Those opposed to including the presumption express concern that a charity may interpret the provision to mean that spending below 7% is presumed to be prudent, even though the statute provides otherwise. Other

arguments against the presumption focus on the difficulty of identifying a percentage that can be appropriate for the range of charities and purposes covered by UPMIFA.

The second optional provision appears in the comments following section 4. This provision targets charities with limited initial investment and spending experience that could benefit from additional scrutiny by the attorney general. This optional provision states that if a charity with endowment funds valued, in the aggregate, at less than \$2 million, plans to authorize spending that will take the total value of all endowment funds held by the charity below total HDV for those funds, then the charity must notify the attorney general in that state before proceeding. The optional provision gives the attorney general 60 days to take action before the charity spends below HDV but does not require approval from the attorney general. If the attorney general's office gets notice of proposed spending, someone in the office can review the decision, talk with the charity, and provide advice on prudent spending before the charity spends the money.

#### **Release or Modification of Restrictions**

A charity can continue indefinitely. Over time, changing circumstances may necessitate changes in the way the charity carries out its purposes or changes in the purposes themselves. UPMIFA provides rules for modification that clarify the ways in which nonprofit corporations can change restrictions.

UPMIFA, like UMIFA, permits a donor to release a restriction the donor imposed on a charitable gift. The donor cannot direct the use of the property after the release, but a charity would likely work with the donor to decide on the appropriate changes.

Under UMIFA, if the charity could not obtain the donor's consent, perhaps because the donor was dead, the charity could ask a court to release a restriction. The problem with this approach is that the statute gives the court authority to release the restriction but appears to give the charity control over the use of the assets after the release, without the application of cy pres principles. Section 7(d) of UMIFA then cryptically notes that the release provision "does not limit the application of the doctrine of cy pres."

Rather than permitting release by a court, with no restrictions on future use, UPMIFA adopts the doctrines of cy pres and deviation from trust law, taking language from the Uniform Trust Code. Deviation, in UPMIFA 5 6(b), allows a charity to ask the court to release or modify a restriction that has become impracticable or wasteful or one that impairs the management or investment of the fund. The same section permits a request to modify a restriction if, because of circumstances not anticipated by the donor, the modification will further the purposes of the fund. Any change must be consistent with the donor's probable intention. Cy pres allows a charity to ask a court to approve a change because a restriction has become unlawful, impracticable, impossible to achieve, or wasteful. Under the application of cy pres, a change must be consistent with the charitable purposes expressed in the document that created the gift.

# **UPMIFA** Uniform Prudent Management of Institutional Funds Act

UPMIFA adds a new provision that should be of help to charities. Section 6(d) provides that if a fund is both old (20 years) and small (\$25,000), then a charity can apply cy pres to the fund to change a restriction, after first giving notice to the attorney general but without obtaining court approval. The charity must wait 60 days before modifying the restriction, to give the attorney general time to take action if the attorney general finds a problem with the proposed modification. This provision addresses the problem that occurs when a restriction on a fund no longer makes sense, but the fund is too small to justify the costs of a court proceeding to request deviation or cy pres.

In keeping with the approach taken under trust law for modification using cy pres or deviation, the Act does not require notification of donors. Of course, a charity's self-interest in maintaining good donor relations will encourage contacting any known donors about any need to release or modify a restriction. UPMIFA does not change the general rule that donors do not have standing to bring a court challenge to a charity's actions. UPMIFA maintains the attorney general's traditional role in protecting donor intent and the public's interest in charitable assets.

## **Enactment**

Now that the Uniform Law Commission has approved UPMIFA, legislatures will begin considering enactment. A copy of UPMIFA, including comments that provide additional information, can be found at [www.nccusl.org](http://www.nccusl.org) or obtained by contacting Susan Gary at [sgary@law.uoregon.edu](mailto:sgary@law.uoregon.edu). Prof. Gary is happy to answer questions, hear comments, and help with legislative efforts in connection with UPMIFA.

**QUICK COMPARISON**

UPMIFA	UMIFA
<p><b>Scope:</b> All charitable institutions holding "institutional funds" including trusts without noncharitable beneficiaries</p>	<p><b>Scope:</b> Charitable organizations except for trusts</p>
<p><b>Investment Conduct:</b></p> <ul style="list-style-type: none"> <li>• Express duty of loyalty</li> <li>• Express cost management obligation</li> <li>• Whole portfolio management standard of performance</li> <li>• Express diversification requirement</li> <li>• Portfolio balancing required</li> <li>• Special skills standard of performance</li> </ul>	<p><b>Investment Conduct:</b> General obligation to invest prudently using ordinary business care</p>
<p><b>Expenditure of Funds:</b> Express prudent total return standard, 7 factors:</p> <ul style="list-style-type: none"> <li>- Fund duration</li> <li>- Fund/institution purposes</li> <li>- General economic conditions</li> <li>- Effects, inflation/deflation</li> <li>- Expected total return</li> <li>- Other resources</li> <li>- Institutional investment policy</li> </ul> <p>Optional, over 7% of total return presumed imprudent</p>	<p><b>Expenditure of Funds:</b> Net appreciation may be spent for purposes of endowment Historic dollar value limitation</p>
<p><b>Delegation of Management/Investment:</b> Prudent delegation in good faith, care standard of prudent person</p> <ul style="list-style-type: none"> <li>- To select agent</li> <li>- Establish scope and terms of delegation</li> <li>- Requires periodic review and supervision of agent</li> </ul> <p>Agent has duty of reasonable care Agent subject to court jurisdiction</p> <p>Delegation to committees, officers or employees as authorized by other law</p>	<p><b>Delegation of Management/Investment:</b> Delegation allowed without express standards</p>

# UPMIFA

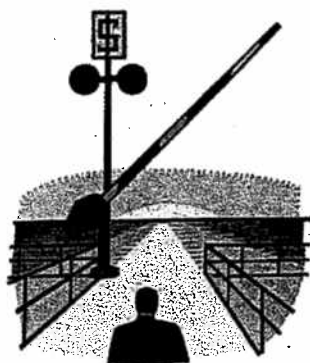
## Uniform Prudent Management of Institutional Funds Act

UPMIFA	UMIFA
<p><b>Release or Modification of Restrictions:</b></p> <p><u>Restriction</u> Court may release or modify     ImpRACTICABLE or wasteful     Impairment of management or investment     Unanticipated circumstances allow release or modification furthering purposes of the fund</p> <p>Notice to Attorney General required</p> <p><u>Purpose</u> Court may release or modify     Unlawful to retain     ImpRACTICABLE     Impossible to achieve     Wasteful</p> <p>Consistent with donor's intent</p> <p>Notice to Attorney General Required</p> <p><u>Small Old Fund</u> Institution may institute release or modification without court approval</p> <p>Notice to Attorney General required</p>	<p><b>Release or Modification of Restrictions:</b> Court release if restriction obsolete, inappropriate or impracticable</p> <p>Notice to Attorney General required</p> <p>Cy pres (modification of purpose) not limited or addressed</p>

## Opening Up

### New endowment management guidelines offer more flexibility

By SUSAN N. GARY



**The new act means big changes—for the better—in the way charitable organizations manage and spend endowment funds.**

**Y**ou might have heard about institutional endowments going under water, if not in the September 2003 CURRENTS article, "That Sinking Feeling," then in the news surrounding the fluctuating stock market of a few years ago. Underwater endowments have been a concern because of the Uniform Management of Institutional Funds Act, a law in effect in most states. But a new uniform act, ready for state legislatures to adopt, will make the process of managing underwater funds easier if it becomes law.

In almost all states UMIFA governs how nonprofits, including educational institutions and their foundations, manage, invest, and spend endowed funds. UMIFA has been successful, but portions of it are out of date, and the National Conference of Commissioners on Uniform State Laws recently approved a revised and renamed version of the act. The new Uniform Prudent Management of Institutional Funds Act means big changes—for the better—in the way charitable organizations manage and spend endowment funds.

UPMIFA updates the prudence standard that applies to the management and investment of charitable funds and brings the law in line with modern investment practice. The new act modifies the rules governing expenditures from endowment funds by providing better spending guidelines and giving institutions more flexibility to cope with fluctuations in the value of the endowment. In addition, UPMIFA adopts provisions that govern the release and modification of restrictions on charitable funds to permit more efficient management of these funds.

#### PRUDENCE STANDARD

The standard for investing and managing charitable funds is prudence. The new articulation of the standard in UPMIFA reflects the merging of corporate and trust law standards and states that a manager must act "in good faith and with the care an ordinarily prudent person in a like position would exercise under

similar circumstances." The act lists economic and fund-related factors that a manager should consider and directs the manager to consider the investment strategy of the fund, the fund's portfolio of investments, and the expected total return of the investments as it relates to the fund's risk and return objectives.

Prudence is a standard that evolves over time, and UPMIFA is simply updating the statutory language to provide good direction about the role of prudence in investment and management. The language should be helpful to nonprofits but does not make changes that organizations need to specifically address.

#### ENDOWMENT SPENDING

Perhaps the biggest change UPMIFA brings is the elimination of the concept of "historic dollar value." UPMIFA no longer restricts endowment spending to amounts above historic dollar value and instead offers a more flexible spending standard.

Under UMIFA, HDV was defined as the value of contributions made to an endowment fund, without increases or decreases due to investment results, inflation, or anything else. Under UMIFA, a nonprofit, after considering its purpose, could spend from an endowment fund the amount it deemed prudent, but could never spend below HDV.

Under UPMIFA, a nonprofit can spend the amount it deems prudent after considering the donor's intent that the endowment fund continue in perpetuity, the purposes of the fund (and not just of the organization), and other relevant economic factors. The intent of the change is not to permit unrestricted spending from an endowment fund. Rather, UPMIFA lists specific factors an organization must consider in determining an appropriate amount to spend and emphasizes the perpetuation of the purchasing power of the fund, not just of the original dollars contributed to the fund.

Under UPMIFA, any agreed-upon donor restrictions will control the management of an endowment fund. If a donor wants to create an endowment fund that can spend only 4 percent each year, he or she can do so. If, however, the donor restricts the fund by indicating that the charity should "pay only income" or "hold the

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fund as an endowment," then the rule of construction UPMIFA provides will treat the fund as an endowment fund subject to the UPMIFA rules on spending. The act assumes that a donor who gives to an endowment fund wants the charity to use modern investment strategies to generate enough funds to distribute while maintaining the long-term viability of the fund.

UPMIFA will apply to charitable funds created both before and after its enactment. Some people have expressed concern that the change in endowment spending rules will affect donor intent. The UPMIFA drafting committee concluded that the new rules provide better protection for donors and nonprofits, and that unless UPMIFA applies retroactively, organizations will face unwieldy and costly administrative burdens.

#### OPTIONAL PROVISIONS

To address concerns about the removal of HDV as a floor for spending, the committee provided two optional provisions for state legislatures to consider. UPMIFA should function well without these provisions, but some states might prefer to include one or both of them. The first provision creates a rebuttable "7 percent rule" that presumes that spending more than 7 percent of the value of an endowment fund in one year is imprudent. This is a high number and is not intended as a safe harbor. It was made high enough to allow for some fluctuation in a year when an organization needs to spend more and to allow for some changes in economic conditions.

The second optional provision states that if an organization plans to authorize spending that will take the total value of all its endowment funds below total HDV for those funds, then the organization must notify the state attorney general before proceeding. The optional provision gives the attorney general a period of time to take action, but does not require his or her approval. The thinking behind this provision is that, with notice, someone in the attorney general's office could check in with the organization and provide advice on prudent spending before the organization spent the money.

#### MODIFICATION OF RESTRICTIONS

UPMIFA adopts the doctrines of *cy pres* and *deviation* from trust law. Deviation and *cy pres* probably already apply to all nonprofit organizations, but UPMIFA clarifies that they apply to charities other than trusts.

Deviation allows a nonprofit to ask the court to release or modify a restriction on the management or investment of a fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of purposes not anticipated by the donor, the change will further the purposes of the fund. Any change must be consistent with the donor's probable intention. *Cy pres* allows a nonprofit to ask a court to approve a change because a restriction on the use or purpose of a fund has become unlawful, impracticable, impossible to achieve, or wasteful. A change must be consistent with the charitable purposes expressed in the document that created the gift.

UPMIFA adds a new provision that should help charities. Section 6(d) provides that if a fund is both old (20 years) and small (\$25,000), a nonprofit can apply *cy pres* to the fund to change a restriction, after first giving notice to the attorney general. This provision addresses the problem that occurs when a restriction on a fund no longer makes sense, but the fund is too small to justify the costs of a court proceeding to request deviation or *cy pres*.

UPMIFA does not require notification of donors, but assumes that a charity's self-interest in maintaining good donor relations will encourage contacting any known donors about any need to release or modify a restriction. UPMIFA does not change the general rule that donors do not have standing to bring a court challenge to an organization's actions.

#### ENACTMENT

Now that NCCUSL has approved UPMIFA, the next step will be to get UPMIFA before state legislatures. Other than possible style changes, the text of UPMIFA is ready to go.

To read a copy of the act with explanatory comments, go to [www.nccusl.org](http://www.nccusl.org). ■