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Legislative Document **No. 1402**

H.P. 981 House of Representatives, April 2, 2009

An Act To Enact the Uniform Prudent Management of Institutional Funds Act

Reference to the Committee on Judiciary suggested and ordered printed.

Millicent M. MacFarland
MILLICENT M. MacFARLAND
Clerk

Presented by Representative PRIEST of Brunswick.
Cosponsored by Senator BLISS of Cumberland and
Representatives: BEAULIEU of Auburn, BRYANT of Windham, CLEARY of Houlton, CROCKETT of Bethel, DILL of Cape Elizabeth, HILL of York, NASS of Acton, Senator: HASTINGS of Oxford.

Printed on recycled paper.

1 **Be it enacted by the People of the State of Maine as follows:**

2 **Sec. 1. 13 MRSA c. 97,** as amended, is repealed.

3

4 **UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT**

5

6 **Prefatory Note**

7 **Reasons for Revision.** The Uniform Prudent Management of Institutional Funds Act
8 (UPMIFA) replaces the Uniform Management of Institutional Funds Act (UMIFA). The
9 National Conference of Commissioners on Uniform State Laws approved UMIFA in
10 1972, and 47 jurisdictions have enacted the act. UMIFA provided guidance and authority
11 to charitable organizations within its scope concerning the management and investment
12 of funds held by those organizations, UMIFA provided endowment spending rules that
13 did not depend on trust accounting principles of income and principal, and UMIFA
14 permitted the release of restrictions on the use or management of funds under certain
15 circumstances. The changes UMIFA made to the law permitted charitable organizations
16 to use modern investment techniques such as total-return investing and to determine
17 endowment fund spending based on spending rates rather than on determinations of
18 "income" and "principal."

19 UMIFA was drafted almost 35 years ago, and portions of it are now out of date. The
20 prudence standards in UMIFA have provided useful guidance, but prudence norms evolve
21 over time. The new Act provides modern articulations of the prudence standards for the
22 management and investment of charitable funds and for endowment spending. The
23 Uniform Prudent Investor Act (UPIA), an Act promulgated in 1994 and already enacted
24 in 43 jurisdictions, served as a model for many of the revisions. UPIA updates rules on
25 investment decision making for trusts, including charitable trusts, and imposes additional
26 duties on trustees for the protection of beneficiaries. UPMIFA applies these rules and
27 duties to charities organized as nonprofit corporations. UPMIFA does not apply to trusts
28 managed by corporate and other fiduciaries that are not charities, because UPIA provides
29 management and investment standards for those trusts.

30 In applying principles based on UPIA to charities organized as nonprofit
31 corporations, UPMIFA combines the approaches taken by UPIA and by the Revised
32 Model Nonprofit Corporation Act (RMNCA). UPMIFA reflects the fact that standards
33 for managing and investing institutional funds are and should be the same regardless of
34 whether a charitable organization is organized as a trust, a nonprofit corporation, or some
35 other entity. *See* Bevis Longstreth, Modern Investment Management and the Prudent
36 Man Rule 7 (1986) (stating "[t]he modern paradigm of prudence applies to all fiduciaries
37 who are subject to some version of the prudent man rule, whether under ERISA, the
38 private foundation provisions of the Code, UMIFA, other state statutes, or the common
39 law."); Harvey P. Dale, *Nonprofit Directors and Officers - Duties and Liabilities for*
40 *Investment Decisions,* 1994 N.Y.U. Conf. Tax Plan. 501(c)(3) Org's. Ch. 4.

41 UPMIFA provides guidance and authority to charitable organizations concerning the
42 management and investment of funds held by those organizations, and UPMIFA imposes

additional duties on those who manage and invest charitable funds. These duties provide additional protections for charities and also protect the interests of donors who want to see their contributions used wisely.

UPMIFA modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines 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 updates the provisions governing the release and modification of restrictions on charitable funds to permit more efficient management of these funds. These provisions derive from the approach taken in the Uniform Trust Code (UTC) for modifying charitable trusts. Like the UTC provisions, UPMIFA's modification rules preserve the historic position of the attorneys general in most states as the overseers of charities.

As under UMIFA, the new Act applies to charities organized as charitable trusts, as nonprofit corporations, or in some other manner, but the rules do not apply to funds managed by trustees that are not charities. Thus, the Act does not apply to trusts managed by corporate or individual trustees, but the Act does apply to trusts managed by charities.

Prudent Management and Investment. UMIFA applied the 1972 prudence standard to investment decision making. In contrast, UPMIFA will give charities updated and more useful guidance by incorporating language from UPIA, modified to fit the special needs of charities. The revised Act spells out more of the factors a charity should consider in making investment decisions, thereby imposing a modern, well accepted, prudence standard based on UPIA.

Among the expressly enumerated prudence factors in UPMIFA is "the preservation of the endowment fund," a standard not articulated in UMIFA.

In addition to identifying factors that a charity must consider in making management and investment decisions, UPMIFA requires a charity and those who manage and invest its funds to:

1. Give primary consideration to donor intent as expressed in a gift instrument,
2. Act in good faith, with the care an ordinarily prudent person would exercise,
3. Incur only reasonable costs in investing and managing charitable funds,
4. Make a reasonable effort to verify relevant facts,
5. Make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy,
6. Diversify investments unless due to special circumstances, the purposes

of the fund are better served without diversification,

7. Dispose of unsuitable assets, and

8. In general, develop an investment strategy appropriate for the fund and the charity.

UMIFA did not articulate these requirements.

Thus, UPMIFA strengthens the rules governing management and investment decision making by charities and provides more guidance for those who manage and invest the funds.

Donor Intent with Respect to Endowments. UPMIFA improves the protection of donor intent with respect to expenditures from endowments. When a donor expresses intent clearly in a written gift instrument, the Act requires that the charity follow the donor's instructions. When a donor's intent is not so expressed, UPMIFA directs the charity to spend an amount that is prudent, consistent with the purposes of the fund, relevant economic factors, and the donor's intent that the fund continue in perpetuity. This approach allows the charity to give effect to donor intent, protect its endowment, assure generational equity, and use the endowment to support the purposes for which the endowment was created.

Retroactivity. Like UMIFA, UPIA, the Uniform Principal and Income Act of 1961, and the Uniform Principal and Income Act of 1997, UPMIFA applies retroactively to institutional funds created before and prospectively to institutional funds created after enactment of the statute. Regarding the considerations motivating this treatment of the issues, see the comment to Section 4.

Endowment Spending. UPMIFA improves the endowment spending rule by eliminating the concept of historic dollar value and providing better guidance regarding the operation of the prudence standard. Under UMIFA a charity can spend amounts above historic dollar value that the charity determines to be prudent. The Act directs the charity to focus on the purposes and needs of the charity rather than on the purposes and perpetual nature of the fund. Amounts below historic dollar value cannot be spent. The Drafting Committee concluded that this endowment spending rule created numerous problems and that restructuring the rule would benefit charities, their donors, and the public. The problems include:

1. Historic dollar value fixes valuation at a moment in time, and that moment is arbitrary. If a donor provides for a gift in the donor's will, the date of valuation for the gift will likely be the donor's date of death. (UMIFA left uncertain what the appropriate date for valuing a testamentary gift was.) The determination of historic dollar value can vary significantly depending upon when in the market cycle the donor dies. In addition, the fund may be below historic dollar value at the time the charity receives the gift if the value of the asset declines between the date of the donor's death and the date the asset is actually distributed to the charity from the estate.

1 2. After a fund has been in existence for a number of years, historic dollar value
2 may become meaningless. Assuming reasonable long term investment success, the value
3 of the typical fund will be well above historic dollar value, and historic dollar value will
4 no longer represent the purchasing power of the original gift. Without better guidance on
5 spending the increase in value of the fund, historic dollar value does not provide adequate
6 protection for the fund. If a charity views the restriction on spending simply as a
7 direction to preserve historic dollar value, the charity may spend more than it should.

8 3. The Act does not provide clear answers to questions a charity faces when the
9 value of an endowment fund drops below historic dollar value. A fund that is so
10 encumbered is commonly called an "underwater" fund. Conflicting advice regarding
11 whether an organization could spend from an underwater fund has led to difficulties for
12 those managing charities. If a charity concluded that it could continue to spend trust
13 accounting income until a fund regained its historic dollar value, the charity might invest
14 for income rather than on a total-return basis. Thus, the historic dollar value rule can
15 cause inappropriate distortions in investment policy and can ultimately lead to a decline
16 in a fund's real value. If, instead, a charity with an underwater fund continues to invest
17 for growth, the charity may be unable to spend anything from an underwater endowment
18 fund for several years. The inability of a charity to spend anything from an endowment is
19 likely to be contrary to donor intent, which is to provide current benefits to the charity.

20 The Drafting Committee concluded that providing clearly articulated guidance on the
21 prudence rule for spending from an endowment fund, with emphasis on the permanent
22 nature of the fund, would provide the best protection of the purchasing power of
23 endowment funds.

24 **Presumption of Imprudence.** UPMIFA includes as an optional provision a
25 presumption of imprudence if a charity spends more than seven percent of an endowment
26 fund in any one year. The presumption is meant to protect against spending an
27 endowment too quickly. Although the Drafting Committee believes that the prudence
28 standard of UPMIFA provides appropriate and adequate protection for endowments, the
29 Committee provided the option for states that want to include a mechanical guideline in
30 the statute. A major drawback to any statutory percentage is that it is unresponsive to
31 changes in the rate of inflation or deflation.

32 **Modification of Restrictions on Charitable Funds.** UPMIFA clarifies that the
33 doctrines of cy pres and deviation apply to funds held by nonprofit corporations as well
34 as to funds held by charitable trusts. Courts have applied trust law rules to nonprofit
35 corporations in the past, but the Drafting Committee believed that statutory authority for
36 applying these principles to nonprofit corporations would be helpful. UMIFA permitted
37 release of restrictions but left the application of cy pres uncertain. Under UPMIFA, as
38 under trust law, the court will determine whether and how to apply cy pres or deviation
39 and the attorney general will receive notice and have the opportunity to participate in the
40 proceeding. The one addition to existing law is that UPMIFA gives a charity the
41 authority to modify a restriction on a fund that is both old and small. For these funds, the
42 expense of a trip to court will often be prohibitive. By permitting a charity to make an
43 appropriate modification, money is saved for the charitable purposes of the charity. Even
44 with respect to small, old funds, however, the charity must notify the attorney general of

1 the charity's intended action. Of course, if the attorney general has concerns, he or she
2 can seek the agreement of the charity to change or abandon the modification, and if that
3 fails, can commence a court action to enjoin it. Thus, in all types of modification the
4 attorney general continues to be the protector both of the donor's intent and of the
5 public's interest in charitable funds.

6 **Other Organizational Law.** For matters not governed by UPMIFA, a charitable
7 organization will continue to be governed by rules applicable to charitable trusts, if it is
8 organized as a trust, or rules applicable to nonprofit corporations, if it is organized as a
9 nonprofit corporation.

10 **Relation to Trust Law.** Although UPMIFA applies a number of rules from trust law
11 to institutions organized as nonprofit corporations, in two respects UPMIFA creates rules
12 that do not exist under the common law applicable to trusts. The endowment spending
13 rule of Section 4 and the provision for modifying a small, old fund in subsection (d) of
14 Section 6 have no counterparts in the common law or the UTC. The Drafting Committee
15 believes that these rules could be useful to charities organized as trusts, and the
16 Committee recommends conforming amendments to the UTC and the Principal and
17 Income Act to incorporate these changes into trust law.

18 **Sec. 2. 13 MRSA c. 99** is enacted to read:

19 **CHAPTER 99**

20 **UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT**

21 **§5101. Short title**

22 This chapter may be known and cited as "the Uniform Prudent Management of
23 Institutional Funds Act."

24 **§5102. Definitions**

25 As used in this chapter, unless the context otherwise indicates, the following terms
26 have the following meanings.

27 **1. Charitable purpose.** "Charitable purpose" means the relief of poverty, the
28 advancement of education or religion, the promotion of health, the promotion of a
29 governmental purpose or any other purpose the achievement of which is beneficial to the
30 community.

31 **2. Endowment fund.** "Endowment fund" means an institutional fund or part
32 thereof that, under the terms of a gift instrument, is not wholly expendable by the
33 institution on a current basis. "Endowment fund" does not include assets that an
34 institution designates as an endowment fund for its own use.

35 **3. Gift instrument.** "Gift instrument" means a record or records, including an
36 institutional solicitation, under which property is granted to, transferred to or held by an
37 institution as an institutional fund.

4. Institution. "Institution" means:

A. A person, other than an individual, organized and operated exclusively for charitable purposes;

B. A government or governmental subdivision, agency or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or

C. A trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated.

5. Institutional fund. "Institutional fund" means a fund held by an institution exclusively for charitable purposes. "Institutional fund" does not include:

A. Program-related assets;

B. A fund held for an institution by a trustee that is not an institution; or

C. A fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund.

6. Person. "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency or instrumentality or any other legal or commercial entity.

7. Program-related asset. "Program-related asset" means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.

8. Record. "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Uniform Comment

(This is Section 2 of the Uniform Prudent Management of Institutional Funds Act (2006).)

Subsection (1). Charitable Purpose. The definition of charitable purpose follows that of UTC § 405 and Restatement (Third) of Trusts § 28 (2003). This long-familiar standard derives from the English Statute of Charitable Uses, enacted in 1601.

Some 17 states have created statutory definitions of charitable purpose for various purposes. *See, e.g.*, 10 Pa. CONS. STAT. § 162.3 (2005) (defining charitable purpose within the Solicitation of Funds for Charitable Purposes Act to include "humane," "patriotic," social welfare and advocacy," and "civic" purposes). The definition in subsection (1) applies for purposes of this Act and does not affect other definitions of charitable purpose.

Subsection (2). Endowment Fund. An endowment fund is an institutional fund or a part of an institutional fund that is not wholly expendable by the institution on a current basis. A restriction that makes a fund an endowment fund arises from the terms of a gift instrument. If an institution has more than one endowment fund, under Section 3 the

institution can manage and invest some or all endowment funds together. Section 4 and Section 6 must be applied to individual funds and cannot be applied to a group of funds that may be managed collectively for investment purposes.

Board-designated funds are institutional funds but not endowment funds. The rules on expenditures and modification of restrictions in this Act do not apply to restrictions that an institution places on an otherwise unrestricted fund that the institution holds for its own benefit. The institution may be able to change these restrictions itself, subject to internal rules and to the fiduciary duties that apply to those that manage the institution.

If an institution transfers assets to another institution, subject to the restriction that the other institution hold the assets as an endowment, then the second institution will hold the assets as an endowment fund.

Subsection (3). Gift Instrument. The term gift instrument refers to the records that establish the terms of a gift and may consist of more than one document. The definition clarifies that the only legally binding restrictions on a gift are the terms set forth in writing.

As used in this definition, "record" is an expansive concept and means a writing in any form, including electronic. The term includes a will, deed, grant, conveyance, agreement, or memorandum, and also includes writings that do not have a donative purpose. For example, under some circumstances the bylaws of the institution, minutes of the board of directors, or canceled checks could be a gift instrument or be one of several records constituting a gift instrument. Although the term can include any of these records, a record will only become a gift instrument if both the donor and the institution were or should have been aware of its terms when the donor made the gift. For example, if a donor sends a contribution to an institution for its general purposes, then the articles of incorporation may be used to clarify those purposes. If, in contrast, the donor sends a letter explaining that the institution should use the contribution for its "educational projects concerning teenage depression," then any funds received in response must be used for that purpose and not for broader purposes otherwise permissible under the articles of incorporation.

Solicitation materials may constitute a gift instrument. For example, a solicitation that suggests in writing that any gifts received pursuant to the solicitation will be held as an endowment may be integrated with other writings and may be considered part of the gift instrument. Whether the terms of the solicitation become part of the gift instrument will depend upon the circumstances, including whether a subsequent writing superseded the terms of the solicitation. Each gift received in response to a solicitation will be subject to any restrictions indicated in the gift instrument pertaining to that gift. For example, if an initial gift establishes an endowment fund, and the charity then solicits additional gifts "to be held as part of the Charity X Endowment Fund," those additional gifts will each be subject to the restriction that the gifts be held as part of that endowment fund.

The term gift instrument includes matching funds provided by an employer or some other person. Whether matching funds are treated as part of the endowment fund or otherwise will depend on the terms of the matching gift.

1 The term gift instrument also includes an appropriation by a legislature or other
2 public or governmental body for the benefit of an institution.

3 **Subsection (4). Institution.** The Act applies generally to institutions organized and
4 operated exclusively for charitable purposes. The term includes charitable organizations
5 created as nonprofit corporations, unincorporated associations, governmental
6 subdivisions or agencies, or any form of entity, however organized, that is organized and
7 operated exclusively for charitable purposes. The term includes a trust organized and
8 operated exclusively for charitable purposes, but only if a charity acts as trustee. This
9 approach leaves unchanged the coverage of UMIFA. The exclusion of "individual" from
10 the definition of institution is not intended to exclude a corporation sole.

11 Although UPMIFA does not apply to all charitable trusts, many of UPMIFA's
12 provisions derive from trust law. Prudent investor standards apply to trustees of
13 charitable trusts in states that have adopted UPIA. Trustees of charitable trusts can use
14 the doctrines of cy pres and deviation to modify trust provisions, and the UTC includes a
15 number of modification provisions. The Uniform Principal and Income Act permits
16 allocation between principal and income to facilitate total-return investing. Charitable
17 trusts not included in UPMIFA, primarily those managed by corporate trustees and
18 individuals, will lose the benefits of UPMIFA's endowment spending rule and the
19 provision permitting a charity to apply cy pres, without court supervision, for
20 modifications to a small, old fund. Enacting jurisdictions may choose to incorporate
21 these rules into existing trust statutes to provide the benefits to charitable funds managed
22 by corporate trustees.

23 The definition of institution includes governmental organizations that hold funds
24 exclusively for the purposes listed in the definition. A governmental entity created by
25 state law may fall outside the definition on account of the form of organization under
26 which the state created it. Because state arrangements are so varied, creating a definition
27 that encompasses all charitable entities created by states is not feasible. States should
28 consider applying the core principles of UPMIFA to such governmental institutions. For
29 example, the control over a state university may be held by a State Board of Regents. In
30 that situation, the state may have created a governing structure by statute or in the state
31 constitution so that the university is, in effect, privately chartered. The Drafting
32 Committee does not intend to exclude these universities from the definition of institution,
33 but additional state legislation may be necessary to address particular situations.

34 **Subsection (5). Institutional Fund.** The term institutional fund includes any fund
35 held by an institution for charitable purposes, whether the fund is expendable currently or
36 subject to restrictions. The term does not include a fund held by a trustee that is not an
37 institution.

38 Some institutions combine assets from multiple funds for investment purposes, and
39 some institutions invest funds from different institutions in a common fund. Typically
40 each fund is assigned units representing the share value of the individual fund. The assets
41 are invested collectively, permitting more efficient investment and improved
42 diversification of the overall portfolio. The collective fund makes annual distributions to
43 the individual funds based on the units held by each fund. For purposes of Section 3 [and

1 Section 5], the collective fund is considered one institutional fund. Section 4 and Section
2 6 apply to each fund individually and not to the collective fund.

3 Assets held by an institution primarily for program-related purposes rather than
4 exclusively for investment are not subject to UPMIFA. For example, a university may
5 purchase land adjacent to its campus for future development. The purchase might not
6 meet prudent investor standards for commercial real estate, but the purchase may be
7 appropriate because the university needs to build a new dormitory. The classroom
8 buildings, administration buildings, and dormitories held by the university all have value
9 as property, but the university does not hold those buildings as financial assets for
10 investment purposes. The Act excludes from the prudent investor norms those assets that
11 a charity uses to conduct its charitable activities, but does not exclude assets that have a
12 tangential tie to the charitable purpose of the institution but are held primarily for
13 investment purposes.

14 A fund held by an institution is not an institutional fund if any beneficiary of the fund
15 is not an institution. For example, a charitable remainder trust held by a charity as trustee
16 for the benefit of the donor during the donor's lifetime, with the remainder interest held
17 by the charity, is not an institutional fund. However, this subsection treats as an
18 institution a charitable remainder trust that continues to operate for charitable purposes
19 after the termination of the noncharitable interests. The Act will have only a limited effect
20 on a charitable remainder trust that terminates after the noncharitable interest ends.
21 During the period required to complete the distribution of the trust's property, the
22 prudence norm will apply to the actions of the trustee, but the short timeframe will affect
23 investment decision making.

24 **Subsection (6). Person.** The Act uses as the definition of person the definition
25 approved by the National Conference of Commissioners on Uniform State Laws. The
26 definition of institution uses the term person, but to be an institution a person must be
27 organized and operated exclusively for charitable purposes. A person with a commercial
28 purpose cannot be an institution. Thus, although the definition of person includes
29 "business trust" and "any other . . . commercial entity," the Act does not apply to an
30 entity organized for business purposes and not exclusively for charitable purposes.
31 Further, the definition of person includes trusts, but only trusts managed by charities can
32 be institutional funds. UPMIFA does not apply to trusts managed by corporate trustees or
33 by individual trustees.

34 If a governing instrument provides that a fund will revert to the donor if, and only if,
35 the institution ceases to exist or the purposes of the fund fail, then the fund will be
36 considered an institutional fund until such contingency occurs.

37 **Subsection (7). Program-Related Asset.** Although UPMIFA does not apply to
38 program-related assets, if program-related assets serve, in part, as investments for an
39 institution, then the institution should identify categories for reporting those investments
40 and should establish investment criteria for the investments that are reasonably related to
41 achieving the institution's charitable purposes. For example, a program providing below-
42 market loans to inner-city businesses may be "primarily to accomplish a charitable
43 purpose of the institution" but also can be considered, in part, an investment. The

institution should create reasonable credit standards and other guidelines for the program to increase the likelihood that the loans will be repaid.

Subsection (8). Record. This definition was added to clarify that the definition of instrument includes electronic records as defined in Section 2(8) of the Uniform Electronic Transactions Act (1999).

§5103. Standard of conduct in managing and investing institutional fund

1. Consideration of purposes. Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.

2. Loyalty; good faith; care. In addition to complying with the duty of loyalty imposed by law other than this chapter, each person responsible for managing and investing an institutional fund shall 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.

3. Costs; facts. In managing and investing an institutional fund, an institution:

A. May incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution and the skills available to the institution; and

B. Shall make a reasonable effort to verify facts relevant to the management and investment of the fund.

4. Pooling funds. An institution may pool 2 or more institutional funds for purposes of management and investment.

5. Rules. Except as otherwise provided by a gift instrument, the following rules apply.

A. In managing and investing an institutional fund, the following factors, if relevant, must be considered:

(1) General economic conditions;

(2) The possible effect of inflation or deflation;

(3) The expected tax consequences, if any, of investment decisions or strategies;

(4) The role that each investment or course of action plays within the overall investment portfolio of the fund;

(5) The expected total return from income and the appreciation of investments;

(6) Other resources of the institution;

(7) The needs of the institution and the fund to make distributions and to preserve capital; and

(8) An asset's special relationship or special value, if any, to the charitable purposes of the institution.

B. Management and investment decisions about an individual asset must be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution.

C. Except as otherwise provided by law other than this chapter, an institution may invest in any kind of property or type of investment consistent with this section.

D. An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification.

E. Within a reasonable time after receiving property, an institution shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio, in order to bring the institutional fund into compliance with the purposes, terms and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of this chapter.

F. A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

Uniform Comment

(This is Section 3 of the Uniform Prudent Management of Institutional Funds Act (2006).)

Purpose and Scope of Revisions. This section adopts the prudence standard for investment decision making. The section directs directors or others responsible for managing and investing the funds of an institution to act as a prudent investor would, using a portfolio approach in making investments and considering the risk and return objectives of the fund. The section lists the factors that commonly bear on decisions in fiduciary investing and incorporates the duty to diversify investments absent a conclusion that special circumstances make a decision not to diversify reasonable. Thus, the section follows modern portfolio theory for investment decision making. Section 3 applies to all funds held by an institution, regardless of whether the institution obtained the funds by gift or otherwise and regardless of whether the funds are restricted.

The Drafting Committee discussed extensively the standard that should govern nonprofit managers. UMIFA states the standard as "ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision." Since the decision in *Stern v. Lucy Webb Hayes National* Training *School for Deaconesses,* 381 F. Supp. 1003 (1974), the trend has been to hold directors of nonprofit corporations to a standard nominally similar to the corporate standard but with the recognition that the facts and circumstances considered include the fact that the entity is a charity and not a business corporation.

The language of the prudence standard adopted in UPMIFA is derived from the RMNCA and from the prudent investor rule of UPIA. The standard is consistent with the business judgment standard under corporate law, *as applied to charitable institutions.* That is, a manager operating a charitable organization under the business judgment rule

1 would look to the same factors as those identified by the prudent investor rule. The
2 standard for prudent investment set forth in Section 3 first states the duty of care as
3 articulated in the RMNCA, but provides more specific guidance for those managing and
4 investing institutional funds by incorporating language from UPIA. The criteria derived
5 from UPIA are consistent with good practice under current law applicable to nonprofit
6 corporations.

7 Trust law norms already inform managers of nonprofit corporations. The Preamble
8 to UPIA explains: "Although the Uniform Prudent Investor Act by its terms applies to
9 trusts and not to charitable corporations, the standards of the Act can be expected to
10 inform the investment responsibilities of directors and officers of charitable
11 corporations." *See also*, Restatement (Third) of Trusts: Prudent Investor Rule § 379,
12 Comment b, at 190 (1992) (stating that "absent a contrary statute or other provision, the
13 prudent investor rule applies to investment of funds held for charitable corporations.").
14 Trust precedents have routinely been found to be helpful but not binding authority in
15 corporate cases.

16 The Drafting Committee decided that by adopting language from both the RMNCA
17 and UPIA, UPMIFA could clarify that common standards of prudent investing apply to
18 all charitable institutions. Although the principal trust authorities, UPIA § (2)(a),
19 Restatement (Third) of Trusts §337, UTC § 804, and Restatement (Second) of Trusts §
20 174 (prudent administration) use the phrase "care, skill and caution," the Drafting
21 Committee decided to use the more familiar corporate formulation as found in RMNCA.
22 The standard also appears in Sections 3, 4 and 5 of UPMIFA. The Drafting Committee
23 does not intend any substantive change to the UPIA standard and believes that
24 "reasonable care, skill, and caution" are implicit in the term "care" as used in the
25 RMNCA. The Drafting Committee included the detailed provisions from UPIA, because
26 the Committee believed that the greater precision of the prudence norms of the
27 Restatement and UPIA, as compared with UMIFA, could helpfully inform managers of
28 charitable institutions. For an explanation of the Prudent Investor Act, see John H.
29 Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa
30 L. Rev. 641 (1996), and for a discussion of the effect UPIA has had on investment
31 decision making, see Max M. Schanzenbach & Robert H. Sitkoff, *Did Reform of Prudent
32 Trust Investment Laws Change Trust Portfolio Allocation?*, 50 J. L. & Econ.
33 (forthcoming 2007).

34 Section 3 has incorporated the provisions of UPIA with only a few exceptions. UPIA
35 applies to private trusts and is entirely default law. The settlor of a private trust has
36 complete control over virtually all trust provisions. See UTC § 105. Because UPMIFA
37 applies to charitable organizations, UPMIFA makes the duty of care, the duty to
38 minimize costs, and the duty to investigate mandatory. The duty of loyalty is mandatory
39 under applicable organization law, corporate or trust. Other than these duties, the
40 provisions of Section 3 are default rules. A gift instrument or the governing instruments
41 of an institution can modify these duties, but the charitable purpose doctrine limits the
42 extent to which an institution or a donor can restrict these duties. In addition, subsection
43 (a) of Section 3 reminds the decision maker that the intent of a donor expressed in a gift
44 instrument will control decision making. Further, the decision maker must consider the
45 charitable purposes of the institution and the purposes of the institutional fund for which

decisions are being made. These factors are specific to charitable organizations; UPIA § 2(a) states the duty to consider similar factors in the private trust context.

UPMIFA does not include the duty of impartiality, stated in UPIA § 6, because nonprofit corporations do not confront the multiple beneficiaries problem to which the duty is addressed. Under UPIA, a trustee must treat the current beneficiaries and the remainder beneficiaries with due regard to their respective interests, subject to alternative direction from the trust document. A nonprofit corporation typically creates one charity. The institution may serve multiple beneficiaries, but those beneficiaries do not have enforceable rights in the institution in the same way that beneficiaries of a private trust do. Of course, if a charitable trust is created to benefit more than one charity, rather than being created to carry out a charitable purpose, then UPIA will apply the duty of impartiality to that trust.

In other respects, the Drafting Committee made changes to language from UPIA only where necessary to adapt the language for charitable institutions. No material differences are intended. Subsection (e)(1)(D) of Section 3 of UPMIFA does not include a clause that appears at the end of UPIA § 2(c)(4) ("which may include financial assets, interest in closely held enterprises, tangible and intangible personal property, and real property."). The Drafting Committee deemed this clause unnecessary for charitable institutions. The language of subsection (e)(1)(G) reflects a modification of the language of UPIA § (2)(c)(7). Other minor modifications to the UPIA provisions make the language more appropriate for charitable institutions.

The duties imposed by this section apply to those who govern an institution, including directors and trustees, and to those to whom the directors or managers delegate responsibility for investment and management of institutional funds. The standard applies to officers and employees of an institution and to agents who invest and manage institutional funds. Volunteers who work with an institution will be subject to the duties imposed here, but state and federal statutes may provide reduced liability for persons who act without compensation. UPMIFA does not affect the application of those shield statutes.

Subsection (a). Donor Intent and Charitable Purposes. Subsection (a) states the overarching duty to comply with donor intent as expressed in the terms of the gift instrument. The emphasis in the Act on giving effect to donor intent does not mean that the donor can or should control the management of the institution. The other fundamental duty is the duty to consider the charitable purposes of the institution and of the institutional fund in making management and investment decisions. UPIA § 2(a) states a similar duty to consider the purposes of a trust in investing and managing assets of a trust.

Subsection (b). Duty of Loyalty. Subsection (b) reminds those managing and investing institutional funds that the duty of loyalty will apply to their actions, but Section 3 does not state the loyalty standard that applies. The Drafting Committee was concerned, at least nominally, that different standards of loyalty may apply to directors of nonprofit corporations and to trustees of charitable trusts. The RMNCA provides that under the duty of loyalty a director of a nonprofit corporation should act "in a manner the director reasonably believes to be in the best interests of the corporation." RMNCA §

1 8.30. The trust law articulation of the loyalty standard uses "sole interests" rather than
2 "best interests." As the Restatement of Trusts explains, "[t]he trustee is under a duty to
3 the beneficiary to administer the trust solely in the interest of the beneficiary."
4 Restatement (Second) of Trusts § 170 (1). Although the standards for loyalty, like the
5 standard of care, are merging, *see* Evelyn Brody, *Charitable Governance: What's Trust*
6 *Law Got to do With It?* Chi.-Kent L. Rev. (2005); John H. Langbein, *Questioning the*
7 *Trust Law Duty of Loyalty: Sole Interest or Best Interest*, 114 Yale L.J. 929 (2005), the
8 Drafting Committee concluded that formulating a duty of loyalty provision for UPMIFA
9 was unnecessary. Thus the duty of loyalty under nonprofit corporation law will apply to
10 charities organized as nonprofit corporations, and the duty of loyalty under trust law will
11 apply to charitable trusts.

12 **Subsection (b). Duty of Care.** Subsection (b) also applies the duty of care to
13 performance of investment duties. The language derives from § 8.30 of the RMNCA.
14 This subsection states the duty to act in good faith, "with the care an ordinarily prudent
15 person in a like position would exercise under similar circumstances." Although the
16 language in the RMNCA and in UPMIFA is similar to that of § 8.30 of the Model
17 Business Corporation Act (3d ed. 2002), the standard as applied to persons making
18 decisions for charities is informed by the fact that the institution is a charity and not a
19 business corporation. Thus, in UPMIFA the references to "like position" and "similar
20 circumstances" mean that the charitable nature of the institution affects the decision
21 making of a prudent person acting under the standard set forth in subsection (b). The
22 duty of care involves considering the factors set forth in subsection (e)(1).

23 **Subsection (c)(1). Duty to Minimize Costs.** Subsection (c)(1) tracks the language of
24 UPIA § 7 and requires an institution to minimize costs. An institution may prudently
25 incur costs by hiring an investment advisor, but the costs incurred should be appropriate
26 under the circumstances. *See* UPIA § 7 cmt; Restatement (Third) of Trusts: Prudent
27 Investor Rule § 227, cmt. M, at 58 (1992); Restatement (Second) of Trusts § 188 (1959).
28 The duty is consistent with the duty to act prudently under § 8.30 of the RMNCA.

29 **Subsection (c)(2). Duty to Investigate.** This subsection incorporates the traditional
30 fiduciary duty to investigate, using language from UPIA § 2(d). The subsection requires
31 persons who make investment and management decisions to investigate the accuracy of
32 the information used in making decisions.

33 **Subsection (d). Pooling Funds.** An institution holding more than one institutional
34 fund may find that pooling its funds for investment and management purposes will be
35 economically beneficial. The Act permits pooling for these purposes. The prohibition
36 against commingling no longer prevents pooling funds for investment and management
37 purposes. *See* UPIA § 3, cmt. (duty to diversify aided by pooling); UPIA § 7, cmt.
38 (pooling to minimize costs); Restatement (Third) of Trusts: Duty to Segregate and
39 Identify Trust Property § 84 (T.D. No. 4 2005). Funds will be considered individually for
40 other purposes of the Act, including for the spending rule for endowment funds of
41 Section 4 and the modification rules of Section 6.

42 **Subsection (e)(1). Prudent Decision Making.** Subsection (e)(1) takes much of its
43 language from UPIA § 2(c). In making decisions about whether to acquire or retain an
44 asset, the institution should consider the institution's mission, its current programs, and

1 the desire to cultivate additional donations from a donor, in addition to factors related
2 more directly to the asset's potential as an investment.

3 Subsection (e)(1)(C) reflects the fact that some organizations will invest in taxable
4 investments that may generate unrelated business taxable income for income tax
5 purposes.

6 Assets held primarily for program-related purposes are not subject to UPMIFA. The
7 management of those assets will continue to be governed by other laws applicable to the
8 institution. Other assets may not be held primarily for program-related purposes but may
9 have both investment purposes and program-related purposes. Subsections (a) and
10 (e)(1)(H) indicate that a prudent decision maker can take into consideration the
11 relationship between an investment and the purposes of the institution and of the
12 institutional fund in making an investment that may have a program-related purpose but
13 not be primarily program-related. The degree to which an institution uses an asset to
14 accomplish a charitable purpose will affect the weight given that factor in a decision to
15 acquire or retain the asset.

16 **Subsection (e)(2). Portfolio Approach.** This subsection reflects the use of portfolio
17 theory in modern investment practice. The language comes from UPIA § 2(b), which
18 follows the articulation of the prudent investor standard in Restatement (Third) of Trusts:
19 Prudent Investor Rule § 227(a) (1992).

20 **Subsection (e)(3). Broad** Investment **Authority.** Consistent with the portfolio theory
21 of investment, this subsection permits a broad range of investments. The language
22 derives from UPIA § 2(e).

23 Section 4 of UMIFA indicated that an institution could invest "without restriction to
24 investments a fiduciary may make." The committee removed this language from
25 subsection (e)(3) as unnecessary, because states no longer have legal lists restricting
26 fiduciary investing to the specific types of investments identified in statutory lists.

27 Subsection (e)(3) also provides that other law may limit the authority under this
28 subsection. In addition, all of subsection (e) is subject to contrary provisions in a gift
29 instrument, and a gift instrument may restrict the ability to invest in particular assets. For
30 example, the gift instrument for a particular institutional fund might preclude the
31 institution from investing the assets of the fund in companies that produce tobacco
32 products.

33 In her book, Governing Nonprofit Organizations: Federal and State Law and
34 Regulation 434 (Harv. Univ. Press 2004), Marion R. Fremont-Smith reports that some
35 large charities pledge their endowment funds as security for loans. Subsection (e)(3)
36 permits this sort of debt financing, subject to the guidelines of subsection (e)(1).

37 **Subsection (e)(4). Duty to Diversify.** This subsection assumes that prudence
38 requires diversification but permits an institution to determine that nondiversification is
39 appropriate under exceptional circumstances. A decision not to diversify must be based
40 on the needs of the charity and not solely for the benefit of a donor. A decision to retain
41 property in the hope of obtaining additional contributions from the same donor may be

considered made for the benefit of the charity, but the appropriateness of that decision will depend on the circumstances. This subsection derives its language from UPIA § 3. *See* UPIA § 3 cmt. (discussing the rationale for diversification); Restatement (Third) of Trusts: Prudent Investor Rule § 227 (1992).

Subsection (e)(5). Disposing of Unsuitable Assets. This subsection imposes a duty on an institution to review the suitability of retaining property contributed to the institution within a reasonable period of time after the institution receives the property. Subsection (e)(5) requires the institution to make a decision but does not require a particular outcome. The institution may consider a variety of factors in making its decision, and a decision to retain the property either for a period of time or indefinitely may be a prudent decision.

Section 4(2) of UMIFA specifically authorized an institution to retain property contributed by a donor. The comment explained that an institution might retain property in the hope of obtaining additional contributions from the donor. Under UPMIFA the potential for developing additional contributions by retaining property contributed to the institution would be among the "other circumstances" that the institution might consider in deciding whether to retain or dispose of the property. The institution must weigh the potential for obtaining additional contributions with all other factors that affect the suitability of retaining the property in the investment portfolio.

The language of subsection (e)(5) comes from UPIA § 4, which restates Restatement (Third) of Trusts: Prudent Investor Rule § 229 (1992), which adopted language from Restatement (Second) of Trusts § 231 (1959). *See* UPIA § 4 cmt.

Subsection (e)(6). Special Skills or Expertise. Subsection (e)(6) states the rule provided in UPIA § 2(f) requiring a trustee to use the trustee's own skills and expertise in carrying out the trustee's fiduciary duties. The comment to RMNCA § 8.30 describes the existence of a similar rule under the law of nonprofit corporations. Section 8.30(a)(2) provides that in discharging duties a director must act "with the care an ordinarily prudent person in a like position would exercise under similar circumstances. . . ." The comment explains that"[t]he concept of 'under similar circumstances' relates not only to the circumstances of the corporation but to the special background, qualifications, and management experience of the individual director and the role the director plays in the corporation." After describing directors chosen for their ability to raise money, the comment notes that "[n]o special skill or expertise should be expected from such directors unless their background or knowledge evidences some special ability."

The intent of subsection (e)(6) is that a person managing or investing institutional funds must use the person's own judgment and experience, including any particular skills or expertise, in carrying out the management or investment duties. For example, if a charity names a person as a director in part because the person is a lawyer, the lawyer's background may allow the lawyer to recognize legal issues in connection with funds held by the charity. The lawyer should identify the issues for the board, but the lawyer is not expected to provide legal advice. A lawyer is not expected to be able to recognize every legal issue, particularly issues outside the lawyer's area of expertise, simply because the board member is lawyer. *See* ALI Principles of the Law of Nonprofit Organizations, Preliminary Draft No. 3 (May 12, 2005) § 315 (Duty of Care), cmt. c.

1 UMIFA contained two provisions that authorized investments in pooled or common
2 investment funds. UMIFA §§ 4(3), 4(4). The Drafting Committee concluded that Section
3 3(e)(3) of UPMIFA authorizes these investments. The decision not to include the two
4 provisions in UPMIFA implies no disapproval of such investments.

5 **§5104. Appropriation for expenditure or accumulation of endowment fund; rules of**
6 **construction**

7 **1. Appropriate; accumulate; donor-restricted; good faith; care.** Subject to the
8 intent of a donor expressed in the gift instrument, an institution may appropriate for
9 expenditure or accumulate so much of an endowment fund as the institution determines is
10 prudent for the uses, benefits, purposes and duration for which the endowment fund is
11 established. Unless stated otherwise in the gift instrument, the assets in an endowment
12 fund are donor-restricted assets until appropriated for expenditure by the institution. In
13 making a determination to appropriate or accumulate, the institution shall act in good
14 faith, with the care that an ordinarily prudent person in a like position would exercise
15 under similar circumstances, and shall consider, if relevant, the following factors:

16 A. The duration and preservation of the endowment fund;

17 B. The purposes of the institution and the endowment fund;

18 C. General economic conditions;

19 D. The possible effect of inflation or deflation;

20 E. The expected total return from income and the appreciation of investments;

21 F. Other resources of the institution; and

22 G. The investment policy of the institution.

23 **2. Limitation.** To limit the authority to appropriate for expenditure or accumulate
24 under subsection 1, a gift instrument must specifically state the limitation.

25 **3. Terms.** Terms in a gift instrument designating a gift as an endowment, or a
26 direction or authorization in the gift instrument to use only "income," "interest,"
27 "dividends" or "rents, issues or profits," or "to preserve the principal intact" or words of
28 similar import:

29 A. Create an endowment fund of permanent duration unless other language in the
30 gift instrument limits the duration or purpose of the fund; and

31 B. Do not otherwise limit the authority to appropriate for expenditure or accumulate
32 under subsection 1.

33 **Uniform Comment**

34 (This is Section 4 of the Uniform Prudent Management of Institutional Funds Act
35 (2006).)

36 **Purpose and Scope of Revisions.** This section revises the provision in UMIFA that
37 permitted the expenditure of appreciation of an endowment fund to the extent the fund
38 had appreciated in value above the fund's historic dollar value. UMIFA defined historic
39 dollar value to mean all contributions to the fund, valued at the time of contribution.

1 Instead of using historic dollar value as a limitation, UPMIFA applies a more carefully
2 articulated prudence standard to the process of making decisions about expenditures from
3 an endowment fund. The expenditure rule of Section 4 applies only to the extent that a
4 donor and an institution have not reached some other agreement about spending from an
5 endowment. If a gift instrument sets forth specific requirements for spending, then the
6 charity must comply with those requirements. However, if the gift instrument uses more
7 general language, for example directing the charity to "hold the fund as an endowment"
8 or "retain principal and spend income," then Section 4 provides a rule of construction to
9 guide the charity.

10 Prior to the promulgation of UMIFA, "income" for trust accounting purposes meant
11 interest and dividends but not capital gains, whether or not realized. Many institutions
12 assumed that trust accounting principles applied to charities organized as nonprofit
13 corporations, and the rules limited the institutions' ability to invest their endowment
14 funds effectively. UMIFA addressed this problem by construing "income" in gift
15 instruments to include a prudent amount of capital gains, both realized and unrealized.
16 Under UMIFA an institution could spend appreciation in addition to spending income
17 determined under trust accounting rules. This rule of construction likely carried out the
18 intent of the donor better than a rule limiting spending to trust accounting income, while
19 permitting the charity to invest in a manner that could generate better returns for the fund.

20 UPMIFA also applies a rule of construction to terms like "income" or "endowment."
21 The assumption in the Act is that a donor who uses one of these terms intends to create a
22 fund that will generate sufficient gains to be able to make ongoing distributions from the
23 fund while at the same time preserving the purchasing power of the fund. Because
24 historic dollar value under UMIFA was a number fixed in time, the use of that approach
25 may not have adequately captured the intent of a donor who wanted the endowment fund
26 to continue to maintain its value in current dollars. UPMIFA takes a different approach,
27 directing the institution to determine spending based on the total assets of the endowment
28 fund rather than determining spending by adding a prudent amount of appreciation to
29 trust accounting income.

30 UPMIFA requires the persons making spending decisions for an endowment fund to
31 focus on the purposes of the endowment fund as opposed to the purposes of the
32 institution more generally, as was the case under UMIFA. When the institution considers
33 the purposes and duration of the fund, the institution will give priority to the donor's
34 general intent that the fund be maintained permanently. Although the Act does not
35 require that a specific amount be set aside as "principal," the Act assumes that the charity
36 will act to preserve "principal" (i.e., to maintain the purchasing power of the amounts
37 contributed to the fund) while spending "income" (i.e. making a distribution each year
38 that represents a reasonable spending rate, given investment performance and general
39 economic conditions). Thus, an institution should monitor principal in an accounting
40 sense, identifying the original value of the fund (the historic dollar value) and the
41 increases in value necessary to maintain the purchasing power of the fund.

42 **Subsection (a). Expenditure of Endowment Funds.** Subsection (a) uses the
43 RMNCA articulation of the standard of care for decision making under Section 4. The

change in language does not reflect a substantive change. The comment to Section 3 more fully describes that standard of care.

Section 4 permits expenditures from an endowment fund to the extent the institution determines that the expenditures are prudent after considering the factors listed in subsection (a). These factors emphasize the importance of the intent of the donor, as expressed in a gift instrument. Section 4 looks to written documents as evidence of donor's intent and does not require an institution to rely on oral expressions of intent. By requiring written evidence of intent, the Act protects reliance by the donor and the institution on the written terms of a donative agreement. Informal conversations may be misremembered and may be subject to multiple interpretations. Of course, oral expressions of intent may guide an institution in further carrying out a donor's wishes and in understanding a donor's intent.

The factors in subsection (a) require attention to the purposes of the institution and the endowment fund, economic conditions, and present and reasonably anticipated resources of the institution. As under UMIFA, determinations under Section 4 do not depend on the characterization of assets as income or principal and are not limited to the amount of income and unrealized appreciation. The authority in Section 4 is permissive, however, and an institution organized as a trust may continue to make spending decisions under trust accounting principles so long as doing so is prudent.

Institutions have operated effectively under UMIFA and have operated more conservatively than the historic dollar value rule would have permitted. Institutions have little incentive to maximize allowable spending. Good practice has been to provide for modest expenditures while maintaining the purchasing power of a fund. Institutions have followed this practice even though UMIFA (1) does not require an institution to maintain a fund's purchasing power and (2) does allow an institution to spend any amounts in a fund above historic dollar value, subject to the prudence standard. The Drafting Committee concluded that eliminating historic dollar value and providing institutions with more discretion would not lead to depletion of endowment funds. Instead, UPMIFA should encourage institutions to establish a spending policy that will be responsive to short-term fluctuations in the value of the fund. Section 4 allows an institution to maintain appropriate levels of expenditures in times of economic downturn or economic strength. In some years, accumulation rather than spending will be prudent, and in other years an institution may appropriately make expenditures even if a fund has not generated investment return that year.

Several levels of safeguard exist to prevent an institution from depleting an endowment fund or diverting assets from the purposes for which the fund was created. In comparison with UMIFA, UPMIFA provides greater direction to the institution with respect to making a prudent determination about spending from an endowment. UMIFA told the decision maker to consider "long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions." UPMIFA clarifies that in making spending decisions the institution should attempt to ensure that the value of the fund endures while still providing that some amounts be spent for the purposes of the

1 endowment fund. In UPMIFA prudent decision making emphasizes the endowment
2 aspect of the fund, rather than the overall purposes or needs of the institution.

3 In addition to the guidance provided by Section 4, other safeguards exist. Donors can
4 restrict gifts and can provide specific instructions to donee institutions regarding
5 appropriate uses for assets contributed. Within institutions, fiduciary duties govern the
6 persons making decisions on expenditures. Those persons must operate both with the best
7 interests of the institution in mind and in keeping with the intent of donors. If an
8 institution diverts an institutional fund from the charitable purposes of the institution, the
9 state attorney general can enforce the charitable interests of the public. By relying on
10 these safeguards while providing institutions with adequate discretion to make
11 appropriate expenditures, the Act creates a standard that takes into consideration the
12 diversity of the charitable sector. The committee expects that accumulated experience
13 with such spending formulas will continue to inform institutional practice under the Act.

14 **Distinguishing Legal and Accounting Standards.** Deleting historic dollar value
15 does not transform any portion of an endowment fund into unrestricted assets from a legal
16 standpoint. An endowment fund is restricted because of the donor's intent that the fund
17 be restricted by the prudent spending rule, that the fund not be spent in the current year,
18 and that the fund continue to maintain its value for a long time. Regardless of the
19 treatment of endowment fund from an accounting standpoint, legally an endowment fund
20 should not be considered unrestricted. Subsection (a) states that endowment funds will be
21 legally restricted until the institution appropriates funds for expenditure. The UMIFA
22 statutes in Utah and Maine contain similar language. 13 Me. Rev. Stat. Ann. tit. 13 §
23 4106 (West 2005); Utah Code Ann. 1953 § 13-29-3 (2005). *See, also*, advisory
24 published by Mass. Attorney General, "The Attorney General's Position on FASB
25 Statement of Financial Accounting Standards No. 117, ¶ 22 and Related G.L.C. 180A
26 Issues" (January 2004) http://www.ago.state.ma.us/filelibrary/fasb.pdf (last visited May
27 22, 2006) (concerning the treatment of endowments as legally restricted assets).

28 The term "endowment fund" includes funds that may last in perpetuity but also funds
29 that are created to last for a fixed term of years or until the institution achieves a specified
30 objective. Section 4 requires the institution to consider the intended duration of the fund
31 in making determinations about spending. For example, if a donor directs that a fund be
32 spent over 20 years, Section 4 will guide the institution in making distribution decisions.
33 The institution would amortize the fund over 20 years rather than try to maintain the fund
34 in perpetuity. For an endowment fund of limited duration, spending at a rate higher than
35 rates typically used for endowment spending will be both necessary and prudent.

36 **Subsection (c). Rule of Construction.** Donor's intent must be respected in the
37 process of making decisions to expend endowment funds. Section 4 does not allow an
38 institution to convert an endowment fund into a non-endowment fund nor does the
39 section allow the institution to ignore a donor's intent that a fund be maintained as an
40 endowment. Rather, subsection (c) provides rules of construction to assist institutions in
41 interpreting donor's intent. Subsection (c) assumes that if a donor wants an institution to
42 spend "only the income" from a fund, the donor intends that the fund both support current
43 expenditures and be preserved permanently. The donor is unlikely to be concerned about
44 designation of particular returns as "income" or "principal" under accounting principles.

Rather the donor is more likely to assume that the institution will use modern total-return investing techniques to generate enough funds to distribute while maintaining the long-term viability of the fund. Subsection (c) is an intent effectuating provision that provides default rules to construe donor's intent.

As subsection (b) explains, a donor who wants to specify particular spending guidelines can do so. For example, a donor might require that a charity spend between three and five percent of an endowed gift each year, regardless of investment performance or other factors. Because the charity agrees to the restriction in accepting the gift, the restriction will govern spending decisions by the charity. Another donor might want to limit expenditures to trust accounting income and not want the institution to be able to expend appreciation. An instruction to "pay only the income" will not be specific enough, but an instruction to "pay only interest and dividend income earned by the fund and not to make other distributions of the kind authorized by Section 4 of UPMIFA" should be sufficient. If a donor indicates that the rules on investing or expenditures under Section 4 do not apply to a particular fund, then as a practical matter the institution will probably invest the fund separately. Thus, a decision by a donor to require fund specific expenditure rules will likely also have consequences in the way the institution invests the fund.

Retroactive Application of the Rule of Construction. A constructional rule resolves an ambiguity, in this case, because donors use words like endowment or income without specific directions regarding the intended meaning. Changing a statutory constructional rule does not change the underlying intent, and instead changes the way an ambiguity is resolved, in an attempt to increase the likelihood of giving effect to the intent of most donors.

If a donor has stated in a gift instrument specific directions as to spending, then the institution must respect those wishes, but many donors do not give precise instructions about how to spend endowment funds. In Section 4 UPMIFA provides guidance for giving effect to a donor's intent when the donor has not been specific. Like Section 3 of UMIFA, Section 4 of UPMIFA is a rule of construction, so it does not violate either donor intent or the Constitution.

The issue of whether to apply a rule of construction retroactively was considered in connection with UMIFA. When the New Hampshire legislature considered UMIFA, the Senate asked the New Hampshire Supreme Court for an opinion regarding whether UMIFA, if adopted, would violate a provision of the state constitution prohibiting retrospective laws, and also whether the statute would encroach on the functions of the judicial branch. The opinion answered no to both questions. Opinion of the Justices, Request of the Senate No. 6667, 113 N.H. 287, 306 A.2d 55 (1973).

More recently the Colorado Supreme Court considered the retroactive application of another constructional statute, one that deems the designation of a spouse as the beneficiary of a life insurance policy to be revoked in a case in which the marriage was dissolved after the naming of the spouse as beneficiary. In re Estate of DeWitt, 54 P. 3d 849 (Colo. 2002). In holding that retroactive application of the statute did not violate the Contracts Clause, the court cited approvingly from a statement prepared by the Joint Editorial Board for Uniform Trusts and Estates Acts (JEB). JEB Statement Regarding the

1 Constitutionality of Changes in Default Rules as Applied to PreExisting Documents, 17
2 Am. Coll. Tr. & Est. Couns. Notes 184 app. II (1991).

3 The JEB Statement explains that the purpose of the anti-retroactivity norm is to
4 protect a transferor who relies on existing rules of law. By definition, however, rules of
5 construction apply only in situations in which a transferor did not spell out his or her
6 intent and hence did not rely on the then-current rule of construction. *See also In re*
7 *Gardner's Trust*, 266 Minn. 127, 132, 123 N.W. 2d 69, 73 (1963) ("[I]t is doubtful
8 whether the testatrix had any clear intention in mind at the time the will was executed. It
9 is equally plausible that if she had thought about it at all she would have desired to have
10 the dividends go where the law required them to go at the time they were received by the
11 trustee.") (Uniform Principal and Income Act).

12 Non-retroactivity would produce serious practical problems: If the Act were not
13 retroactive, a charity would need to keep two sets of books for each endowment fund
14 created before the enactment of UPMIFA, if new funds were added after the enactment.
15 The burden that such a rule would impose is out of proportion to the benefit sought.

16 **Subsection (d). Rebuttable Presumption of Imprudence.** The Drafting
17 Committee debated at length whether to include a presumption of imprudence for
18 spending above a fixed percentage of the value of the fund. The Drafting Committee
19 decided to include a presumption in the Act in brackets, as an option for states to
20 consider, and to include in these Comments a discussion of the advantages and
21 disadvantages of including a presumption in the Act.

22 Some who commented on the Act viewed the presumption as linked to the retroactive
23 application of the rule of construction of subsection (c). A donor who contributed to an
24 endowment fund under UMIFA may have assumed that the historic dollar value of the
25 gift would be subject to a no-spending rule under the statute. Because UPMIFA removes
26 the concept of historic dollar value, the bracketed presumption of imprudence would
27 assure the donor that spending from an endowment fund will be so limited.

28 Those in favor of the presumption of imprudence argued that the presumption would
29 curb the temptation that a charity might have to spend endowment assets too rapidly.
30 Although the presumption would be rebuttable, and spending above the identified
31 percentage might, in some years and for some charities, be prudent, institutions would
32 likely be reluctant to authorize spending above seven percent. In addition, the
33 presumption would give the attorney general a benchmark of sorts.

34 A variety of considerations cut against including a presumption of imprudence in the
35 statute. A fixed percentage in the statute might be perceived as a safe harbor that could
36 lead institutions to spend more than is prudent. Although the provision should not be
37 read to imply that spending below seven percent will be considered prudent, some
38 charities might interpret the statute in that way. Decision makers might be pressured to
39 spend up to the percentage, and in doing so spend more than is prudent, without adequate
40 review of the prudence factors as required under the Act.

41 Perhaps the biggest problem with including a presumption in the statute is the
42 difficulty of picking a number that will be appropriate in view of the range of institutions

and charitable purposes and the fact that economic conditions will change over time. Under recent economic conditions, a spending rate of seven percent is too high for most funds, but in a period of high inflation, seven percent might be too low. In making a prudent decision regarding how much to spend from an endowment fund, each institution must consider a variety of factors, including the particular purposes of the fund, the wishes of the donors, changing economic factors, and whether the fund will receive future donations.

Whether or not a statute includes the presumption, institutions must remember that prudence controls decision making. Each institution must make decisions on expenditures based on the circumstances of the particular charity.

Application of Presumption. For a state wishing to adopt a presumption of imprudence, subsection (d) provides language. Under subsection (d), a rebuttable presumption of imprudence will arise if expenditures in one year exceed seven percent of the assets of an endowment fund. The subsection applies a rolling average of three or more years in determining the value of the fund for purposes of calculating the seven-percent amount. An institution can rebut the presumption of imprudence if circumstances in a particular year make expenditures above that amount prudent. The concept and the language for the presumption of imprudence comes from Mass. Gen. L. ch. 180A, § 2 (2004). Massachusetts enacted this rule in 1975 as part of its UMIFA statute. New Mexico adopted the same presumption in 1978. N.M.S.A. § 46-9-2 (C) (2004). New Hampshire has a similar provision. N.H. Rev. Stat. § 292-B:6.

The period that a charity uses to calculate the presumption (three or more years) and the frequency of valuation (at least quarterly) will be binding in any determination of whether the presumption applies. For example, if a charity values an endowment fund on a quarterly basis and averages the quarterly values over three years to determine the fair market value of the fund for purposes calculating seven percent of the fund, the charity's choices of three years as a smoothing period and quarterly as a valuation period cannot be challenged. If the charity makes an appropriation that is less than seven percent of this value, then the presumption of imprudence does not arise even if the appropriation would exceed seven percent of the value of the fund calculated based on monthly valuations averaged over five years.

If sufficient evidence establishes, by the preponderance of the evidence, the facts necessary to raise the presumption of imprudence, then the institution will have to carry the burden of production of (i.e., the burden of going forward with) other evidence that would tend to demonstrate that its decision was prudent. The existence of the presumption does not shift the burden of persuasion to the charity.

Expenditures from an endowment fund may include distributions for charitable purposes and amounts used for the management and administration of the fund, including annual charges for fundraising. The value of a fund, as calculated for purposes of determining the seven percent amount, will reflect increases due to contributions and investment gains and decreases due to distributions and investment losses. The seven percent figure includes charges for fundraising and administrative expenses other than investment management expenses. All costs or fees associated with an endowment fund are factors that prudent decision makers consider. High costs or fees of investment

1 management could be considered imprudent regardless of whether spending exceeds
2 seven percent of the fund's value.

3 The presumption of imprudence does not create an automatic safe harbor.
4 Expenditures at six percent might well be imprudently high. See James P. Garland, *The*
5 *Fecundity of Endowments and Long-Duration Trusts*, The Journal of Portfolio
6 Management (2005). Evidence reviewed by the Drafting Committee suggests that at
7 present few funds can sustain spending at a rate above five percent. *See* Roger G.
8 Ibbotson & Rex A. Sinquefield, Stocks, Bonds, Bills, and Inflation: Historical Returns
9 (1926-1987) (Research Foundation of the Institute of Chartered Financial Analysts,
10 1989). Indeed, under current conditions five percent can be too high. *See* Joel C. Dobris,
11 *Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust*
12 *and Spending Rate on Settlors, Their Advisers, and Retirees*, 40 Real Prop. Prob. & Tr. J.
13 39 (2005). Further, spending at a lower rate, particularly in the early years of an
14 endowment, may result in greater distributions over time. *See* DeMarche Associates, Inc,
15 Spending Policies and Investment Planning for Foundations: A Structure for Determining
16 a Foundation's Asset Mix (Council on Foundations: 3d ed. 1999). A presumption of
17 imprudence can serve as a reminder that spending at too high a rate will jeopardize the
18 long-term nature of an endowment fund. If an endowment fund is intended to continue
19 permanently, the institution should take special care to limit annual spending to a level
20 that protects the purchasing power of the fund.

21 Subsection (d) provides that the terms of the gift instrument can provide additional
22 spending authority. For example, if a gift instrument directs that an institution expend a
23 fund over a ten-year period, exhausting the fund after ten years, spending at a rate higher
24 than seven percent will be necessary.

25 Subsection (d) does not require an institution to spend a minimum amount each year.
26 The prudence standard and the needs of the institution will supply sufficient guidance
27 regarding whether to accumulate rather than to spend in a particular year.

28 Spending above seven percent in any one year will not necessarily be imprudent. For
29 some endowment funds fluctuating spending rates may be appropriate. Although the Act
30 does not apply the percentage for the presumption on a rolling basis (e.g., 21 percent over
31 three years), some endowment funds may prudently spend little or nothing in some years
32 and more than seven percent in other years. For example, a charity planning a
33 construction project might decide to spend nothing from an endowment for three years
34 and then in the fourth year might spend 20 percent of the value of the fund for
35 construction costs. The decision to accumulate in years one through three and then to
36 spend 20 percent in the fourth year might be prudent for the charity, depending on the
37 other factors. The charity should maintain adequate records during the accumulation
38 period and should document the decision-making process in the fourth year to be able to
39 meet the burden of production associated with the presumption. Another charity might
40 prudently spend 20 percent in year one and nothing for the following three years. That
41 charity would also need to document the decision-making process through which the
42 decision to spend occurred and maintain records explaining why the decision was prudent
43 under the circumstances.

1 A charity might establish a "capital replacement fund" designed to provide funds to
2 the institution for repair or replacement of major items of equipment. Disbursements
3 from such a fund will likely fluctuate, with limited expenditures in some years and big
4 expenditures in others. The fund would not exhibit a uniform spending rate. Indeed, an
5 advantage of a capital replacement fund is the ability to absorb a significant capital
6 expenditure in a single year without a negative impact on the operating budget of the
7 institution. Disbursements might average five percent per year but would vary, with
8 spending in some years more and in some years less. Even if this fund is an endowment
9 fund subject to Section 4, spending above seven percent in a particular year could well be
10 prudent. Subsection (d) does not preclude spending above seven percent.

11 A charity creating a capital replacement fund or a building fund might chose to adopt
12 spending rules for the fund that would not be subject to UPMIFA. Specific donor intent
13 can supersede the rules of UPMIFA. If the charity creates a gift instrument that
14 establishes appropriate rules on spending for the fund, and if donors agree to those
15 restrictions, then the UPMIFA rules on spending, including the bracketed presumption,
16 will not apply.

17 **Institutions with Limited Investment and Spending Experience.** Several
18 attorneys general and other charity officials raised concerns about whether small
19 institutions would be able to adjust to a spending rule based solely on prudence, without
20 the bright-line guidance of historic dollar value. Some charity regulators who spoke with
21 the Drafting Committee noted that large institutions have sophisticated investment
22 strategies, access to good investment advisors, and experience with spending rules that
23 maintain purchasing power for endowment funds. For these institutions, the rules of
24 UPMIFA should work well. For smaller institutions, however, the state regulators
25 thought that additional guidance could be helpful. After discussing strategies to address
26 this concern, the Drafting Committee decided to include in these comments an additional
27 optional provision that a state could choose to include in its UPMIFA statute.

28 The optional provision focuses on institutions with endowment funds valued, in the
29 aggregate, at less than $2,000,000. The number is in brackets to indicate that it could be
30 set higher or lower. The number was chosen to address the concern of the state regulators
31 that some small charities might be more likely to spend imprudently than large charities.
32 The Drafting Committee selected $2,000,000 as the value that might include most
33 unsophisticated institutions but would not be overinclusive.

34 The optional provision creates a notification requirement for an institution with a
35 small endowment that plans to spend below historic dollar value. If an institution subject
36 to the provision decides to appropriate an amount that would cause the value of its
37 endowment funds to drop below the aggregate historic dollar value for all of its
38 endowment funds, then the institution will have to notify the attorney general before
39 proceeding with the expenditure. The provision does not require that the institution
40 obtain the approval of the attorney general before making the distribution. Rather, the
41 notification requirement gives the attorney general the opportunity to take a closer look at
42 the institution and its spending decision, to educate the institution on prudent decision
43 making for endowment funds, and to intervene if the attorney general determines that the
44 spending would be imprudent for the institution. Although the Drafting Committee

thinks that the prudence standard in UPMIFA provides adequate guidance to all institutions within the scope of the Act, if a state chooses to adopt a notification provision for institutions with small endowments, the Drafting Committee recommends the following language:

(-) If an institution has endowment funds with an aggregate value of less than [$2,000,000], the institution shall notify the [Attorney General] at least [60 days] prior to an appropriation for expenditure of an amount that would cause the value of the institution's endowment funds to fall below the aggregate historic dollar value of the institution's endowment funds, unless the expenditure is permitted or required under law other than this [act] or in the gift instrument. For purposes of this subsection, "historic dollar value" means the aggregate value in dollars of (i) each endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time the donation is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. The institution's determination of historic dollar value made in good faith is conclusive.

§5105. Delegation of management and investment functions

1. Delegation. Subject to any specific limitation set forth in a gift instrument or in law other than this chapter, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances. An institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in:

A. Selecting an agent;

B. Establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and

C. Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

2. Agent's duty. In performing a delegated function, an agent owes a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.

3. Liability of institution. An institution that complies with subsection 1 is not liable for the decisions or actions of an agent to which the function was delegated.

4. Submits to jurisdiction. By accepting delegation of a management or investment function from an institution that is subject to the laws of this State, an agent submits to the jurisdiction of the courts of this State in all proceedings arising from or related to the delegation or the performance of the delegated function.

5. Committees; officers; employees. An institution may delegate management and investment functions to its committees, officers or employees as authorized by the laws of this State other than provisions of this chapter.

Uniform Comment

(This is Section 5 of the Uniform Prudent Management of Institutional Funds Act (2006).)

The prudent investor standard in Section 4 presupposes the power to delegate. For some types of investment, prudence requires diversification, and diversification may best be accomplished through the use of pooled investment vehicles that entail delegation. The Drafting Committee decided to put Section 5 in brackets because many states already provide sufficient authority to delegate authority through other statutes. If such authority exists, then an enacting state should enact UPMIFA without Section 5. Enacting delegation rules that duplicate existing rules could be confusing and might create conflicts. For charitable trusts, UPIA provides the same delegation rules as those in Section 5. For nonprofit corporations, nonprofit corporation statutes often provide comparable rules. A state enacting UPMIFA must be certain that its laws authorize delegation, either through other statutes or by enacting Section 5.

Section 5 incorporates the delegation rule found in UPIA § 9, updating the delegation rules in UMIFA § 5. Section 5 permits the decision makers in an institution to delegate management and investment functions to external agents if the decision makers exercise reasonable skill, care, and caution in selecting the agent, defining the scope of the delegation and reviewing the performance of the agent. In some circumstances, the scope of the delegation may include redelegation. For example, an institution may select an investment manager to assist with investment decisions. The delegation may include the authority to redelegate to investment managers with expertise in particular investment areas. All decisions to delegate require the exercise of reasonable care, skill, and caution in selecting, instructing, and monitoring agents. Further, decision makers cannot delegate the authority to make decisions concerning expenditures and can only delegate management and investment functions. Subsection (c) protects decision makers who comply with the requirement for proper delegation from liability for actions or decisions of the agents. In making decisions concerning delegation, the institution must be mindful of Section 3(c)(1) of UPMIFA, the provision that directs the institution to incur only reasonable costs in managing and investing an institutional fund.

Section 5 does not address issues of internal delegation and potential liability for internal delegation, and subsection (c) does not affect laws that govern personal liability of directors or trustees for matters outside the scope of Section 5. Directors will look to nonprofit corporation laws for these rules, while trustees will look to trust law. *See, e.g.*, RMNCA, § 8.30(b) (permitting directors to rely on information prepared by an officer or employee of the institution if the director reasonably believes the officer or employee to be reliable and competent in the matters presented).

The language of subsection (c) is similar to that of UPIA § 9(c) and RMNCA § 8.30(d). The decision not to include the terms "beneficiaries" or "members" in subsection (c) does not indicate a decision that this section does not create immunity from claims brought by beneficiaries or members. Instead, a decision maker who complies with section 5 will be protected from any liability resulting from actions or decisions made by an external agent.

Subsection (d) creates personal jurisdiction over the agent. This subsection is not a choice of law rule.

Subsection (e) notes that law other than this Act governs internal delegation. Section 5 of UMIFA included internal delegation as well as external delegation, due to a concern at that time that trust law concepts might govern internal delegation in nonprofit corporations. With the widespread adoption of nonprofit corporation statutes, that concern no longer exists. The decision not to address internal delegation in UPMIFA does not suggest that a governing board of a nonprofit corporation cannot delegate to committees, officers, or employees. Rather, a nonprofit corporation must look to other law, typically a nonprofit corporation statute, for the rules governing internal delegation.

§5106. Release or modification of restrictions on management, investment or purpose

1. Release or modification of restriction with consent. If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment or purpose of an institutional fund. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

2. Modification of restriction by court. The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The institution shall notify the Attorney General of the application and the Attorney General must be given an opportunity to be heard. To the extent practicable, any modification must be made in accordance with the donor's probable intention.

3. Modification by court when unlawful, impracticable, impossible or wasteful restriction. If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument. The institution shall notify the Attorney General of the application and the Attorney General must be given an opportunity to be heard.

4. Release or modification by institution. If an institution determines that a restriction contained in a gift instrument on the management, investment or purpose of an institutional fund is unlawful, impracticable, impossible to achieve or wasteful, the institution, 60 days after notification to the Attorney General, may release or modify the restriction, in whole or part, if:

A. The institutional fund subject to the restriction has a total value of less than $100,000, except that the dollar limit established in this paragraph must be adjusted for inflation in accordance with the annual percentage change in the Consumer Price

Index for all Urban Consumers, CPI-U, as compiled by the United States Department of Labor, Bureau of Labor Statistics, or its successor index, using 2007 as the base year. On or before January 1, 2010, and each even-numbered year thereafter, the Attorney General shall calculate the adjusted dollar amount for the next 2-year cycle using inflation for the prior 2 calendar years as of the date of the calculation. The adjusted exemption must be rounded upward to the nearest $100 increment. The Attorney General shall certify the amount of the adjustment for the next 2-year cycle and shall publish the amount on the Attorney General's publicly accessible website;

B. More than 20 years have elapsed since the fund was established; and

C. The institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument.

Uniform Comment

(This is Section 6 of the Uniform Prudent Management of Institutional Funds Act (2006).)

Section 6 expands the rules on releasing or modifying restrictions that are found in Section 7 of UMIFA. Subsection (a) restates the rule from UMIFA allowing the release of a restriction with donor consent. Subsections (b) and (c) make clear that an institution can always ask a court to apply equitable deviation or cy pres to modify or release a restriction, under appropriate circumstances. Subsection (d), a new provision, permits an institution to apply cy pres on its own for small funds that have existed for a substantial period of time, after giving notice to the state attorney general.

Although UMIFA stated that it did not "limit the application of the doctrine of *cy pres*", UMIFA § 7(d), what that statement meant under the Act was unclear. UMIFA itself appeared to permit only a release of a restriction and not a modification. That all-or-nothing approach did not adequately protect donor intent. *See* Yale Univ. v. Blumenthal, 621 A.2d 1304 (Conn. 1993). By expressly including deviation and cy pres, UPMIFA requires an institution to seek modifications that are "in accordance with the donor's probable intention" for deviation and "in a manner consistent with the charitable purposes expressed in the gift instrument" for cy pres.

Individual Funds. The rules on modification require that the institution, or a court applying a court-ordered doctrine, review each institutional fund separately. Although an institution may manage institutional funds collectively, for purposes of this Section each fund must be considered individually.

Subsection (a). Donor Release. Subsection (a) permits the release of a restriction if the donor consents. A release with donor consent cannot change the charitable beneficiary of the fund. Although the donor has the power to consent to a release of a restriction, this section does not create a power in the donor that will cause a federal tax problem for the donor. The gift to the institution is a completed gift for tax purposes, the property cannot be diverted from the charitable beneficiary, and the donor cannot redirect the property to another use by the charity. The donor has no retained interest in the fund.

Subsection (b). Equitable Deviation. Subsection (b) applies the rule of equitable deviation, adapting the language of UTC § 412 to this section. *See also* Restatement

(Third) of Trusts § 66 (2003). Under the deviation doctrine, a court may modify restrictions on the way an institution manages or administers a fund in a manner that furthers the purposes of the fund. Deviation implements the donor's intent. A donor commonly has a predominating purpose for a gift and, secondarily, an intent that the purpose be carried out in a particular manner. Deviation does not alter the purpose but rather modifies the means in order to carry out the purpose.

Sometimes deviation is needed on account of circumstances unanticipated when the donor created the restriction. In other situations the restriction may impair the management or investment of the fund. Modification of the restriction may permit the institution to carry out the donor's purposes in a more effective manner. A court applying deviation should attempt to follow the donor's probable intention in deciding how to modify the restriction. Consistent with the doctrine of equitable deviation in trust law, subsection (b) does not require an institution to notify donors of the proposed modification. Good practice dictates notifying any donors who are alive and can be located with a reasonable expenditure of time and money. Consistent with the doctrine of deviation under trust law, the institution must notify the attorney general who may choose to participate in the court proceeding. The attorney general protects donor intent as well as the public's interest in charitable assets. Attorney general is in brackets in the Act because in some states another official enforces the law of charities.

Subsection (c). Cy Pres. Subsection (c) applies the rule of cy pres from trust law, authorizing the court to modify the purpose of an institutional fund. The term "modify" encompasses the release of a restriction as well as an alteration of a restriction and also permits a court to order that the fund be paid to another institution. A court can apply the doctrine of cy pres only if the restriction in question has become unlawful, impracticable, impossible to achieve, or wasteful. This standard, which comes from UTC § 413, updates the circumstances under which cy pres may be applied by adding "wasteful" to the usual common law articulation of the doctrine. Any change must be made in a manner consistent with the charitable purposes expressed in the gift instrument. *See also* Restatement (Third) of Trusts § 67 (2003). Consistent with the doctrine of cy pres, subsection (c) does not require an institution seeking cy pres to notify donors. Good practice will be to notify donors whenever possible. As with deviation, the institution must notify the attorney general who must have the opportunity to be heard in the proceeding.

Subsection (d). Modification of Small, Old Funds. Subsection (d) permits an institution to release or modify a restriction according to cy pres principles but without court approval if the amount of the institutional fund involved is small and if the institutional fund has been in existence for more than 20 years. The rationale is that under some circumstances a restriction may no longer make sense but the cost of a judicial cy pres proceeding will be too great to warrant a change in the restriction. The Drafting Committee discussed at length the parameters for allowing an institution to apply cy pres without court supervision. The Committee drafted subsection (d) to balance the needs of an institution to serve its charitable purposes efficiently with the policy of enforcing donor intent. The Committee concluded that an institutional fund with a value of $25,000 or less is sufficiently small that the cost of a judicial proceeding will be out of proportion to its protective purpose. The Committee included a requirement that the institutional

1 fund be in existence at least 20 years, as a further safeguard for fidelity to donor intent.
2 The 20-year period begins to run from the date of inception of the fund and not from the
3 date of each gift to the fund. The amount and the number of years have been placed in
4 brackets to signal to an enacting jurisdiction that it may wish to designate a higher or
5 lower figure. Because the amount should reflect the cost of a judicial proceeding to
6 obtain a modification, the number may be higher in some states and lower in others.

7 As under judicial cy pres, an institution acting under subsection (d) must change the
8 restriction in a manner that is in keeping with the intent of the donor and the purpose of
9 the fund. For example, if the value of a fund is too small to justify the cost of
10 administration of the fund as a separate fund, the term "wasteful" would allow the
11 institution to combine the fund with another fund with similar purposes. If a fund has
12 been created for nursing scholarships and the institution closes its nursing school, the
13 institution might appropriately decide to use the fund for other scholarships at the
14 institution. In using the authority granted under subsection (d), the institution must
15 determine which alternative use for the fund reasonably approximates the original intent
16 of the donor. The institution cannot divert the fund to an entirely different use. For
17 example, the fund for nursing scholarships could not be used to build a football stadium.

18 An institution seeking to modify a provision under subsection (d) must notify the
19 attorney general of the planned modification. The institution must wait 60 days before
20 proceeding; the attorney general may take action if the proposed modification appears
21 inappropriate.

22 **Notice to Donors.** The Drafting Committee decided not to require notification of
23 donors under subsections (b), (c), and (d). The trust law rules of equitable deviation and
24 cy pres do not require donor notification and instead depend on the court and the attorney
25 general to protect donor intent and the public's interest in charitable assets.

26 With regard to subsection (d), the Drafting Committee concluded that an institution
27 should not be required to give notice to donors. Subsection (d) can only be used for an
28 old and small fund. Locating a donor who contributed to the fund more than 20 years
29 earlier may be difficult and expensive. If multiple donors each gave a small amount to
30 create a fund 20 years earlier, the task of locating all of those donors would be harder
31 still. The Drafting Committee concluded that an institution's concern for donor relations
32 would serve as a sufficient incentive for notifying donors when donors can be located.

33 **§5107. Reviewing compliance**

34 Compliance with this chapter is determined in light of the facts and circumstances
35 existing at the time a decision is made or action is taken and not by hindsight.

36 **§5108. Application to existing institutional funds**

37 This chapter applies to institutional funds existing on or established after July 1,
38 2010. As applied to institutional funds existing on July 1, 2010, this chapter governs only
39 decisions made or actions taken on or after that date.

1 **§5109. Relation to federal Electronic Signatures in Global and National Commerce**
2 **Act**

3 This chapter modifies, limits and supersedes the federal Electronic Signatures in
4 Global and National Commerce Act, 15 United States Code, Section 7001 et seq., but
5 does not modify, limit or supersede 15 United States Code, Section 7001(a), or authorize
6 electronic delivery of any of the notices described in 15 United States Code, Section
7 7003(b).

8 **§5110. Uniformity of application and construction**

9 In applying and construing this uniform Act, consideration must be given to the need
10 to promote uniformity of the law with respect to its subject matter among states that enact
11 it.

12 **§5111. Effective date**

13 This chapter takes effect July 1, 2010.

14 **SUMMARY**

15 This bill repeals the existing Uniform Management of Institutional Funds Act and
16 replaces it with the Uniform Prudent Management of Institutional Funds Act adopted by
17 the National Conference of Commissioners on Uniform State Laws in 2006. The
18 Prefatory Note and Uniform Comments are included.

19 This bill does not include the optional clause identifying 7% as the maximum level of
20 "prudent spending."

21 This bill increases the amount that defines a small fund for which an institution may
22 release or modify a restriction according to cy pres principles but without court approval.
23 The dollar limit is established at $100,000, but must be indexed to inflation by the
24 Attorney General. The restriction may be released or modified only if the fund is at least
25 20 years old and the institution uses the property in a manner consistent with the
26 charitable purposes expressed in the gift instrument.

27 This bill takes effect July 1, 2010.