DRAFT

FOR DISCUSSION ONLY

UNIFORM

MANAGEMENT OF INSTITUTIONAL FUNDS

ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

WITH PREFATORY NOTE AND PRELIMINARY COMMENTS

January 5, 2005

DRAFTING COMMITTEE TO REVISE UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

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REVISION OF UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

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UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

PREFATORY NOTE

In 1972 the National Conference of Commissioners on Uniform State Laws approved the Uniform Management of Institutional Funds Act [hereafter referred to as UMIFA (1972)]. At that time uncertainty existed as to the standards that governed directors of charitable corporations in managing and investing the funds of the charitable organizations. Directors of a charity organized as a nonprofit corporation had been held to the investment standards that applied to trustees of private trusts. *See Lynch v. John M. Redfield Foundation*, 9 Cal. App. 3d 293 (1970), (stating that directors of a charitable corporation are essentially trustees and as such are held to an investment duty similar to that of a trustee of a private trust). *See also* Restatement (Second) of Trusts § 389 (1959). For directors of large institutions, the then-current restrictions on trust investing made the use of modern investment strategies problematic.

UMIFA (1972) provided guidance and authority to the governing boards of those charitable organizations within its scope on several issues. The statute gave a governing board broad investment authority and indicated that a governing board was not restricted to investments authorized for trustees. The statute permitted a board to delegate authority to independent financial advisors. With respect to endowment funds, the statute authorized a governing board to expend unrealized appreciation, even if the endowment fund provided only for the distribution of "income." This provision enabled fund managers to use modern investment techniques such as total-return investing and unitrust-style spending. UMIFA (1972) also permitted the governing board to release restrictions on the use or investment of institutional funds if the donor consented and to release restrictions that had become "obsolete, inappropriate, or impracticable" if a court approved. Thus, the statute provided a modification mechanism for charities organized as corporations similar to the doctrine of cy pres that applies to charitable trusts.

The investment standards adopted by UMIFA (1972) foreshadowed changes to trust investment law in the Uniform Prudent Investor Act (1994) [hereafter referred to as UPIA]. UPIA applies modern portfolio theory to trusts, including charitable trusts. The Uniform Principal and Income Act (1997) furthered the principles of UPIA, providing tools for the use of investment techniques authorized under UPIA. The Uniform Trust Code (2000) [hereafter referred to as the UTC] expanded the application of the doctrine of cy pres. These Uniform Acts have informed the work of the Drafting Committee of the Uniform Management of Institutional Funds Act (200-) [hereafter UMIFA (200-)].

Objectives of the Act. UMIFA (200-) uses language from UPIA and the Revised Model Nonprofit Corporation Act [hereafter referred to as the RMNCA], reflecting the fact that standards for investing and managing institutional funds are and should be the same regardless of whether a charitable organization is organized as a trust, as a nonprofit corporation or in some other manner. The rules governing expenditures from endowment funds have been modified to give a governing board more flexibility in making expenditure decisions, so that the board can cope with fluctuations in the value of the endowment. These rules are available to decision makers of charities organized as charitable trusts, as nonprofit corporations, or in some other manner. The provisions governing the release and modification of restrictions have been changed to permit more efficient management of institutional funds.

Other Legal Rules. UMIFA (200-) addresses investment issues and issues relating to endowment funds but is not a comprehensive statute addressing all legal issues that apply to charitable organizations. For matters not governed by UMIFA (200-), a charitable organization will continue to be governed by rules applicable to charitable trusts, if it is organized as a trust, or rules applicable to nonprofit corporations, if it is organized as a nonprofit corporation.

UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Management of Institutional Funds Act.

SECTION 2. DEFINITIONS. In this [act]:

(1) "Charitable purpose" means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of governmental purposes, or another purpose the achievement of which is beneficial to the community.

(2) "Endowment fund" means an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of a gift instrument. The term includes two or more endowment funds collectively managed. The term does not include assets of an institution designated by the institution as an endowment fund for its own use.

(3) "Gift instrument" means a record or records under which property is granted to, transferred to, or held by an institution as an institutional fund. The term includes an institutional solicitation in the form of a record from which an institutional fund results if the solicitation indicates the intent of the institution that the solicitation constitute a gift instrument and if another record does not supersede the solicitation.

(4) "Institution" means a nonprofit corporation, trust, unincorporated association, or entity organized and operated exclusively for charitable purposes. The term includes a government, or governmental subdivision, agency, or instrumentality to the extent that it holds funds exclusively for a charitable purpose. The term also includes a trust that has both charitable and noncharitable interests after all noncharitable interests have terminated.

(5) “Institutional fund” means a fund held for the exclusive use, benefit, and purposes of an institution. The term includes two or more institutional funds collectively managed. The term does not include: (A) program-related assets; or (B) a fund in which a beneficiary that is not an institution has an interest, other than a right that could arise upon violation or failure of the purposes of the fund.

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

(7) “Program-related asset” means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for appreciation or for producing income.

(8) “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.

Preliminary Comment

Subsection (1). Charitable Purpose. The definition of charitable purpose uses the same formulation as that in UTC § 405 and Restatement (Third Second) of Trusts § 28 368 (2003 1959). The definition is the standard legal definition of charitable purposes, developed from the definition of charity set forth in the English Statute of Charitable Uses, enacted in 1601. Some 17 states have created statutory definitions of charitable purpose for other purposes. See, e.g., [PA]. 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 on use that makes a fund an endowment fund arises from the terms of a gift instrument. An institution may manage several funds together if the funds all have the same purpose. These funds would be considered one endowment fund for purposes of this Act.

Board-restricted funds are institutional funds but not endowment funds. The rules on expenditures and modification of restrictions in this Act do not apply to restrictions placed by an institution on an otherwise unrestricted fund held by the institution 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 an institution.

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

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 of the gift and whether a subsequent writing superseded the terms of the solicitation.

The term gift instrument also includes matching funds provided by an employer or some other person and includes an appropriation by a legislature or other public or governmental body for the benefit of an institution.

Subsection (4). Institution. The Act applies generally to institutions organized and operated exclusively for charitable purposes. The term includes charitable organizations created as nonprofit corporations, trusts, unincorporated associations, governmental subdivisions or agencies, or any form of entity, however organized, that is organized and operated exclusively for charitable purposes. As used in this definition, the term "trust" is intended to mean a trustee acting under a charitable trust. The term includes a trust organized and operated exclusively for charitable purposes, regardless of whether a charity or a noncharitable corporation such as a bank acts as trustee.

UMIFA (1972) did not apply to trusts managed by non-charitable trustees. The application of UMIFA (200-) to charitable trusts will benefit charities operated as trusts in two ways. The endowment spending rules of Section 4 will allow trusts to making spending decisions based on prudence rather than on the characterization of funds as income or principal for trust accounting purposes. The Drafting Committee learned that under UMIFA (1972) charitable trusts managed by corporate trustees have sought court approval to be treated under the rules of UMIFA (1972). Bringing trusts within the purview of UMIFA (200-) will reduce the cost of managing charitable trusts.

UMIFA (200-) will also benefit charities organized as trusts by making additional rules on modification applicable to those charities. The modification rules provide for more efficient management of charitable funds, and should be available to charities regardless of organizational form.

In other respects, UMIFA (200-) will not alter the rules applicable to charitable trusts under UPIA and the Principal and Income Act. Charities organized as trusts are already subject to prudent investor standards, either under UPIA (enacted uniformly in – states and in substance in – states) or under common law standards of prudence. The prudence rules enacted in UMIFA (200-) simply provide guidance to charities for investment decision making and do not alter the rules already applicable to charitable trusts.

The definition of institution includes governmental organizations that hold funds exclusively for the purposes listed in the definition. Some organizations created by state government may fall outside the definition due to the way in which the state created the organizations. Because state arrangements are so varied, creating a definition that encompasses all charitable entities created by states is not feasible. States should consider the core principles of UMIFA (200-) for application to governmental institutions. For example, the control over a state university may be held by a State Board of Regents. In that situation, the state may have created a governing structure by statute or in the state constitution so that the university is, in effect, privately chartered. The Drafting Committee does not intend to exclude these universities from the definition of institution, but additional state legislation may be necessary to address particular situations.

Subsection (5). Institutional Fund. The term institutional fund includes any fund held by an institution for its own use, benefit, or purposes, whether expendable currently or subject to restrictions. The term also includes a fund held by a trustee that is not an institution, if the fund is held exclusively for the benefit of an institution. UMIFA (1972) excluded funds managed by 9 corporate trustees. The Drafting Committee concluded that the provisions of UMIFA should be available to any fund managed exclusively for charitable purposes.

A fund held by an institution is not an institutional fund if any beneficiary of the fund is not an institution. For example, a charitable remainder trust held by a charity as trustee for the benefit of the donor during the donor's lifetime, with the remainder interest held by the charity, is not an institutional fund. However, this subsection treats as an institution a charitable remainder trust that continues to operate for charitable purposes after the termination of the noncharitable interests. The Act will have only a limited effect on a charitable remainder trust during the period required to complete the distribution of the trust's property after the noncharitable interest ends. The prudence norm will apply to the actions of the trustee, but the trustee will make decisions about investment and management of funds knowing that the trust will distribute its assets and not continue indefinitely.

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

Subsection (7). Program-related asset. Although UMIFA (200-) does not apply to program-related assets, if program-related assets serve, in part, as investments for an institution, then the institution should identify categories for reporting those investments and should establish investment criteria for the investments that are reasonably related to achieving the institution's charitable purposes. For example, a program providing below-market loans to inner-city businesses may be "primarily to accomplish a charitable 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 would 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).

SECTION 3. STANDARD OF CONDUCT IN MANAGING AND INVESTING INSTITUTIONAL FUNDS.

(a) In managing and investing an institutional fund, an institution must consider the terms of the gift instrument, the charitable purposes of the institution, and the purposes of the institutional fund.

(b) In addition to the duty of loyalty imposed by law other than this [act], each person responsible for managing and investing an institutional fund must 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.

(c) In managing and investing an institutional fund, an institution 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.

(d) An institution shall make a reasonable effort to verify facts relevant to the management and investment of an institutional fund.

(e) Subsections (f) through (k) are default rules and may be expanded, restricted, eliminated, or otherwise altered by the terms of a gift instrument.

(f) 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 institutional 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 institutional 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.

(g) Management and investment decisions about an individual asset must be made not in isolation but 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.

(h) In addition to an investment otherwise authorized by law or by a gift instrument, and without restriction to investments a fiduciary may make, an institution, subject to any specific limitations set forth in the gift instrument, may invest in any kind of property or type of investment consistent with the standards of this section.

(i) 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 diversifying.

(j) Within a reasonable time after receiving property, an institution shall make and implement 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, distribution requirements, and other circumstances of the institution and the requirements of this [act].

(k) An individual who has special skills or expertise, or is named in reliance upon the individual's representation that the individual has special skills or expertise, has a duty to use those special skills or expertise in managing and investing institutional funds.

Preliminary Comment

Purpose and Scope of Revisions. This section adopts the prudence standard for investment decision making. The section directs directors, trustees 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 or not the funds are restricted.

The Drafting Committee discussed at great length the standard that should govern nonprofit managers. UMIFA (1972) 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 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 UMIFA (200-) 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 would look to the same factors as those identified by the prudent investor rule. The standard for prudent investment set forth in Section 3 first states the duty of care as articulated in the RMNCA. The standard then provides more specific guidance for those managing and investing institutional funds by incorporating language from UPIA. The factors and rules derived from UPIA are consistent with good practice under current law applicable to nonprofit corporations.

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

The Drafting Committee decided that by adopting language from both the RMNCA and UPIA, UMIFA (200-) could clarify that the same standards of prudent investing apply to all charitable institutions. Although principal trust authorities, UPIA § (2)(a), Restatement (Third) of Trusts §337, UTC § 804, and Restatement (Second) of Trusts § 174 (prudent administration) use the phrase "care, skill and caution" the Drafting Committee decided to use the more familiar corporate formulation as found in RMNCA. The Drafting Committee found no material difference between the trust standard and the RMNCA standard of "care" which necessarily imports skill and caution. The Drafting Committee included the detailed provisions from UPIA, because the Committee believed that the greater precision of the prudence norms of the Restatement and UPIA as compared with UMIFA (1972), could helpfully inform managers of charitable institutions. For an explanation of the Prudent Investor Act, see John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641

(1996).

Subsection (b) of Section 3 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 that different standards of loyalty may apply to directors of nonprofit corporations and 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 § 8.30. The trust law articulation of the loyalty standard uses "sole interests" rather than "best interests." As the Restatement of Trusts explains, "[t]he trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary." Restatement (Second) of Trusts § 170 (1). Although the standards for loyalty, like the standard of care, are merging, *see* John H. Langbein [cite to new article], the Drafting Committee concluded that incorporating the duty of loyalty into UMIFA (200-) was unnecessary. Thus the duty of loyalty under nonprofit corporation law will apply to charities organized as nonprofit corporations, and the duty of loyalty under trust law will apply to charitable trusts.

Section 3 has incorporated the provisions of UPIA with only a few exceptions. UPIA applies to private trusts and thus is entirely default law. A settlor of a private trust has complete control over trust provisions. Because UMIFA (200-) applies to charitable organizations, UMIFA (200-) makes the duty of care, the duty to minimize costs, and the duty to investigate mandatory. The duty of loyalty is mandatory under other law. In addition, subsection (a) of Section 3 requires a decision maker to consider the terms of the gift instrument, the 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, but UPIA § 2(a) states the duty to consider similar factors in the private trust context.

As explained above, in stating the standard of care, UMIFA (200-) uses language from the RMNCA rather than UPIA. The change from UPIA's "reasonable care, skill and caution" to "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances" occurs in Sections 3, 4 and 5 of UMIFA (200-). The Drafting Committee does not intend any substantive change to the UPIA standard and believes that "reasonable care, skill, and caution" are implicit in the term "care" as used in the RMNCA. The standard expressed in UPIA § 2(a) appears in subsections (a) and (b) of Section 3.

UMIFA (200-) does not include the duty of impartiality, stated in UPIA § 6, because a charitable institution will not have more than one beneficiary.

In other respects, the Drafting Committee made changes to language from UPIA only where necessary to make the language appropriate for charitable institutions. No material differences are intended. Subsection (f)(4) of UMIFA (200-) does not include a clause 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 (f)(7) reflects a modification of the language of UPIA § (2)(c)(7). In subsection (h) a reminder that terms of the gift instrument control was added to the formulation of UPIA § 2(e). 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.

Other than, the duty of care, the duty to minimize costs, and the duty to investigate act in good faith, the provisions of Section 3 are default rules. A gift instrument or the governing instruments of an institution can modify these duties, but the charitable purpose doctrine limits the extent to which an institution or a donor can restrict these duties.

Subsection (a). Donor Intent and Charitable Purposes. Subsection (a) states the overarching direction to consider the donor's intent as expressed in the terms of the gift instrument and to consider the charitable purposes of the institution and of the institutional fund. A donor's intent is always important guidance for the charity, but the direction to consider the terms of the gift instrument does not mean that the donor can or should control the management of the institution. The UPIA counterpart of subsection (a) is UPIA § 2(a).

Subsection (b). Duty of Care. This subsection applies the duty of care to performance of investment duties. The language derives from § 8.30 of the RMNCA. Subsections (a)(1) and (2) state the duty to act in good faith, "with the care an ordinarily prudent person in a like position would exercise under similar circumstances." Although the language in the RMNCA and in UMIFA (200-) is similar to that of § 8.30 of the Model Business Corporation Act (3d ed. 2002), the standard as applied to persons making decisions for charities is informed by the fact that the institution is a charity and not a business corporation. Thus, in UMIFA (200-) the references to "like position" and "similar circumstances" mean that the charitable nature of the institution affects the decision making of a prudent person acting under the standard set forth in subsection (b). The duty of care involves considering the factors set forth in subsection (f).

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

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

Subsection (f). Prudent Decision Making. Subsection (f) takes much of its language from UPIA § 2(c). In making decisions about whether to acquire or retain an asset, the institution should consider the institution's mission, its current programs, and the desire to cultivate additional donations from a donor, in addition to factors related more directly to the asset's potential as an investment.

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

Assets held primarily for program-related purposes are not subject to UMIFA (200-). The management of those assets will continue to be governed by other laws applicable to the institution. Other assets may not be held primarily for program-related purposes but may have both investment purposes and program-related purposes. Subsections (a), and (e)(8) indicate that a prudent decision maker can take into consideration the relationship between an investment and the purposes of the institution and of the institutional fund in making an investment that may have a program-related purpose but not be primarily program-related. The degree to which an institution uses an asset to accomplish a charitable purpose will affect the weight given that factor in a decision to acquire or retain the asset.

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

Subsection (h). Broad Investment Authority. Consistent with the portfolio theory of investment, this subsection permits a broad range of investments. The reference to investments "authorized by law other than this [act]" includes state statutes creating legal lists for investments. This provision does not contravene any other state statute that authorizes specific investments. The language derives from UPIA § 2(e).

*[**Legislative Note:** A state may want to delete the clause "in addition to an investment authorized by law other than this [act]" as unnecessary or may want to add a specific reference to other law. Legislative counsel should review existing law to determine whether the legislature should repeal existing rules on investments or should add a specific reference to those rules here.]*

Subsection (h) also provides that terms of a gift instrument or other law applicable to institutions may limit the authority under this subsection. For example, the gift instrument for a particular institutional fund might preclude the institution from investing the assets of the fund in companies that produce tobacco products.

Subsection (i). Duty to Diversify. This subsection assumes that prudence requires diversification but permits an institution to determine that nondiversification is appropriate under the circumstances applicable to a fund. A decision to retain property due to "special circumstances" must be made based on the needs of the charity and not solely for the benefit of a donor. A decision to retain property in the hope of obtaining additional contributions from the same donor will be considered made for the benefit of the charity. This subsection derives its language from UPIA § 3. *See* UPIA § 3 cmt. (discussing the rationale for diversification); Restatement (Third): Prudent Investor Rule § 227 (1992).

Subsection (j). 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 (ji) 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 (1972) 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. This concept continues under UMIFA (200-), because the potential for developing additional contributions by retaining property contributed to the institution is one of the "other circumstances" the institution may 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 (j) comes from UPIA § 4, which restates Restatement (Third) of Trusts: Prudent Investor Rule § 229 (1992), which itself took language from Restatement (Second) of Trusts § 231 (1959). *See* UPIA § 4 cmt.

Subsection (k). Special Skills or Expertise. Subsection (k) 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. [E. Brody will provide additional material for this comment]

UMIFA (1972) contained two provisions that authorized investments in pooled or common investment funds. UMIFA (1972) §§ 4(3), 4(4). The Drafting Committee concluded that Section 3(h) of UMIFA (200-) authorizes these investments. The decision not to include the two provisions in UMIFA (200-) implies no disapproval of such investments.

SECTION 4. EXPENDITURE OF ENDOWMENT FUNDS; RULE OF CONSTRUCTION.

(a) Subject to the terms of the gift instrument, an institution may expend or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. In making its determinations on expenditures and accumulations, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

(1) the duration and preservation of the endowment fund;

(2) the purposes of the institution and the endowment fund;

(3) general economic conditions;

(4) the possible effect of inflation or deflation;

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

(6) other resources of the institution; and

(7) the investment policy of the institution.

(b) The expenditure in any one year of an amount greater than seven percent of the fair market value of the endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years, shall create a rebuttable presumption of imprudence. This subsection does not limit the authority to expend funds as permitted under law other than this [act] or the terms of the gift instrument. This subsection does not create a presumption of prudence for expenditure of an amount less than seven percent of the fair market value of the endowment fund. The presumption of imprudence leaves to the institution the determination of the amount that will be prudent to expend from an endowment fund.

(c) The following rules of construction apply to gift instruments existing on or created after the effective date of this [act]:

(1) To limit the authority to expend or accumulate funds under subsection (a), a gift instrument must specifically state the limitation.

(2) Terms in a gift instrument designating a gift as an endowment, or a direction or authorization in the gift instrument to use only “income”, “interest”, “dividends”, or “rents, issues, or profits”, or “to preserve the principal intact” or similar words, create an endowment fund of indefinite duration but do not otherwise limit the authority to expend or accumulate under subsection (a).

Preliminary Comment

Purpose and Scope of Revisions. This section revises the provision in UMIFA (1972) that permitted the expenditure of appreciation of an endowment fund to the extent the fund had appreciated in value above the fund’s historic dollar value. UMIFA (1972) defined historic dollar value to mean the value of all contributions to the fund. The new approach abandons the use of historic dollar value as a floor for expenditures and provides more flexibility to the institution in making decisions about whether to expend any part of an endowment fund. As under UMIFA (1972), a prudence standard applies to the process of making decisions about expenditures from an endowment fund.

Subsection (a). Expenditure of Endowment Funds. Subsection (a) uses the 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 this 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 keeping in mind the intent of the donor and the purposes of the institution and of the endowment fund, while also considering economic conditions. As under UMIFA (1972), 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 rule in Section 4 is permissive, however, and an institution may continue to make spending decisions under trust accounting principals if it prefers.

Institutions have operated effectively under UMIFA (1972) and have operated more conservatively than the historic dollar value rule would have permitted. Institutions have no incentive to spend everything the law permits them to spend, and good practice has been to provide for modest expenditures while maintaining the purchasing power of a fund. Institutions have followed this approach even though UMIFA (1972) does not require an institution to maintain a fund's purchasing power and allows 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, UMIFA (200-) should encourage institutions to establish a spending approach 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 generated no investment return that year.

Several levels of safeguards exist to prevent institutions from depleting endowment funds or diverting funds from the purposes for which they were created. Donors can restrict gifts and can provide specific instructions to donee institutions as to appropriate uses for assets contributed. Within institutions, fiduciary duties govern the persons making decisions on expenditures. Those persons must operate with the best interests of the institution in mind and in keeping with the intent of donors. If an institution diverts an institutional fund from the charitable purposes of the institution, the state attorney general can enforce the charitable interests of the public. By relying on these safeguards while providing institutions with adequate discretion to make decisions on appropriate expenditures, the Act creates a standard that takes into consideration the diversity of the charitable sector. The committee expects that industry standards will continue to evolve and inform institutions as the institutions apply this standard.

Section 4 provides guidance on factors to consider in exercising discretion but does not take away discretion by providing a safe harbor for spending within a range based on percentages of the assets of the fund. The Committee concluded that specifying a range for appropriate distributions was unwise because a fixed range could not take into account the factors listed in subsection (a) or changes in market conditions. A fixed range that might be appropriate for some charities under current economic conditions would be unlikely to remain appropriate over time. Institutions have done a good job of developing spending policies under UMIFA (1972) and should be able to continue to develop spending policies that take into consideration the specific needs of a particular fund. Prudent decision making after considering all the factors is the standard under UMIFA (200-). A safe-harbor would simply create a new standard that could not take into account the needs of individual institutions and funds.

Subsection (b). Presumption of Imprudence. Although prudence will dictate the amount an institution should spend, subsection (b) creates a rebuttable presumption of imprudence if expenditures in one year exceed seven percent of the assets of an endowment fund. The statute applies a three year rolling average in determining the value of the fund for purposes of calculating the seven percent amount. Endowment spending will rarely exceed seven percent, but the 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 subsection (b) 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).

The Drafting Committee decided to include the presumption to respond to concerns that the statute should include a bright-line rule, albeit a rebuttable one, to curb the temptation to spend endowment assets too rapidly. The subsection does not imply that spending below 7 percent is prudent, and charitable institutions must carefully consider the factors in subsection (a) before making a determination on the prudent amount to spend. The section does not require an institution to spend a minimum amount each year because the prudence standard and the needs of the institution will be sufficient guidance as to whether accumulation rather than spending might be appropriate in a particular year.

As subsection (b) indicates, spending less than seven percent of the value of an endowment fund will not necessarily be considered prudent. Indeed, under many circumstances expenditures at six or seven percent would be imprudently high. Evidence discussed by the Drafting Committee suggests that few funds can sustain spending at a rate above five percent. *See* Roger G. Ibbotson & Rex A. Sinquefield, Stocks, Bonds, Bills, and Inflation : Historical Returns (1926-1987) (Research Foundation of the Institute of Chartered Financial Analysts, 1989). Further, spending at a lower rate, particularly in the early years of an endowment, may result in greater distributions over time. *See* DeMarche Associates, Inc, Spending Policies and Investment Planning for Foundations: A Structure for Determining a Foundation's Asset Mix (Council on Foundations: 3d ed. 1999). Subsection (b) serves as a reminder that spending at too high a rate will jeopardize the long-term nature of an endowment fund. If an endowment fund is intended to continue indefinitely, the institution should take special care to limit annual spending to a level that protects the purchasing power of the fund.

For a discussion of spending approaches, see Joel C. Dobris, *New Forms of Private Trusts for the Twenty-First Century—Principal and Income*, 31 Real. Prop., Prob. & Tr. J. 1 (1996). For example, Dobris suggests spending 5% or 4% of a five-year moving average of 11 market values might be appropriate. *Id.*, at 39.

The term "endowment fund" includes funds that may last in perpetuity but also funds that should continue for a fixed term of years or until the institution achieves a specified objective. Section 4 requires the institution to consider the intended duration of the fund in making determinations about spending. For example, if a donor directs that a fund be spent over 20 years, Section 4 will guide the institution in making distribution decisions. The institution would amortize the fund over 20 years rather than try to maintain the fund in perpetuity. For an endowment fund of limited duration, spending at a rate above seven percent will be both necessary and prudent.

Subsection (c). Rule of Contruction. Donor's intent must be respected in the process of making decisions to expend endowment funds. Section 4 does not allow an institution to convert an endowment fund into a non-endowment fund nor does the section allow the institution to ignore a donor's intent that a fund be maintained as an endowment. Rather, subsection (c) provides rules of construction to assist institutions in interpreting donor's intent. Subsection (c) assumes that if a donor wants an institution to spend "only the income" from a fund, the donor intends that the fund both support current expenditures and be preserved indefinitely. The donor is unlikely to be concerned about designation of returns as "income" or "principal" under accounting principles. Rather the donor likely assumes that the institution will use modern investing strategies like total-return investing 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.

A donor who wants to specify spending guidelines can do so, but must do so specifically. 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. If the charity agrees to the restriction in accepting the gift, the restriction will govern spending decisions by the charity. 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 specific expenditure rules will likely also have consequences in the way the institution invests the fund.

As a rule of construction, subsection (c) applies retroactively. Retroactive application is appropriate because subsection (b) does not alter the substance of an existing contract, but rather serves as a default rule that implements donor's intent. The Colorado Supreme Court recently considered the question of retroactive application of a default statute involving the donative aspect of an insurance contract. *See* In re Estate of DeWitt, 54 P. 3d 849 (Colo. 2002). In holding that 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 (the "JEB"). JEB Statement Regarding the Constitutionality of Changes in Default Rules as Applied to PreExisting Documents, 17 Am. Coll. Tr. & Est. Couns. Notes 184 app. II (1991). The JEB Statement explains why retroactive application of default statutes is appropriate and is not unconstitutional and states, "The JEB is aware of no authority for the application of the Contracts Clause to state legislation applying altered rules of construction or other default rules to pre-existing documents in any field of law, and especially not in the field of estates, trusts, and donative transfers." *Id.* at 4 (citing J. Nowak & R. Rotunda, Constitutional Law § 11.8, at 394 et seq. (4th ed. 1991)).

The Drafting Committee considered concerns that retroactive application of the construction provision might alter the intent of a donor who contributed money to an endowment fund with the understanding that the institution could never spend the actual amount contributed (the historic dollar value). Although the Committee agreed that in some cases a donor might have specifically considered the concept of historic dollar value, the Committee concluded that the construction provision in UMIFA (200-) would effectively carry out the intent of most donors.

The Drafting Committee was also concerned that retaining the historic dollar value concept for endowment funds in existence before the enactment of UMIFA (200-) would require institutions to manage endowment funds separately. For example, an institution with an endowment fund for scholarships would have to create a new fund for post-enactment contributions. Managing two funds would result in economic inefficiencies and greater administration cost for the institution. Further, an institution with a fund created under UMIFA (1972) with a value below historic dollar value might choose to invest in assets that produce trust accounting income rather than appreciation. Choosing investments based on the characterization of the income could reduce the long-term yield of the fund.

SECTION 5. DELEGATION OF MANAGEMENT AND INVESTMENT FUNCTIONS.

(a) Subject to any specific limitation set forth in a gift instrument or in law other than this [act], an institution may delegate to an external agent the management and investment of an institutional fund 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:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and

(3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(b) 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.

(c) An institution that complies with subsection (a) is not liable for the decisions or actions of an agent to which the function was delegated.

(d) 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 the delegation.

(e) An institution may delegate to committees, officers, or employees of the institution as authorized by law other than this [act].

Preliminary Comment

This section incorporates into UMIFA (200-) the delegation rule found in UPIA § 9, updating the delegation rules in UMIFA (1972) § 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. 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.

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 (1972) 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 UMIFA (200-) 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.

SECTION 6. RELEASE OR MODIFICATION OF RESTRICTIONS ON USE OR INVESTMENT.

(a) For purposes of this section, "institutional fund" includes a fund that is one of two or more institutional funds collectively managed.

(b) With the consent of the donor in a record, an institution may release, in whole or in part, a restriction imposed by a gift instrument on the use or investment of an institutional fund. A release may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

(c) If an institution cannot obtain consent of a donor in a record by reason of the donor's death, disability, unavailability, or impossibility of identification, the institution may apply to the [appropriate court] for release of a restriction imposed by a gift instrument on the use or investment of an institutional fund. The institution shall notify the [Attorney General], who must be given an opportunity to be heard. If the court finds that the restriction is [obsolete, inappropriate or impracticable] [unlawful, impracticable, impossible to achieve, or wasteful,] the court may release the restriction, in whole or in part.

(d) This section does not limit the application of the doctrine of cy pres, except that in applying the doctrine of cy pres, the [appropriate court] may apply cy pres if a restriction becomes unlawful, impracticable, impossible to achieve, or wasteful.

(e) This section does not limit the application of the doctrine of equitable deviation.

(f) If an institution determines that a restriction imposed by a gift instrument on the use or investment of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, after notification to the [Attorney General], may release the restriction or modify it, in whole or part, if:

(1) the institutional fund subject to the restriction has a total value of less than [$25,000]; and

(2) more than [20] years have elapsed since the fund was established.

(g) If a restriction is released or modified, in whole or part, under subsection (f), the institution must use the property in a manner the institution determines, in good faith, to be consistent with the charitable purposes expressed in the gift instrument.

Preliminary Comment

Section 6 expands the rules on releasing or modifying restrictions that are found in Section 7 of UMIFA (1972). Subsection (b) restates the rule from UMIFA (1972) allowing the release of a restriction with donor consent. Subsection (c) explains that if the consent of the donor cannot be obtained because the donor is deceased or cannot be found, the institution can seek court approval to release the restriction. Subsections (d) and (e) make clear that an institution can always ask a court to apply cy pres or equitable deviation to modify or release a restriction. Subsection (f), 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.

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 (c) restates the rule in UMIFA (1972) that indicates that if a donor is dead or disabled, or cannot be found, then an institution can apply to a court for the release of a restriction. [A court can approve a release under subsection (b) even if the restriction does not fall within the circumstances required for the application of cy pres.] The institution must give notice to the state attorney general, who represents the interests of the public in ensuring that the donor's charitable wishes as expressed in the gift instrument are followed.

Subsection (d) states that the doctrine of cy pres will continue to apply to institutions, but updates the circumstances under which cy pres will apply by adopting the rule set forth in UTC § 413. Under subsection (d) a court may use cy pres to modify or release a restriction that has become unlawful, impracticable, impossible to achieve, or wasteful. A restriction that may have made sense when a donor made a gift, may no longer be appropriate due to unanticipated changes. Under the doctrine of cy pres the institution can apply for modification of the restriction, in keeping with the original intent of the donor. The institution must give notice to the state attorney general, In determining the appropriate modification, the court will consider what the donor would likely have preferred if the donor had been aware of the unanticipated circumstances. Subsection (e) clarifies that the doctrine of equitable deviation applies to institutions. Under the doctrine of equitable deviation a court can modify an administrative restriction under which an institution manages or invests a fund. A court can order equitable deviation if unanticipated circumstances have caused a restriction to impede rather than facilitate the donor's intent. Equitable deviation can be used to modify an administrative restriction but not a purpose restriction. *See* UTC §§ 412, 413; Restatement (Second) of Trusts § 167.

Subsection (f) permits an institution to release or modify a restriction using a cy pres approach 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 Drafting Committee determined 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 Committee discussed at length the parameters for allowing an institution to apply cy pres itself, without court supervision. The Committee drafted subsection (f) to balance the needs of an institution to operate efficiently for its charitable purposes and the need to protect donors' wishes. The subsection assumes 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 with the need to change the restriction. The Committee included a requirement that the institutional fund be in existence at least 20 years because it seemed reasonable to require additional safeguards for donors' intent for some period of time after the creation of the institutional fund. The 20 year period begins to run from the date of inception of the fund and not from the date of each gift to the fund. The amount and the number of years have been placed in brackets to signal to enacting jurisdictions that they may wish to designate a higher or lower figure.

As under judicial cy pres, an institution acting under subsection (f) must change the restriction in a manner that is in keeping with the intent of the donor and the purpose of the fund. For example, if the value of a fund is too small to justify the cost of administration of the fund as a separate fund, the term "wasteful" would allow the institution to combine the fund with another fund with similar purposes. If a fund had been created for nursing scholarships and the institution closed its nursing school, the institution might appropriately decide to use the fund for other scholarships at the institution. In using the authority granted under subsection (f), the institution must make a good faith determination of which alternative use for the fund reasonably approximates the original intent of the donor. The institution cannot divert the fund to an entirely different use. For example, the fund for nursing scholarships could not be used to build a football stadium.

The Drafting Committee decided not to require an institution acting under subsection (f) to give notice to the donors who had contributed to the fund. Subsection (f) can only be used for an old and small fund. For such a fund, locating multiple donors may be prohibitively expensive, and notice by publication is not likely to be effective in providing actual notice to the donors. Good practice dictates notifying known donors of any change considered by the institution. The Drafting Committee concluded that an institution's concern for donor relations would serve as a sufficient incentive for following that practice when donors can be located. In other circumstances, the attorney general can protect the interests of the donors and the public.

SECTION 7. REVIEWING COMPLIANCE. Compliance with this [act] is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, and not by hindsight.

SECTION 8. APPLICATION TO EXISTING INSTITUTIONAL FUNDS. This [act] applies to institutional funds existing on or established after the effective date of this [act]. As applied to institutional funds existing on its effective date, this [act] governs only decisions made or actions taken after that date.

SECTION 9. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act (15 U.S.C. Section 7001 et seq.) but does not modify, limit, or supersede Section 101 of that act (15 U.S.C. Section 7001(a)) or authorize electronic delivery of any of the notices described in Section 103 of that act (15 U.S.C. Section 7003(b)).

SECTION 10. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 11. EFFECTIVE DATE. This [act] takes effect . . . .

SECTION 12. REPEAL. The following acts and parts of acts are repealed: