

Memorandum

To: UMIFA Drafting Committee, Advisors, and Observers

From: Susan Gary, Reporter

Date: January 3, 2006

Re: Fall Drafting Committee Meeting and January 2006 Draft

This memo reports discussions at our November 2005 committee meeting. Circulated with this memo is the new draft of the Act. We will discuss this draft at our next committee meeting, to be held in Austin, Texas, January 20-22. Anyone with comments should send the comments to me, electronically if possible, prior to the January meeting. The January meeting will likely be our last meeting before the Annual Meeting at which NCCUSL will consider whether to approve the Act.

As a reminder, the Comments are still very much a work in progress. I continue to try to provide as much detail as possible in the Comments, revising the Comments as we revise the Act, so that the Drafting Committee's thoughts are set forth in a way that may help explain the statutory language. Significant gaps remain, however, and the Drafting Committee will provide more input on the Comments if the Act is approved by NCCUSL. The Comments should not be read at this stage as finished Comments. I welcome questions and suggestions for the Comments at any stage in our process.

At the January 2006 the Drafting Committee will discuss the following issues:

- Endowment spending rule

- Accounting issues (the sentence added to Section 4(a))

In addition to these broad topics, we will discuss specific issues raised by committee members or observers. With this memo I am circulating a second memo, titled "Issues for Discussion." At present, this memo lists specific issues raised by Susan Budak. If I receive additional questions for discussion, I will add those to the Issues for Discussion. We can then use that memo at our January memo. Anyone who will be unable to attend the January meeting can send comments to the questions raised in the Issues memo.

I am circulating comments received during the fall by the committee, including the complete version of the comments from Susan Budak and comments from James LoPrete and Jeffrey West. I will collect any additional comments I receive before mid-January and circulate them prior to the meeting. The letter from Jeffrey West asks that we consider the problem universities faced when some of their endowment funds were underwater and they received conflicting advice about the appropriate way to proceed. This concern will be part of our discussion of the endowment spending rule.

The remainder of this memo outlines the issues discussed and decisions made at the November 2005 meeting.

Section 4 – Endowment Spending

Language Change

The spending rule in Section 4(a) authorized a charity to “expend or accumulate”. The committee agreed to change to language to “may appropriate for expenditure or accumulate” The change reflects the fact that the appropriation to expend funds may occur some period of time prior to the actual expenditure. The key decision, for purposes of this section, is the decision to appropriate. The committee made a few additional language changes in the act, and those changes appear in the redlined version of the new draft.

Historic dollar value.

The committee discussed whether the concept of historic dollar value belongs in revised UMIFA. Donor intent on the concept of hdv is not at all clear, given that hdv is a default rule that applies when a donor did not clearly articulate intent. Observers who advise donors have provided us with input that suggests that donors have various intents with respect to spending. The committee concluded that the new, more restrictive spending rule under UMIFA (200-), even without hdv, may be closer to donor intent than the rule under UMIFA (1972).

Presumption of imprudence.

Some observers have suggested that the deletion of historic dollar value should be combined with the addition of a presumption of imprudence for spending above a specified percentage of a fund’s assets in one year. The committee agreed to put a 7% presumption in Section 4 in brackets (to indicate that each legislature should consider whether to include the presumption). The amount will be calculated as 7% of a three-year rolling average of the fund’s asset value.

Terry Knowles, an assistant attorney general from New Hampshire and the president of the National Association of State Charity Officials, joined our meeting by telephone to report on discussions among state attorneys general. She expressed concern over the removal of the historic dollar value concept, but said that she and those with whom she had consulted had not yet considered the effect of the 7% presumption. Ms. Knowles will attend our January meeting.

Retroactive application of the spending rule.

The committee concluded that a revised UMIFA should apply retroactively, to funds contributed before the enactment of a new statute as well as to contributions made after enactment. The logistics of managing two sets of funds would be hugely problematic for

charities, and the potential benefit (continuation of the concept of historic dollar value for old contributions) will affect only funds for which the asset value is below the historic dollar value – a distinct minority of funds as far as we can tell. Retroactive application of UMIFA (1972) raised concerns similar to those being raised about revised UMIFA, but we are aware of no difficulties that followed the adoption of UMIFA (1972). The New Hampshire Supreme Court issued an opinion on this question (whether retroactive application of UMIFA (1972) would violate the State constitution) and concluded that it would not. Cases from other states have determined that retroactive application of a default statute does not violate the contracts clause.

Section 6 – Modification

We discussed but decided not to change the modification provisions in the Act, except for some minor language changes. As under trust law, the attorney general will receive notice of any proposed changes and a court must determine whether to apply equitable deviation or cy pres. One provision in UMIFA differs from current trust law and permits a charity to modify a restriction on a fund that is both old and small, after notice to the attorney general, but without court action.

Coverage of UMIFA – Charitable Trusts

The committee concluded that UMIFA (200-) should not apply to charitable trusts with corporate trustees. Many of the rules in UMIFA (200-) already apply to trusts, including, in particular, the prudent investor standard from the Uniform Prudent Investor Act. UMIFA (200-) adds two options for nonprofit corporations that do not exist under trust law: the ability to modify old, small funds and a prudent spending rule for endowment funds. The Committee will recommend that NCCUSL consider amendments to the Uniform Trust Code and the Uniform Principal and Income Act to make these two options (these are not mandatory rules) available to trusts.

Accounting Rules

The committee agreed to add language to UMIFA (200-) that stresses the fact that funds held in donor-designated endowments are legally restricted funds until the charity appropriates funds for expenditures. UMIFA (200-) sets legal rules and not accounting rules, but the hope is that the additional language will clarify that endowments are legally restricted funds.

Donor Standing

The committee discussed donor standing and concluded that UMIFA (200-) was not the place to create donor standing.

Name for UMIFA (200-)

The conference and not the committee will determine the final name for revised UMIFA, but the committee agreed to recommend that the name be the Uniform Prudent Management of Institutional Funds Act (UPMIFA).