

Memorandum

To: UMIFA Drafting Committee, Advisors, and Observers

From: Susan Gary, Reporter

Date: February 1, 2006

Re: January Drafting Committee Meeting and February 2006 Draft

The Drafting Committee met in Austin, Texas, January 20 and 21. We were joined by Terry M. Knowles, President of the National Association of State Charity Officials and Registrar - Charitable Trusts Unit in the Department of the Attorney General of New Hampshire.

Name Change. The Executive Committee of NCCUSL approved our request for a name change for UMIFA. The new Act will be the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”). The purpose for the name change is to be able to distinguish between “old” UMIFA and “new” UMIFA. We also liked adding “Prudent” to the name to emphasize the importance of prudence under the Act. We enjoyed a number of jokes about the new name.

Historic Dollar Value. We discussed continuing expressions of concern that the removal of historic dollar value from UPMIFA would threaten the perpetual existence of some endowment funds. We had received letters from attorneys general in California, Michigan, and New York, raising this issue. In addition, Terry Knowles, in her leadership role at NASCO, had raised the issue with a number of state charity regulators across the country. It was extremely helpful to have Ms. Knowles with us, and after two days of hard work we developed a strategy that we hope will assuage the fears concerning the removal from the statute of historic dollar value as a rule (although not as a concept).

In our discussions, we talked about the fact that big institutions obtain sophisticated investment advice and have experience and guidance with spending rules. The big institutions are not likely to need to spend below historic dollar value, and if they do spend below historic dollar value for a particular fund, the institutions will adopt appropriate strategies to grow the fund and will limit spending until the fund recovers its value. This approach has been the experience in Florida, which has been operating without historic dollar value for several years.

The concern voiced by Ms. Knowles at our meeting, and a concern we have heard from others, is that small institutions, and in particular institutions with small endowment funds, may not have the experience or expertise to know how to invest in a prudent manner and how to spend in a prudent manner. With the help of Ms. Knowles, we crafted a provision that addresses this concern directly, while permitting the new UPMIFA approach to apply to most institutions. The new provision, which appears in

the comments as an option for states to consider, requires an institution to notify the attorney general before making an expenditure that causes its endowment funds to drop below historic dollar value. The provision only applies to institutions with aggregate endowment funds valued below \$2,000,000 and thus targets the institutions that may need help in making prudent decisions. The provision does not require the approval of the attorney general, but instead gives the attorney general notice. The attorney general can then decide whether to check further into the spending decision. Ms. Knowles indicated that she might ask the managers of a charity to meet with her to discuss prudent investing and spending. The notice would give her the chance to provide education where needed and to keep an eye on institutions that may be planning to spend too much.

The new provision appears in the comments to Section 4, with an explanation of the purpose for the provision.

An issue with the new provision and with the amount set for small funds is that those numbers will become less useful over time. Is there a way to index the numbers? Could NCCUSL provide guidance over time by issuing recommended increases (to try to maintain uniformity) as necessary?

Other Changes. Beyond this new optional provision, the changes to UPMIFA were minimal. The February 2006 draft indicates the changes from the prior draft. One change that appears in the new draft is still temporary until we get more information. In Section 6(a), we agreed to add the word “modify” to the donor’s power to release, if we can determine that doing so will not cause adverse tax consequences to the donor. I will check with a couple of tax experts.

Presumption of Imprudence. At our meeting we discussed the fact that the calculation for the presumption of imprudence is not based on a fixed number of years. The subsection directs the charity to value the fund “at least quarterly” and to average the values over a period of “not less than three years”. Although a charity could conceivably alter its computation period each year to take advantage of changes over time, the states that currently use the seven percent presumption have not experienced problems of this sort, at least no one at the meeting was aware of problems caused by the flexibility. The Committee therefore decided to use the formulation currently in use in the three states that have the presumption. Currently charities use different periods for their spending calculations, typically either three years or five years, and we wanted to permit each charity to use the period it preferred.

A problem remains, however, that we should address in the comments and possibly in the Act itself. The concern is that if a charity makes a spending determination and based on its calculations does not exceed seven percent, no one should be able later to argue that the presumption of prudence arises because the spending would have exceeded seven percent if the charity had used a different number of years for the computation. I have included in the Comments a paragraph that discusses the issue:

The period 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.

Comments; New Prefatory Note. The more major work on my part has been to draft a new Prefatory Note to UPMIFA and to make additional changes to the comments. I have not indicated changes to the comments using strike-and-score, because at this point it is probably better to read the comments in their entirety rather than focusing on changes. The Prefatory Note is almost entirely new. Thanks to Jack Burton for help with restructuring the Prefatory Note. (I had sent Jack a pre-draft, and he helped with restructuring from an enactment standpoint.)

As I have indicated before, the comments are a moving target. I have tried to stay up-to-date as we make changes in the statute, but I have probably missed a few references here and there. The bigger difficulty, I suspect, is that because the comments have been written over a period of several years, there may be redundancies or the need for structural changes. We can work on those issues (and I will continue to do so) as we go forward. In addition, I still need to work on two substantive matters, both in the comments on the rebuttable presumption of imprudence following Section 4. I want to provide additional information about the work that has been done on spending formulas, and I need to explain the difference between a burden of production and a burden of persuasion. Although the comments will not be discussed at the Annual Meeting, I hope to finish these two sections and to get the comments in good shape before the Annual Meeting Draft goes out. Thus, I welcome suggestions on the comments between now and May when I will need to prepare the Annual Meeting draft in May.

In my notes from our meeting, I had two recommendations for changes to the comments that I have not yet made because I need additional input. In Section 2 we use the term "appropriate for expenditure" and someone suggested that we explain in the comments that a gift instrument that directs a charity to "spend" a specified amount (rather than to appropriate that amount for expenditure) is covered by this section. In reviewing my notes I was not sure I understood the comment or where to include it. The second comment recommendation was to make clear the reasons for bracketing Section 5. The comment seems clear to me, so I would welcome suggestions on how to improve the comment.

Style Committee. I have not yet reviewed UPMIFA with our Style Liaison. At our Drafting Committee meeting, a number of style issues were raised, and I will check

on those. I wanted to get this draft out quickly, so I decided not to wait to incorporate any style changes. I will circulate another draft after I get comments from the Style Committee. At that time I can also incorporate any style comments from members of the Drafting Committee. My plan is to provide another draft in a couple of months, with further time to provide feedback before I prepare the Annual Meeting draft.

I will continue to solicit comments and feedback from anyone interested in UPMIFA. Please send comments to sgary@law.uoregon.edu.