

Memorandum

To: UMIFA Drafting Committee

From: Susan Gary, Reporter

Re: Statutory draft

Date: October 20, 2002

With this memorandum you will receive my first draft of the revised UMIFA. Because I was unable to attend the prior meeting, my draft was based on notes that were taken for me. I have tried to represent the discussion and ideas that developed at the meeting in the statutory draft, but this first draft is, necessarily, a means to further discussion.

In preparing the statutory draft, I followed the template provided by NCCUSL. As suggested by that template, I have included "Reporter's Notes" with the statute. As revised, these Notes will become the Comments to the Act. The Reporter's Notes are sketchy at this point, and I expect to be able to add to them substantially after the November meeting.

In addition to the statutory draft in the official format, I have also prepared questions and comments that relate to specific sections. These questions did not seem appropriate for the Reporter's Notes, so I have presented them in this memo. I have reproduced the statute (bolded) and inserted the questions and comments following each section or subsection, as appropriate. The questions include questions that I had as I prepared the draft and questions that were left unanswered after the last meeting. The comments provide information about the sources for the language in the sections.

Reporter's Questions and Comments for Drafting Committee:

Section 1. Short Title.

Section 2. Definitions.

(1) “institution” means any incorporated or unincorporated organization, trust or foundation organized and operated exclusively for *the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other charitable purposes the achievement of which is beneficial to the community.*

Much of the new language (in italics) comes from UTC 405.

To what extent are government organizations included? UMIFA (1972) includes “a governmental organization to the extent that it holds funds for any of these purposes;” Should this language be included? What does it mean? In 1991 the Louisiana AG said that UMIFA does not apply to the Charity Hospital of Louisiana, a government entity, or to donations held by the Charity Hospital Trust Funds. More information in the Comment may be useful.

(2) “institutional fund” means a fund held by an institution for its exclusive use, benefit, or purposes, but does not include (i) a fund held for an institution by a trustee that is not an institution, *unless the fund is held exclusively for the benefit of a community foundation or community trust*, or (ii) a fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purposes of the fund;

The italicized clause comes from the Hawaii statute. Connecticut, Indiana, North Carolina, Virginia and West Virginia contain similar language and Rhode Island omits exclusion (i). If the italicized phrase is included, should the statute include a definition of “community foundation?” Hawaii and Indiana refer to section 170; West Virginia contains a descriptive definition that also refers to regulations under section 170.

(3) “endowment fund” means an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument;

Is each gift a separate fund or are all gifts pooled as one fund? What if gifts are put into a common fund but separate accounts are created? Can this be addressed in the Comment without changing the definition of endowment fund?

(4) “governing board” means the body responsible for the management of an institution or of an institutional fund;

(5) “historic dollar value” means the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it 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 determination of historic dollar value made in good faith by the institution is conclusive.

This provision has been left as it was in UMIFA (1972). I was not clear about how this was being changed, although I gather that this concept may be abandoned.

(6) “gift instrument” means a will, deed, grant, conveyance, agreement, memorandum, electronic record, writing, or other governing document (including the terms of any institutional solicitations from which an institutional fund resulted) under which property is transferred to or held by an institution as an institutional fund.

“Electronic record” has been added to conform to the Uniform Electronic Transactions Act.

(7) “program-related asset” means an asset held by the institution for the primary purpose of accomplishing a purpose of the institution and not primarily for the production of income or the appreciation of the property.

This is a new definition, added so that the term can be used in Section 4.

The language comes from IRC § 4944(c) and Treas. Reg. § 53.4944-3 which create an exception for program-related investments from 4944’s prohibition on jeopardizing investments.

Section 3. Appropriation of Appreciation.

The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by Section 6. This Section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution.

It was not clear to me whether the Committee had made a decision – or suggestions -- on changing this Section.

Section 4. Rule of Construction.

Section 3 does not apply if the applicable gift instrument indicates the donor’s intention that net appreciation shall not be expended. A restriction upon

the expenditure of net appreciation may not be implied from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only “income,” “interest,” “dividends,” or “rents, issues or profits,” or “to preserve the principal intact,” or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after the effective date of this Act.

It was not clear to me whether the Committee had made a decision – or suggestions -- on changing this Section.

Section 5. Investment Authority.

In addition to an investment otherwise authorized by law or by the applicable gift instrument, and without restriction to investments a fiduciary may make, the governing board, subject to any specific limitations set forth in the applicable gift instrument or in the applicable law other than law relating to investments by a fiduciary, may:

(1) invest in any kind of property or type of investment consistent with the standards of this Act.

This broad investment provision replaces the detailed list of permissible investments in Section 4(1) of UMIFA (1972). The language comes from UPIA § 2(e).

If we return to a list of specific types of property, then what should we add? Deeds of trusts, REITs, LLCs, other interests?

(2) within a reasonable time after receiving property contributed by a donor, the governing board shall review the property and make and implement decisions concerning the retention and disposition of the assets, in order to bring the portfolio of the institutional fund into compliance with the purposes, terms, distribution requirements, and other circumstances of the institution, and with the requirements of this Act.

This language comes from UPIA § 4. The prior subsection (2) permitted the governing board to retain property given by a donor.

(3) invest in and retain program-related assets for as long as the governing board deems [prudent] [in the best interests of the institution] [advisable].

This section is new. Subsection (2) may adequately cover this concern, but new subsection (3) is provided for discussion. “Advisable” was the standard used in old subsection (2).

(4) include all or any part of an institutional fund in any pooled or common fund maintained by the institutions; and

Can various funds, for example scholarships or endowed professorships, be pooled?
What guidance should the Comment provide?

(5) invest all or any part of an institutional fund in any other pooled or common fund available for investment, including shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the governing board.

Subsections (4) and (5) come from UMIFA (1972).

Section 6. Delegation of Investment Management.

(a) Except as otherwise provided by applicable law relating to governmental institutions or funds, a governing board may delegate investment and management functions that a prudent governing body could properly delegate under the circumstances. A governing board shall exercise reasonable care, skill and caution in:

(1) selecting an agent;

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

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

(b) In performing a delegated function, an agent owes a duty to the governing board to exercise reasonable care to comply with the terms of the delegation.

(c) The members of a governing board who comply with the requirements of subsection (a) of this section are not liable for the decisions or actions of the agent to whom the function was delegated.

(d) By accepting the delegation of an investment or management function from a governing board of 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 actions arising from the delegation.*

(e) In investing and managing trust assets, a governing board may only incur costs that are appropriate and reasonable in relation to the assets and the purposes of the institution

This section comes primarily from the New Mexico statute, which is based on UPIA § 9. The italicized phrase in subsection (d) is in the New Mexico statute but not in UPIA. Subsection (e) comes from UPIA § 7, but it deletes UPIA's reference to "the skills of the trustee" as a factor because institutional funds will have professional investment advice.

Section 7. Standard of Conduct.

(a) Members of a governing board shall invest and manage an institutional fund as a prudent investor would, by considering the purposes, distribution requirements and other circumstances of the fund. In satisfying this standard, the governing board shall exercise reasonable care, skill and caution.

(b) A governing board's investment and management decisions about individual assets shall 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.

(c) Among circumstances that a governing board shall consider are:

(1) long- and short-term needs of the institution in carrying out its educational, religious, charitable or other eleemosynary purposes;

(2) its present and anticipated financial requirements;

(3) general economic conditions;

(4) the possible effect of inflation or deflation;

(5) the expected tax consequences, if any, of investment decisions or strategies;

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

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

(8) other resources of the institution;

(9) the needs of the institution and the institutional fund for liquidity, regularity of income and preservation or appreciation of capital; and

(10) an asset's special relationship or special value, if any, to the purposes of the applicable gift instrument or to the institution.

(d) A governing board shall make a reasonable effort to verify the facts relevant to the investment and management of institutional fund assets.

(e) A governing board shall diversify the investments of an institutional fund unless the board reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversifying.

(f) A governing board shall invest and manage the assets of an institutional fund solely in the interest of the institution.

This section is based on the New Mexico statute, which was based on UPIA § 2. Subsections (a) – (d) track UPIA § 2 (a) – (d). UPIA § 2(f), which requires a trustee to use special skills, has been deleted, as it was in the New Mexico statute. Subsection (e) comes from UPIA § 3. Subsection (f) is based on UPIA § 5.

At its first meeting the drafting committee discussed the issue of statutes that reduce the liability of volunteer fiduciaries. It does not seem necessary to add a cross-reference here. Although potential liability may be limited if fiduciaries are volunteers, the limitations on liability do not affect these standards directly. Should the Comment discuss volunteers?

Should this section include a statement that the provisions are default rules and may be altered by the gift instrument or by the organizational documents of the institution? *See* UPIA § 1(b).

Whether the governing board can act by majority decision or must act unanimously in making determinations under this Section will depend on the state laws that govern the decision-making process. Directors of nonprofit corporations can make these decisions by majority vote, and Section 703 of the Uniform Trust Code provides that co-trustees can act by majority decision. In jurisdictions that have not adopted Section 703 or a similar rule, the trustees must act unanimously. Section 703 is a default rule and may be changed by the governing instrument of the trust to require unanimous action by co-trustees.

Section 8. Enforcement of Restricted Gifts.

(a) If a gift instrument restricts the use of assets transferred to an institution, then the donor may maintain a proceeding to enforce the restriction on the gift.

(b) Any right held by the donor under subsection (a) may be exercised on the donor's behalf by his [or her] conservator or guardian or by the personal representative of the donor's estate.

Is it appropriate to add conservator or guardian? Should the donor's right be extended to heirs?

(c) A donor's right to maintain a proceeding under subsection (a) is limited to enforcing the restriction on the donor's gift and does not give a donor standing to challenge other actions by the governing board.

(d) A donor may maintain a proceeding under subsection (a) only if the gift to be enforced had a value that was either (i) greater than [\$500,000] at the time the donor made the gift or (ii) greater than [5%] of the value of the assets of the institution at the time the donor begins the proceeding.

(e) A donor's right to maintain a proceeding under subsection (a) ceases [30 years] after the date of the last donation that was subject to the restriction.

This new section creates limited donor standing. A donor can enforce a restricted gift, but only if the gift instrument contains the restriction. The statute includes both a temporal limit (at some number of years after a gift the right to enforce ceases) and a monetary limit (the gift must be of a sufficient size to warrant giving the donor standing). The intent is to allow the donor of a significant gift to enforce the terms of the gift, but not give standing to every donor.

The statute creates standing in the donor under these limited circumstances rather than using a relator approach. An alternative would be to write the relator concept into the statute. Using relators requires the involvement of the attorney general. It did not seem necessary, and perhaps not desirable, to require the involvement of the attorney general for the limited purposes identified here.

The Comments should address the issue of the degree to which the restriction must be stated. What will the effect of the charity's statements in solicitation materials be?

Section 9. Release of Restrictions on Use or Investment.

(a) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund.

This is unchanged.

(b) If written consent of the donor cannot be obtained by reason of his [or her] death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the [appropriate] court for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The [Attorney General] shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is unlawful, impracticable, impossible to achieve, or wasteful, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund.

This is substantially the same as UMIFA (1972), but the standard for the court's decision has been changed from "obsolete, inappropriate, or impracticable" to the language used in the UTC's *cy pres* section (413).

(c) If written consent of the donor cannot be obtained by reason of his [or her] death, disability, unavailability, or impossibility of identification, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund if the fund has a total value of less than [\$50,000] and if the governing board concludes that the value of the fund is insufficient to justify the cost of administration as a separate institutional fund.

This provision is similar to UTC § 414(a) and allows the institution to release a restriction on a fund that has become uneconomical to manage as a separate fund. The release of the restriction would then permit the institution to combine the fund with other funds of the institution.

(d) A release under this section may not allow a fund to be used for purposes other than the educational, religious, or charitable purposes of the institution affected.

(e) This section does not limit the application of the doctrine of *cy pres*.