

DRAFT
FOR DISCUSSION ONLY

**UNIFORM PRUDENT MANAGEMENT OF
INSTITUTIONAL FUNDS ACT**

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

Changes Shown in Strike and Score

WITH PREFATORY NOTE AND PRELIMINARY COMMENTS

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ON UNIFORM STATE LAWS

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~~January 3, February 8, 2006~~

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UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

PREFATORY NOTE

Reasons for Revision. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) replaces the Uniform Management of Institutional Funds Act (UMIFA) which was drafted almost 35 years ago and is now out of date. The prudence standards in UMIFA have provided useful guidance, but prudence norms evolve over time. The new Act provides modern articulations of the prudence standards for the management and investment of charitable funds and for endowment spending. The Uniform Prudent Investor Act (UPIA), an Act promulgated in 1994 and already enacted in 43 jurisdictions, served as a model for many of the revisions. UPIA updates rules on investment decision making for trusts, including charitable trusts, and imposes additional duties on trustees for the protection of beneficiaries. UPMIFA applies these rules and duties to charities organized as nonprofit corporations. UPMIFA does not apply to trusts managed by fiduciaries who are not themselves charities, because UPIA provides management and investment standards for those trusts.

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

Like UPIA, UPMIFA provides guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations. And like UPIA, UPMIFA imposes additional duties on those who manage and invest charitable funds. These duties provide additional protections for charities and also protect the interests of donors who want to see their contributions used wisely.

UPMIFA modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines on spending from endowment funds and to give institutions the ability to cope more easily with fluctuations in the value of the endowment.

Finally, UPMIFA updates the provisions governing the release and modification of restrictions on charitable funds to permit more efficient management of these funds. The new provisions follow the approach taken in the Uniform Trust Code (UTC) for modifying charitable trusts. Like the UTC provisions, the modification rules preserve the historic position of the attorneys general in most states as the overseers of charities.

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

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

One of the new prudence factors is “the preservation of the endowment fund,” a standard not explicitly stated by UMIFA.

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

1. Give primary consideration to donor intent as expressed in a gift instrument,
2. Act in good faith, with the care an ordinarily prudent person would exercise,
3. Incur only reasonable costs in investing and managing charitable funds,
4. Make a reasonable effort to verify relevant facts,
5. Make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy,
6. Diversify investments unless due to special circumstances the purposes of the fund are better served without diversification,
7. Dispose of unsuitable assets, and
8. In general, develop an investment strategy appropriate for the fund and the charity.

None of these requirements is part of the statutory language of UMIFA.

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

Donor Intent with Respect to Endowments. UPMIFA improves the protection of donor intent with respect to expenditures from endowments. When a donor expresses intent clearly in a written gift instrument, the Act requires that the charity follow the donor’s

instructions. When a donor's intent is not so expressed, UPMIFA directs the charity to spend an amount that is prudent while considering the desire that the fund continue in perpetuity, the specific purposes of the fund, and various economic factors. This approach allows the charity to give effect to donor intent, protect its endowment, assure generational equity, and use the endowment to support the purposes for which the endowment was created.

Retroactivity. Like UMIFA, UPIA, the Uniform Principal and Income Act of 1961 and the Uniform Principal and Income Act of 1997, UPMIFA applies retroactively to institutional funds created before and after enactment of the statute.

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

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

More recently the Colorado Supreme Court considered the retroactive application of another default statute, one that treats the designation of a spouse as the beneficiary of a life insurance policy as revoked when the spouses dissolve their marriage. *In re Estate of DeWitt*, 54 P. 3d 849 (Colo. 2002). In holding that retroactive application of the statute did not violate the Contracts Clause, the court cited approvingly from a statement prepared by the Joint Editorial Board for Uniform Trusts and Estates Acts (JEB). JEB Statement Regarding the 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)). As the JEB Statement explains, the purpose of the anti-retroactivity norm is to protect transferors who rely on existing rules of law. By definition, however, rules of construction apply only in situations in which a transferor did not spell out his or her intent. *See also In re Gardner's Trust*, 266 Minn. 127, 132, 123 N.W. 2d 69, 73 (1963) ("[I]t is doubtful whether the testatrix had any clear intention in mind at the time the will was executed. It is equally plausible that if she had thought about it at all she would have desired to

have the dividends go where the law required them to go at the time they were received by the trustee.”) (Uniform Principal and Income Act).

In addition, non-retroactivity would have enormous practical problems: If the Act were not retroactive, charities would need to keep two sets of books for each endowment fund created before the enactment of UPMIFA, if new funds were added after the enactment. This practice would be incredibly burdensome for charities. The burden such a rule would impose is out of proportion to the benefit sought. The benefit, presumably, would be to require that with respect to a fund created before the effective date, a charity would be unable to spend “historic dollar value” (defined as the amounts contributed the fund), but be able to spend appreciation above historic dollar value based on less onerous factors than those in UPMIFA. The concern will only apply to a fund if the value of the fund has fallen below its historic dollar value, a distinct minority of funds. Thus, the burden would be imposed on all charities, in perpetuity, and the benefit would affect only a few cases. The costs in legal fees and administrative fees will reduce amounts available for charitable purposes.

Endowment Spending. UPMIFA improves the endowment spending rule by providing better guidance to charities about spending from endowment funds. In connection with these changes, UPMIFA eliminates the concept of historic dollar value. UMIFA provides that a charity can spend amounts above historic dollar value that the charity determines to be prudent, with an emphasis on the purposes and needs of the charity rather than on the purposes and perpetual nature of the fund. Amounts below historic dollar value cannot be spent. The Drafting Committee concluded that this approach created numerous problems and that restructuring the endowment spending rule would benefit charities, their donors, and the public. The problems include:

1. Historic dollar value requires valuation at a moment in time, and that moment may be arbitrary. If a donor provides for a gift in the donor’s will, the date of valuation for the gift will likely be the donor’s date of death. (Another uncertainty under UMIFA is the appropriate date for valuing a testamentary gift.) Assuming valuation on the date of death, the determination of historic dollar value can vary significantly depending upon whether the donor dies in Month 1 of a given year or Month 6 of that year. In addition, the fund may be below historic dollar value at the time the charity receives the gift if the value of the asset declines between the date of the donor’s death and the date the asset is actually distributed to the charity from the estate.
2. After a fund has been in existence for a number of years, historic dollar value may become meaningless. Assuming reasonable investment success, the value of the fund will be well above historic dollar value, and historic dollar value will no longer represent the purchasing power of the original gift. Without better guidance on spending the increase in value of the fund, historic dollar value does not provide adequate protection for the fund. If a charity views the restriction on spending simply as a direction to preserve historic dollar value, the charity may spend more than it should.
3. Another problem with UMIFA has been that the Act does not provide

clear answers to questions a charity faces when the value of an endowment fund drops below historic dollar value. A fund in this predicament that is encumbered by a historic-dollar-value restriction is commonly called an “underwater” fund. Conflicting advice as to whether an organization could spend from an underwater fund led to difficulties for those managing charities. If a charity concluded that it could continue to spend trust accounting income until a fund regained its historic dollar value, the charity might invest for income rather than on a total-return basis. Thus, the historic dollar value rule can cause inappropriate distortions in the manner of investments and can ultimately result in the decline in a fund’s real value by discouraging investment for growth. If, instead, a charity with an underwater fund continues to invest for growth, the charity may be unable to spend anything from an underwater endowment fund for several years. The inability of a charity to spend anything from an endowment is likely to be contrary to donor intent which is to provide current benefits to the charity.

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

Presumption of Imprudence. UPMIFA includes as an optional provision a presumption of imprudence if a charity spends more than seven percent of an endowment fund in any one year. The presumption provides protection against the temptation to spend an endowment too quickly and provides support to attorneys general who wish to argue that a particular charity is spending more than it should. Although the Drafting Committee believes that the prudence standard of UPMIFA provides appropriate and adequate protection for endowments, the Committee provided the option for states that wanted to include a mechanical guideline in the statute.

Modification of Restrictions on Charitable Funds. Another improvement in UPMIFA is that the revised Act clarifies that the doctrines of cy pres and deviation apply to funds held by nonprofit corporations as well as to funds held by charitable trusts. Courts have applied trust law rules to nonprofit corporations in the past, but the Drafting Committee believed that providing statutory clarification that the rules do apply to nonprofit corporations will be helpful. UMIFA created a rule permitting release of restrictions but left the application of cy pres uncertain. Under UPMIFA, as under trust law, the court will determine whether and how to apply cy pres or deviation and the attorney general will receive notice and have the opportunity to participate in the proceeding. The one addition to existing law is that UPMIFA gives a charity the authority to modify a restriction on a fund that is both old and small. For these funds, the expense of a trip to court will often be prohibitive. By permitting a charity to make an appropriate modification, money is saved for the charitable purposes of the charity. Even with respect to small, old funds, however, the charity must notify the attorney general of the charity’s intended action. Of course, if the attorney general has concerns, he or she can seek the agreement of the charity to change or abandon the modification, and if that fails, can commence a court action to enjoin it. Thus, in all types of modification the role of the attorney general continues to be the protector of the donor’s intent and the protector of the public’s interest in charitable funds.

Other Legal Rules. UPMIFA 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 UPMIFA, 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.

Trust Law. UPMIFA applies a number of rules from trust law to institutions organized as nonprofit corporations. In two respects UPMIFA creates rules that do not exist under the common law applicable to trusts. The endowment spending rule of Section 4 and the small, old fund modification provision of subsection (d) of Section 6 have no counterparts in trust law, either in the common law, in the UTC, or in other trust statutes. The Drafting Committee believes that these rules could be useful to charities organized as trusts, and the Committee recommends amendments to the UTC and the Principal and Income Act to incorporate these changes into trust law.

Drafting Note. In 1972 the National Conference of Commissioners on Uniform State Laws approved UMIFA, and 47 jurisdictions have enacted the Act. UMIFA made significant improvements to the laws governing charities in three respects: UMIFA provided guidance and authority to charitable organizations within its scope concerning the management and investment of funds held by those organizations, UMIFA provided endowment spending rules that did not depend on trust accounting principles of income and principal, and UMIFA permitted the release of restrictions on the use or management of funds under certain circumstances. The changes UMIFA made to the law permitted charitable organizations to use modern investment techniques such as total-return investing and to determine endowment fund spending based on spending rates rather than on determinations of “income” and “principal.”

The investment standards adopted by UMIFA foreshadowed changes to trust investment law when UPIA was drafted in 1994. The Uniform Principal and Income Act (1997) furthered the principles of UPIA, providing tools for the use of investment techniques authorized under UPIA. The UTC expanded the application of the doctrine of cy pres. These Uniform Acts, together with the RMNCA have informed the work of the Drafting Committee.

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

2
3 **SECTION 1. SHORT TITLE.** This [act] may be cited as the Uniform Prudent
4 Management of Institutional Funds Act.

5 **SECTION 2. DEFINITIONS.** In this [act]:

6 (1) “Charitable purpose” means the relief of poverty, the advancement of
7 education or religion, the promotion of health, the promotion of governmental purposes, or any
8 other ~~another~~ purpose the achievement of which is beneficial to the community.

9 (2) “Endowment fund” means an institutional fund, or any part thereof, not
10 wholly expendable by the institution on a current basis under the terms of a gift instrument. The
11 term does not include assets of an institution designated by the institution as an endowment fund
12 for its own use.

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

18 (4) “Institution” means:

19 (A) a person, other than an individual, organized and operated exclusively
20 for charitable purposes;

21 (B) a government, or governmental subdivision, agency, or
22 instrumentality to the extent that it holds funds exclusively for a charitable purpose;

1 (C) a trust that had both charitable and noncharitable interests, after all
2 noncharitable interests have terminated.

3 (5) “Institutional fund” means a fund held by an institution exclusively for
4 charitable purposes. The term does not include:

5 (A) program-related assets;

6 (B) a fund held for an institution by a trustee that is not an institution; or

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

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

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

16 (8) “Record” means information that is inscribed on a tangible medium or that is
17 stored in an electronic or other medium and is retrievable in perceivable form.

18 **Preliminary Comment**

19
20
21 **Subsection (1). Charitable Purpose.** The definition of charitable purpose uses the same
22 formulation as that in UTC § 405 and Restatement (Third) of Trusts § 28 (2003). The definition
23 is the standard legal definition of charitable purposes, developed from the definition of charity
24 set forth in the English Statute of Charitable Uses, enacted in 1601, but evolving from that
25 definition over time. The United Kingdom is considering amending and broadening the 1601
26 statute, and that new articulation, if adopted, should be consistent with the approach taken in
27 UPMIFA.

1 Some 17 states have created statutory definitions of charitable purpose for other
2 purposes. *See, e.g.*, 10 PA. CONS. STAT. § 162.3 (2005) (setting forth a definition of charitable
3 purpose within the Solicitation of Funds for Charitable Purposes Act. The definition includes the
4 words “humane,” “patriotic,” social welfare and advocacy,” and “civic.”) The definition in
5 subsection (1) applies for purposes of this Act and does not affect other definitions of charitable
6 purpose.
7

8 **Subsection (2). Endowment Fund.** An endowment fund is an institutional fund or a part
9 of an institutional fund that is not wholly expendable by the institution on a current basis. A
10 restriction that makes a fund an endowment fund arises from the terms of a gift instrument. If an
11 institution has more than one endowment fund, under Section 3 the institution can manage and
12 invest some or all endowment funds together. Section 4 and Section 6 must be applied to
13 individual funds and cannot be applied to a group of funds that may be managed collectively for
14 investment purposes.
15

16 Board-designated funds are institutional funds but not endowment funds. The rules on
17 expenditures and modification of restrictions in this Act do not apply to restrictions placed by an
18 institution on an otherwise unrestricted fund held by the institution for its own benefit. The
19 institution may be able to change these restrictions itself, subject to internal rules and to the
20 fiduciary duties that apply to those that manage an institution.
21

22 If an institution transfers assets to another institution, subject to the restriction that the
23 other institution hold the assets as an endowment, then the second institution will hold the assets
24 as an endowment fund.
25

26 **Subsection (3). Gift Instrument.** The term gift instrument refers to the records that
27 establish the terms of a gift and may consist of more than one document. The definition clarifies
28 that the only legally binding restrictions on a gift are the terms set forth in writing. Although a
29 donor and a charity may converse about the donor’s ideas and the charity’s plans for a gift, oral
30 expressions of intent do not set the terms for the use of a fund established by a donor.
31 Conversations may be misconstrued or misremembered, and years after a donor makes a gift, a
32 conflict may arise over what the donor and the charity intended. Written documents provide the
33 best evidence of intent and can protect both the donor and the institution.
34

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

1 be used for that purpose and not for broader purposes permissible under the articles of
2 incorporation.

3
4 Solicitation materials may constitute a gift instrument. For example, a solicitation that
5 suggests in writing that any gifts received pursuant to the solicitation will be held as an
6 endowment may be integrated with other writings and may be considered part of the gift
7 instrument. Whether the terms of the solicitation become part of the gift instrument will depend
8 upon the circumstances of the gift and whether a subsequent writing superseded the terms of the
9 solicitation. Each gift received in response to a solicitation will be subject to any restrictions
10 indicated in the gift instrument that applies to that gift. For example, if an initial gift establishes
11 an endowment fund, and then the charity solicits additional gifts “to be held as part of the
12 Charity X Endowment Fund,” those additional gifts will each be subject to the restriction that the
13 gifts be held as part of the endowment fund.

14
15 The term gift instrument includes matching funds provided by an employer or some other
16 person. Whether matching funds are treated as part of the endowment fund or otherwise will
17 depend on the terms of the matching gift.

18
19 The term gift instrument also includes an appropriation by a legislature or other public or
20 governmental body for the benefit of an institution.

21
22 **Subsection (4). Institution.** The Act applies generally to institutions organized and
23 operated exclusively for charitable purposes. By defining institution as a person, the term
24 includes charitable organizations created as nonprofit corporations, trusts, unincorporated
25 associations, governmental subdivisions or agencies, or any form of entity, however organized,
26 that is organized and operated exclusively for charitable purposes. The term includes a trust
27 organized and operated exclusively for charitable purposes, but only if a charity acts as trustee.
28 This approach leaves unchanged the coverage of UMIFA. The exclusion of “individual” from
29 the definition of institution is not intended to exclude a corporation sole.

30
31 In many respects, changes in trust law have caught up with the provisions in UMIFA, so
32 the exclusion of certain trusts from UPMIFA does not mean that many of the rules of UPMIFA
33 will not apply to those trusts. Prudent investor standards apply to trustees of charitable trusts in
34 states that have adopted UPIA, trustees can use the doctrines of cy pres and deviation to modify
35 trust provisions, and the Uniform Principal and Income Act, where enacted, permits allocation
36 between principal and income to facilitate total-return investing. Charitable trusts not included
37 in UPMIFA, primarily those managed by corporate trustees and individuals, will lose the
38 benefits of UPMIFA’s endowment spending rule and the provision permitting a charity to apply
39 cy pres, without court supervision, for modifications to a small, old fund. Enacting jurisdictions
40 may choose to incorporate these rules into existing trust statutes to provide the benefits to
41 charitable funds managed by corporate trustees.

42
43 The definition of institution includes governmental organizations that hold funds
44 exclusively for the purposes listed in the definition. Some organizations created by state
45 government may fall outside the definition due to the way in which the state created the

1 organizations. Because state arrangements are so varied, creating a definition that encompasses
2 all charitable entities created by states is not feasible. States should consider the core principles
3 of UPMIFA for application to governmental institutions. For example, the control over a state
4 university may be held by a State Board of Regents. In that situation, the state may have created
5 a governing structure by statute or in the state constitution so that the university is, in effect,
6 privately chartered. The Drafting Committee does not intend to exclude these universities from
7 the definition of institution, but additional state legislation may be necessary to address particular
8 situations.

9
10 **Subsection (5). Institutional Fund.** The term institutional fund includes any fund held
11 by an institution for charitable purposes, whether expendable currently or subject to restrictions.
12 The term does not include a fund held by a trustee that is not an institution.

13
14 Some institutions combine assets from multiple funds for investment purposes, and some
15 institutions combine funds from different institutions to invest in a common fund. Typically
16 each fund is assigned units representing the value of the individual fund. The assets can then be
17 invested collectively, permitting more efficient investment and improved diversity of the overall
18 portfolio. The collective fund makes annual distributions to the individual funds based on the
19 units held by each fund. For purposes of Section 3 [and Section 5], the collective fund is
20 considered one institutional fund. Section 4 and Section 6 apply to each fund individually and
21 not to the collective fund.

22
23 Assets held by an institution primarily for program-related purposes are not subject to
24 UPMIFA, because assets used to carry out a charity's program should not be subject to the same
25 investment standards that apply to assets held primarily for investment purposes. For example, a
26 university may purchase land adjacent to its campus for future development. The purchase
27 might not meet prudent investor standards, but the purchase may be appropriate because the
28 university needs to build a new dormitory. The classroom buildings, administration buildings,
29 and dormitories held by the university all have value as property, but the university does not hold
30 those buildings for investment purposes. The Act excludes from the prudent investor norms
31 those assets that a charity uses to conduct its charitable activities, but does not exclude assets that
32 have a tangential tie to the charitable purpose of the institution but are held primarily for
33 investment purposes.

34
35 A fund held by an institution is not an institutional fund if any beneficiary of the fund is
36 not an institution. For example, a charitable remainder trust held by a charity as trustee for the
37 benefit of the donor during the donor's lifetime, with the remainder interest held by the charity,
38 is not an institutional fund. However, this subsection treats as an institution a charitable
39 remainder trust that continues to operate for charitable purposes after the termination of the
40 noncharitable interests. The Act will have only a limited effect on a charitable remainder trust
41 during the period required to complete the distribution of the trust's property after the
42 noncharitable interest ends. The prudence norm will apply to the actions of the trustee, but the
43 trustee will make decisions about investment and management of funds knowing that the trust
44 will distribute its assets and not continue indefinitely.

1 **Subsection (6). Person.** The Act uses as the definition of person the definition approved
2 by the National Conference of Commissioners on Uniform State Laws. The definition of
3 institution uses the term person, but to be an institution a person must be organized and operated
4 exclusively for charitable purposes. A person with a commercial purpose cannot be an
5 institution. Thus, although the definition of person includes “business trust” and “any other . . .
6 commercial entity,” the Act does not apply to an entity organized for business purposes and not
7 exclusively for charitable purposes. Further, the definition of person includes trusts, but only
8 trusts managed by charities can be institutional funds. UPMIFA does not apply to trusts
9 managed by corporate trustees or by individual trustees.

10
11 If a governing instrument provides that a fund will revert to the donor if, and only if, the
12 institution ceases to exist or the purposes of the fund fail, then the fund will be considered an
13 institutional fund until such contingency occurs.

14
15 **Subsection (7). Program-Related Asset.** Although UPMIFA does not apply to
16 program-related assets, if program-related assets serve, in part, as investments for an institution,
17 then the institution should identify categories for reporting those investments and should
18 establish investment criteria for the investments that are reasonably related to achieving the
19 institution’s charitable purposes. For example, a program providing below-market loans to
20 inner-city businesses may be “primarily to accomplish a charitable purpose of the institution” but
21 also can be considered, in part, an investment. The institution should create reasonable credit
22 standards and other guidelines for the program to increase the likelihood that the loans will be
23 repaid.

24
25 **Subsection (8). Record.** This definition was added to clarify that the definition of
26 instrument includes electronic records as defined in Section 2(8) of the Uniform Electronic
27 Transactions Act (1999).

28
29 **SECTION 3. STANDARD OF CONDUCT IN MANAGING AND INVESTING**
30 **INSTITUTIONAL FUND.**

31 (a) Subject to the intent of a donor expressed in a gift instrument, an institution,
32 in managing and investing an institutional fund, shall consider the charitable purposes of the
33 institution and the purposes of the institutional fund.

34 (b) In addition to complying with the duty of loyalty imposed by law other than
35 this [act], each person responsible for managing and investing an institutional fund shall manage

1 and invest the fund in good faith and with the care an ordinarily prudent person in a like position
2 would exercise under similar circumstances.

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

4 (1) may incur only costs that are appropriate and reasonable in relation to
5 the assets, the purposes of the institution, and the skills available to the institution; and

6 (2) shall make a reasonable effort to verify facts relevant to the
7 management and investment of the fund.

8 (d) An institution may pool two or more institutional funds for purposes of
9 management and investment.

10 (e) Except as otherwise provided by a gift instrument, the following rules apply:

11 (1) In managing and investing an institutional fund, the following factors,
12 if relevant, must be considered:

13 (A) general economic conditions;

14 (B) the possible effect of inflation or deflation;

15 (C) the expected tax consequences, if any, of investment decisions
16 or strategies;

17 (D) the role that each investment or course of action plays within
18 the overall investment portfolio of the fund;

19 (E) the expected total return from income and the appreciation of
20 investments;

21 (F) other resources of the institution;

1 (G) the needs of the institution and the fund to make distributions
2 and to preserve capital; and

3 (H) an asset's special relationship or special value, if any, to the
4 charitable purposes of the institution.

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

9 (3) ~~An~~ Except as otherwise provided by law other than this [act], an
10 institution, ~~subject to law other than this act,~~ may invest in any kind of property or type of
11 investment consistent with the standards of this section.

12 (4) An institution shall diversify the investments of an institutional fund
13 unless the institution reasonably determines that, because of special circumstances, the purposes
14 of the fund are better served without diversification ~~diversifying~~.

15 (5) Within a reasonable time after receiving property, an institution shall
16 make and implement decisions concerning the retention or disposition of the property or to
17 rebalance a portfolio, in order to bring the institutional fund into compliance with the purposes,
18 terms, distribution requirements, and other circumstances of the institution and the requirements
19 of this [act].

20 (6) A person who has special skills or expertise, or is selected in reliance
21 upon the person's representation that the person has special skills or expertise, has a duty to use
22 those special skills or that expertise in managing and investing institutional funds.
23

1
2
3 **Preliminary Comment**

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

13 The Drafting Committee discussed at great length the standard that should govern
14 nonprofit managers. UMIFA states the standard as “ordinary business care and prudence under
15 the facts and circumstances prevailing at the time of the action or decision.” Since the decision in
16 *Stern v. Lucy Webb Hayes National Training School for Deaconesses*, 381 F. Supp. 1003 (1974),
17 the trend has been to hold directors of nonprofit corporations to a standard similar to the
18 corporate standard but with the recognition that the facts and circumstances considered include
19 the fact that the entity is a charity and not a business corporation.
20

21 The language of the prudence standard adopted in UPMIFA is derived from the RMNCA
22 and from the prudent investor rule of UPIA. The standard is consistent with the business
23 judgment standard under corporate law, *as applied to charitable institutions*. That is, a manager
24 operating a charitable organization under the business judgment rule would look to the same
25 factors as those identified by the prudent investor rule. The standard for prudent investment set
26 forth in Section 3 first states the duty of care as articulated in the RMNCA. The standard then
27 provides more specific guidance for those managing and investing institutional funds by
28 incorporating language from UPIA. The factors and rules derived from UPIA are consistent with
29 good practice under current law applicable to nonprofit corporations.
30

31 Trust law norms already inform managers of nonprofit corporations. The Preamble to
32 UPIA explains: “Although the Uniform Prudent Investor Act by its terms applies to trusts and
33 not to charitable corporations, the standards of the Act can be expected to inform the investment
34 responsibilities of directors and officers of charitable corporations.” *See also*, Restatement
35 (Third) of Trusts: Prudent Investor Rule § 379, Comment b, at 190 (1992) (stating “absent a
36 contrary statute or other provision, the prudent investor rule applies to investment of funds held
37 for charitable corporations.”). Trust precedents have always been helpful but not binding
38 authority in corporate cases.
39

40 The Drafting Committee decided that by adopting language from both the RMNCA and
41 UPIA, UPMIFA could clarify that the same standards of prudent investing apply to all charitable
42 institutions. Although principal trust authorities, UPIA § (2)(a), Restatement (Third) of Trusts
43 §337, UTC § 804, and Restatement (Second) of Trusts § 174 (prudent administration) use the
44 phrase “care, skill and caution,” the Drafting Committee decided to use the more familiar
45 corporate formulation as found in RMNCA. The standard also appears in Sections 3, 4 and 5 of

1 UPMIFA. The Drafting Committee does not intend any substantive change to the UPIA
2 standard and believes that “reasonable care, skill, and caution” are implicit in the term “care” as
3 used in the RMNCA. The Drafting Committee included the detailed provisions from UPIA,
4 because the Committee believed that the greater precision of the prudence norms of the
5 Restatement and UPIA, as compared with UMIFA, could helpfully inform managers of
6 charitable institutions. For an explanation of the Prudent Investor Act, see John H. Langbein,
7 *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641
8 (1996).

9
10 Section 3 has incorporated the provisions of UPIA with only a few exceptions. UPIA
11 applies to private trusts and thus is entirely default law. A settlor of a private trust has complete
12 control over trust provisions. Because UPMIFA applies to charitable organizations, UPMIFA
13 makes the duty of care, the duty to minimize costs, and the duty to investigate mandatory. The
14 duty of loyalty is mandatory under other law. Other than these duties, the provisions of Section
15 3 are default rules. A gift instrument or the governing instruments of an institution can modify
16 these duties, but the charitable purpose doctrine limits the extent to which an institution or a
17 donor can restrict these duties. In addition, subsection (a) of Section 3 reminds the decision
18 maker that the intent of a donor expressed in a gift instrument will control decision making.
19 Further, the decision maker must consider the charitable purposes of the institution and the
20 purposes of the institutional fund for which decisions are being made. These factors are specific
21 to charitable organizations, but UPIA § 2(a) states the duty to consider similar factors in the
22 private trust context.

23
24 UPMIFA does not include the duty of impartiality, stated in UPIA § 6, because the duty
25 under UPIA did not make sense when applied to charities created as nonprofit corporations.
26 Under UPIA, a trustee must treat the current beneficiaries and the remainder beneficiaries
27 impartially, subject to alternative direction from the trust document. A nonprofit corporation
28 typically creates one charity. The institution may serve multiple beneficiaries, but those
29 beneficiaries do not have enforceable rights in the institution in the same way that beneficiaries
30 of a private trust do. Of course, if a charitable trust is created to benefit more than one charity,
31 rather than being created to carry out a charitable purpose, then UPIA will apply the duty of
32 impartiality to that trust.

33
34 In other respects, the Drafting Committee made changes to language from UPIA only
35 where necessary to make the language appropriate for charitable institutions. No material
36 differences are intended. Subsection (e)(1)(D) of Section 3 does not include a clause that
37 appears at the end of UPIA § 2(c)(4) (“which may include financial assets, interest in closely
38 held enterprises, tangible and intangible personal property, and real property.”). The Drafting
39 Committee deemed this clause unnecessary for charitable institutions. The language of
40 subsection (e)(1)(G) reflects a modification of the language of UPIA § (2)(c)(7). Other minor
41 modifications to the UPIA provisions make the language more appropriate for charitable
42 institutions.

43
44 The duties imposed by this section apply to those who govern an institution, including
45 directors and trustees, and to those to whom the directors or managers delegate responsibility for

1 investment and management of institutional funds. The standard applies to officers and
2 employees of an institution and to agents who invest and manage institutional funds. Volunteers
3 who work with an institution will be subject to the duties imposed here, but state and federal
4 statutes may provide reduced monetary liability for persons who act without compensation.
5 UPMIFA does not affect the application of those monetary liability shield statutes.

6
7 **Subsection (a). Donor Intent and Charitable Purposes.** Subsection (a) states the
8 overarching direction provided by the donor’s intent as expressed in the terms of the gift
9 instrument and the duty to consider the charitable purposes of the institution and of the
10 institutional fund in making management and investment decisions. A charity must comply with
11 restrictions imposed on a gift by a donor, but the emphasis in the Act on giving effect to donor
12 intent does not mean that the donor can or should control the management of the institution. The
13 UPIA counterpart of subsection (a) is UPIA § 2(a).

14
15 **Subsection (b). Duty of Loyalty.** Subsection (b) reminds those managing and investing
16 institutional funds that the duty of loyalty will apply to their actions, but Section 3 does not state
17 the loyalty standard that applies. The Drafting Committee was concerned that different standards
18 of loyalty may apply to directors of nonprofit corporations and trustees of charitable trusts. The
19 RMNCA provides that under the duty of loyalty a director of a nonprofit corporation should act
20 “in a manner the director reasonably believes to be in the best interests of the corporation.”
21 RMNCA § 8.30. The trust law articulation of the loyalty standard uses “sole interests” rather
22 than “best interests.” As the Restatement of Trusts explains, “[t]he trustee is under a duty to the
23 beneficiary to administer the trust solely in the interest of the beneficiary.” Restatement
24 (Second) of Trusts § 170 (1). Although the standards for loyalty, like the standard of care, are
25 merging, *see* Evelyn Brody, *Charitable Governance: What’s Trust Law Got to do With It?* Chi.-
26 Kent L. Rev. (2005); John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole*
27 *Interest or Best Interest*, 114 Yale L.J. 929 (2005), the Drafting Committee concluded that
28 incorporating the duty of loyalty into UPMIFA was unnecessary. Thus the duty of loyalty under
29 nonprofit corporation law will apply to charities organized as nonprofit corporations, and the
30 duty of loyalty under trust law will apply to charitable trusts.

31
32 **Subsection (b). Duty of Care.** Subsection (b) also applies the duty of care to
33 performance of investment duties. The language derives from § 8.30 of the RMNCA. This
34 subsection states the duty to act in good faith, “with the care an ordinarily prudent person in a
35 like position would exercise under similar circumstances.” Although the language in the
36 RMNCA and in UPMIFA is similar to that of § 8.30 of the Model Business Corporation Act (3d
37 ed. 2002), the standard as applied to persons making decisions for charities is informed by the
38 fact that the institution is a charity and not a business corporation. Thus, in UPMIFA the
39 references to “like position” and “similar circumstances” mean that the charitable nature of the
40 institution affects the decision making of a prudent person acting under the standard set forth in
41 subsection (b). The duty of care involves considering the factors set forth in subsection (e)(1).

42
43 **Subsection (c)(1). Duty to Minimize Costs.** Subsection (c)(1) tracks the language of
44 UPIA § 7 and requires an institution to minimize costs. An institution may prudently incur costs
45 by hiring an investment advisor, but the costs incurred should be appropriate under the

1 circumstances. *See* UPIA § 7 cmt; Restatement (Third) of Trusts: Prudent Investor Rule § 227,
2 cmt. M, at 58 (1992); Restatement (Second) of Trusts § 188 (1959). The duty is consistent with
3 the duty to act prudently under § 8.30 of the RMNCA.
4

5 **Subsection (c)(2). Duty to Investigate.** This subsection incorporates the traditional
6 fiduciary duty to investigate, using language from UPIA § 2(d). The subsection requires persons
7 who make investment and management decisions to investigate the accuracy of the information
8 used in making decisions.
9

10 **Subsection (d). Pooling Funds.** An institution holding more than one institutional fund
11 may find that pooling its funds for investment and management purposes will be economically
12 beneficial. The Act permits pooling for these purposes, and the prohibition against commingling
13 from trust law does not apply to the extent necessary to pool funds for investment and
14 management purposes. *See* Restatement (Third) of Trusts: Duty to Segregate and Identify Trust
15 Property § 84 (T.D. No. 4 2005). Funds will be considered individually for other purposes of the
16 Act, including for the spending rule for endowment funds of Section 4 and the modification rules
17 of Section 6.
18

19 **Subsection (e)(1). Prudent Decision Making.** Subsection (e)(1) takes much of its
20 language from UPIA § 2(c). In making decisions about whether to acquire or retain an asset, the
21 institution should consider the institution’s mission, its current programs, and the desire to
22 cultivate additional donations from a donor, in addition to factors related more directly to the
23 asset’s potential as an investment.
24

25 Subsection (e)(1)(C) reflects the fact that some organizations will invest in taxable
26 investments that may generate unrelated business taxable income for income tax purposes.
27

28 Assets held primarily for program-related purposes are not subject to UPMIFA. The
29 management of those assets will continue to be governed by other laws applicable to the
30 institution. Other assets may not be held primarily for program-related purposes but may have
31 both investment purposes and program-related purposes. Subsections (a) and (e)(1)(H) indicate
32 that a prudent decision maker can take into consideration the relationship between an investment
33 and the purposes of the institution and of the institutional fund in making an investment that may
34 have a program-related purpose but not be primarily program-related. The degree to which an
35 institution uses an asset to accomplish a charitable purpose will affect the weight given that
36 factor in a decision to acquire or retain the asset.
37

38 **Subsection (e)(2). Portfolio Approach.** This subsection reflects the use of portfolio
39 theory in modern investment practice. The language comes from UPIA § 2(b), which follows the
40 articulation of the prudent investor standard in Restatement (Third) of Trusts: Prudent Investor
41 Rule § 227(a) (1992).
42

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

1
2 Section 4 of UMIFA indicated that an institution could invest “without restriction to
3 investments a fiduciary may make.” The committee removed this language from subsection
4 (e)(3) as unnecessary because states no longer have legal lists restricting fiduciary investing to
5 the specific types of investments identified in statutory lists.
6

7 Subsection (e)(3) also provides that other law may limit the authority under this
8 subsection. In addition, all of subsection (e) is subject to contrary provisions in a gift instrument,
9 and a gift instrument may restrict the ability to invest in particular assets. For example, the gift
10 instrument for a particular institutional fund might preclude the institution from investing the
11 assets of the fund in companies that produce tobacco products.
12

13 In her book, Governing Nonprofit Organizations: Federal and State Law and Regulation
14 434 (Harv. Univ. Press 2004), Marion R. Fremont-Smith notes that some large charities pledge
15 their endowment funds as security for loans. Subsection (e)(3) permits this sort of debt
16 financing, subject to the guidelines of subsection (e)(1).
17

18 **Subsection (e)(4). Duty to Diversify.** This subsection assumes that prudence requires
19 diversification but permits an institution to determine that nondiversification is appropriate under
20 the circumstances applicable to a fund. A decision to retain property due to “special
21 circumstances” must be made based on the needs of the charity and not solely for the benefit of a
22 donor. A decision to retain property in the hope of obtaining additional contributions from the
23 same donor may be considered made for the benefit of the charity, but the appropriateness of that
24 decision will depend on the circumstances. This subsection derives its language from UPIA § 3.
25 See UPIA § 3 cmt. (discussing the rationale for diversification); Restatement (Third) of Trusts:
26 Prudent Investor Rule § 227 (1992).
27

28 **Subsection (e)(5). Disposing of Unsuitable Assets.** This subsection imposes a duty on
29 an institution to review the suitability of retaining property contributed to the institution within a
30 reasonable period of time after the institution receives the property. Subsection (e)(5) requires
31 the institution to make a decision but does not require a particular outcome. The institution may
32 consider a variety of factors in making its decision, and a decision to retain the property either
33 for a period of time or indefinitely may be a prudent decision.
34

35 Section 4(2) of UMIFA specifically authorized an institution to retain property
36 contributed by a donor. The comment explained that an institution might retain property in the
37 hope of obtaining additional contributions from the donor. This concept continues under
38 UPMIFA , because the potential for developing additional contributions by retaining property
39 contributed to the institution is one of the “other circumstances” the institution may consider in
40 deciding whether to retain or dispose of the property. The institution must weigh the potential
41 for obtaining additional contributions with all other factors that affect the suitability of retaining
42 the property in the investment portfolio.
43

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

5 **Subsection (e)(6). Special Skills or Expertise.** Subsection (e)(6) states the rule provided
6 in UPIA § 2(f) requiring a trustee to use the trustee’s own skills and expertise in carrying out the
7 trustee’s fiduciary duties. The comment to RMNCA § 8.30 describes the existence of a similar
8 rule under the law of nonprofit corporations. Section 8.30(a)(2) provides that in discharging
9 duties a director must act “with the care an ordinarily prudent person in a like position would
10 exercise under similar circumstances. . . .” The comment explains that “[t]he concept of ‘under
11 similar circumstances’ relates not only to the circumstances of the corporation but to the special
12 background, qualifications, and management experience of the individual director and the role
13 the director plays in the corporation.” After describing directors chosen for their ability to raise
14 money, the comment notes that “[n]o special skill or expertise should be expected from such
15 directors unless their background or knowledge evidences some special ability.”
16

17 The intent of subsection (e)(6) is that a person managing or investing institutional funds
18 must use the person’s own judgment and experience, including any particular skills or expertise,
19 in carrying out the management or investment duties. For example, if a charity names a person
20 as a director in part because the person is a lawyer, the lawyer’s background may allow the
21 lawyer to recognize legal issues in connection with funds held by the charity. The lawyer should
22 identify the issues for the board, but the lawyer is not expected to provide legal advice. A lawyer
23 is not expected to be able to recognize every legal issue, particularly issues outside the lawyer’s
24 area of expertise, simply because the board member is lawyer. *See* ALI Principles of the Law of
25 Nonprofit Organizations, Preliminary Draft No. 3 (May 12, 2005) § 315 (Duty of Care), cmt. c.
26

27 UMIFA contained two provisions that authorized investments in pooled or common
28 investment funds. UMIFA §§ 4(3), 4(4). The Drafting Committee concluded that Section 3(e)(3)
29 of UPMIFA authorizes these investments. The decision not to include the two provisions in
30 UPMIFA implies no disapproval of such investments.
31

32 **SECTION 4. APPROPRIATION FOR EXPENDITURE OR ACCUMULATION**
33 **OF ENDOWMENT FUND; RULES OF CONSTRUCTION.**

34 (a) Subject to the intent of a donor expressed in a gift instrument [and to
35 subsection (d)], an institution may appropriate for expenditure or accumulate so much of an
36 endowment fund as the institution determines to be prudent for the uses, benefits, purposes, and
37 duration for which the endowment fund is established. Unless stated otherwise in a gift
38 instrument, the assets in an endowment fund are donor restricted assets until appropriated for

1 expenditure by the institution. In making a determination to appropriate or accumulate the
2 institution shall act in good faith, with the care that an ordinarily prudent person in a like position
3 would exercise under similar circumstances, and shall consider, if relevant, the following factors:

- 4 (1) the duration and preservation of the endowment fund;
- 5 (2) the purposes of the institution and the endowment fund;
- 6 (3) general economic conditions;
- 7 (4) the possible effect of inflation or deflation;
- 8 (5) the expected total return from income and the appreciation of
9 investments;
- 10 (6) other resources of the institution; and
- 11 (7) the investment policy of the institution.

12 (b) To limit the authority to ~~expend~~ appropriate for expenditure or accumulate
13 ~~funds~~ under subsection (a), a gift instrument must specifically state the limitation.

14 (c) Terms in a gift instrument designating a gift as an endowment, or a direction
15 or authorization in the gift instrument to use only “income”, “interest”, “dividends”, or “rents,
16 issues, or profits”, or “to preserve the principal intact”, or similar words:

- 17 (1) create an endowment fund of permanent duration unless other
18 language in the gift instrument limits the duration or purpose of the fund; and
- 19 (2) do not otherwise limit the authority to ~~expend~~ appropriate for
20 expenditure or accumulate under subsection (a).

21 [(d) The appropriation for expenditure in any year of an amount greater than
22 seven percent of the fair market value of ~~the~~ an endowment fund, calculated on the basis of

1 market values determined at least quarterly and averaged over a period of not less than three ~~not~~
2 ~~more than five~~ years immediately preceding the year in which the appropriation for expenditure
3 was made, creates a rebuttable presumption of imprudence. For an endowment fund in existence
4 for fewer than three years, the fair market value of the endowment fund ~~will~~ shall be calculated
5 for the period of time the endowment fund has been in existence. This subsection does not:

- 6 (1) apply to an appropriation for expenditure ~~limit the authority to make~~
7 ~~expenditures as~~ permitted under law other than this [act] or the gift instrument; ~~and or~~ and
8 (2) create a presumption of prudence for ~~the~~ an appropriation for
9 expenditure of an amount less than or equal to seven percent of the fair market value of the
10 endowment fund.]

11 Preliminary Comment

12
13 **Purpose and Scope of Revisions.** This section revises the provision in UMIFA that
14 permitted the expenditure of appreciation of an endowment fund to the extent the fund had
15 appreciated in value above the fund’s historic dollar value. UMIFA defined historic dollar value
16 to mean all contributions to the fund, valued at the time of contribution. The new approach
17 abandons the use of historic dollar value and instead applies a more carefully articulated
18 prudence standard to the process of making decisions about expenditures from an endowment
19 fund. The expenditure rule of Section 4 applies only to the extent that a donor and an institution
20 have not reached some other agreement about spending from an endowment. If a gift instrument
21 sets forth specific requirements for spending, then the charity must comply with those
22 requirements. However, if the gift instrument uses more general language, for example directing
23 the charity to “hold the fund as an endowment” or “retain principal and spend income,” then
24 Section 4 provides a rule of construction to guide the charity.

25
26 One of the difficulties addressed by UMIFA and UPMIFA is that the definition of
27 “income” has changed over time. Prior to the promulgation of UMIFA, “income” for trust
28 accounting purposes meant interest and stock dividends but not capital gains, even realized
29 capital gains. Many institutions assumed that trust accounting principles applied to charities
30 organized as nonprofit corporations, and the rules limited the institutions’ ability to invest their
31 endowment funds effectively. UMIFA addressed this problem by including a construction
32 provision, construing “income” in gift instruments to include a prudent amount of capital gains,
33 both realized and unrealized. Under UMIFA an institution could spend appreciation in addition
34 to spending income determined under trust accounting rules. This rule of construction likely

1 carried out the intent of the donor better than a rule limiting spending to trust accounting income,
2 while permitting the charity to invest in a manner that could generate better returns for the fund.
3

4 UPMIFA also applies a rule of construction to terms like “income” or “endowment.”
5 The assumption in the Act is that a donor who uses one of these terms intends to create a fund
6 that will generate sufficient gains to be able to make ongoing distributions from the fund while at
7 the same time preserving the purchasing power of the fund. Because historic dollar value under
8 UMIFA was a number fixed in time, the use of that approach may not have adequately captured
9 the intent of a donor who wanted the endowment fund to continue to maintain its value in current
10 dollars. UPMIFA takes a different approach, directing the institution to determine spending
11 based on the total assets of the endowment fund rather than determining spending by adding a
12 prudent amount of appreciation to trust accounting income.
13

14 UPMIFA requires the persons making spending decisions for an endowment fund to
15 focus on the purposes of the endowment fund and not the purposes of the institution more
16 generally, as was the case under UMIFA. When the institution considers the purposes and
17 duration of the fund, the institution will give priority to the donor’s general intent that the fund
18 be maintained permanently. Although the Act does not require that a specific amount be set
19 aside as “principal,” the Act assumes that the charity will act to preserve “principal” (i.e., to
20 maintain the purchasing power of the amounts contributed to the fund) while spending “income”
21 (i.e. making a distribution each year that represents a reasonable spending rate, given investment
22 performance and general economic conditions). Thus, an institution should monitor principal in
23 an accounting sense, identifying the original value of the fund (the historic dollar value) and the
24 increases in value necessary to maintain the purchasing power of the fund.
25

26 **Subsection (a). Expenditure of Endowment Funds.** Subsection (a) uses the RMNCA
27 articulation of the standard of care for decision making under Section 4. The change in language
28 does not reflect a substantive change. The comment to Section 3 more fully describes this
29 standard of care.
30

31 Section 4 permits expenditures from an endowment fund to the extent the institution
32 determines that the expenditures are prudent after considering the factors listed in subsection (a).
33 These factors emphasize the importance of keeping in mind the intent of the donor, as expressed
34 in a gift instrument. Section 4 relies on written documents as evidence of donor’s intent and
35 does not require an institution to rely on oral expressions of intent because conversations over
36 lunch and other oral expressions of intent may be misremembered and may be subject to multiple
37 interpretations. Of course, oral expressions of intent may guide an institution in carrying out a
38 donor’s wishes and can be used by the institution in understanding a donor’s intent. By requiring
39 written evidence of intent, however, the Act protects reliance by the donor and the institution on
40 the written terms of a donative agreement.
41

42 The factors in subsection (a) require the institution to focus on the purposes of the
43 institution and of the endowment fund, while also considering economic conditions as well as
44 present and reasonably anticipated resources of the institution. As under UMIFA, determinations
45 under Section 4 do not depend on the characterization of assets as income or principal and are

1 not limited to the amount of income and unrealized appreciation. The rule in Section 4 is
2 permissive, however, and an institution organized as a trust may continue to make spending
3 decisions under trust accounting principles so long as doing so is prudent.
4

5 Institutions have operated effectively under UMIFA and have operated more
6 conservatively than the historic dollar value rule would have permitted. Institutions have no
7 incentive to spend everything the law may permit them to spend, and good practice has been to
8 provide for modest expenditures while maintaining the purchasing power of a fund. Institutions
9 have followed this approach even though UMIFA does not require an institution to maintain a
10 fund's purchasing power and allows an institution to spend any amounts in a fund above historic
11 dollar value, subject to the prudence standard but without a direction to focus on the perpetuation
12 of the endowment. The Drafting Committee concluded that eliminating historic dollar value and
13 providing institutions with more discretion would not lead to depletion of endowment funds.
14 Instead, UPMIFA should encourage institutions to establish a spending approach that will be
15 responsive to short-term fluctuations in the value of the fund. Section 4 allows an institution to
16 maintain appropriate levels of expenditures in times of economic downturn or economic
17 strength. In some years, accumulation rather than spending will be prudent, and in other years an
18 institution may appropriately make expenditures even if a fund has generated no investment
19 return that year.
20

21 Several levels of safeguards exist to prevent institutions from depleting endowment funds
22 or diverting funds from the purposes for which they were created. In comparison with UMIFA,
23 UPMIFA provides greater direction to the institution with respect to making a prudent
24 determination about spending from an endowment. UMIFA told the decision maker to consider
25 "long and short term needs of the institution in carrying out its educational, religious, charitable,
26 or other eleemosynary purposes, its present and anticipated financial requirements, expected total
27 return on its investments, price level trends, and general economic conditions." UPMIFA
28 clarifies that in making spending decisions the institution should focus on the fact that the fund is
29 an endowment and should attempt to ensure that the value of the fund endures while still
30 providing that some amounts be spent for the purposes of the endowment fund. In UPMIFA
31 prudent decision making emphasizes the endowment aspect of the fund, rather than the overall
32 purposes or needs of the institution.
33

34 In addition to the guidance provided by Section 4, other safeguards exist. Donors can
35 restrict gifts and can provide specific instructions to donee institutions as to appropriate uses for
36 assets contributed. Within institutions, fiduciary duties govern the persons making decisions on
37 expenditures. Those persons must operate both with the best interests of the institution in mind
38 and in keeping with the intent of donors. If an institution diverts an institutional fund from the
39 charitable purposes of the institution, the state attorney general can enforce the charitable
40 interests of the public. By relying on these safeguards while providing institutions with adequate
41 discretion to make decisions on appropriate expenditures, the Act creates a standard that takes
42 into consideration the diversity of the charitable sector. The committee expects that industry
43 standards will continue to evolve and inform institutions as the institutions apply this standard.
44

1 Section 4 provides factors to consider in exercising discretion but does not take away
2 discretion by providing a safe harbor for spending within a range based on percentages of the
3 assets of the fund. The Committee concluded that specifying a range for appropriate distributions
4 was unwise because a fixed range could not take into account the factors listed in subsection (a)
5 or changes in market conditions. A fixed range that might be appropriate for some charities
6 under current economic conditions would be unlikely to remain appropriate over time. Most
7 institutions have done a good job of developing spending policies under UMIFA and should be
8 able to continue to develop spending policies that take into consideration the specific needs of a
9 particular fund. Prudent decision making after considering all the factors is the standard under
10 UPMIFA. A mechanical safe-harbor would simply create a new standard that could not take into
11 account the needs of individual institutions and funds.
12

13 The changes from UMIFA, and in particular the deletion of historic dollar value, are not
14 intended to make any portion of an endowment fund unrestricted assets from a legal standpoint.
15 An endowment fund is restricted because of the donor's intent that the fund be restricted by the
16 prudent spending rule, that the fund not be spent in the current year, and that the fund continue to
17 maintain its value for a long time. Regardless of the treatment of endowment fund from an
18 accounting standpoint, legally an endowment fund should not be considered unrestricted.
19 Subsection (a) states that endowment funds will be legally restricted until the institution
20 appropriates funds for expenditure. The UMIFA statutes in Utah and Maine contain similar
21 language. 13 Me. Rev. Stat. Ann. tit. 13 § 4106 (West 2005); Utah Code Ann. 1953 § 13-29-3
22 (2005). *See, also*, Mass. Attorney General opinion No. 117 (January 2004) (concerning the
23 treatment of endowments as legally restricted assets).
24

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

34 **Subsection (c). Rule of Construction.** Donor's intent must be respected in the process
35 of making decisions to expend endowment funds. Section 4 does not allow an institution to
36 convert an endowment fund into a non-endowment fund nor does the section allow the institution
37 to ignore a donor's intent that a fund be maintained as an endowment. Rather, subsection (c)
38 provides rules of construction to assist institutions in interpreting donor's intent. Subsection (c)
39 assumes that if a donor wants an institution to spend "only the income" from a fund, the donor
40 intends that the fund both support current expenditures and be preserved permanently. The
41 donor is unlikely to be concerned about designation of returns as "income" or "principal" under
42 accounting principles. Rather the donor likely assumes that the institution will use modern
43 investing strategies like total-return investing to generate enough funds to distribute while
44 maintaining the long-term viability of the fund. Subsection (c) is an intent effectuating provision
45 that provides default rules to construe donor's intent.

1
2 As subsection (b) explains, a donor who wants to specify spending guidelines can do so,
3 but must do so specifically. For example, a donor might require that a charity spend between
4 three and five percent of an endowed gift each year, regardless of investment performance or
5 other factors. If the charity agrees to the restriction in accepting the gift, the restriction will
6 govern spending decisions by the charity. Another donor might want to limit expenditures from
7 an endowment gift to trust accounting income and not want the institution to be able to expend
8 appreciation. An instruction to “pay only the income” will not be specific enough, but an
9 instruction to “pay only interest and dividend income earned by the fund and not to make other
10 distributions of the kind authorized by Section 4 of UPMIFA” should be sufficient. If a donor
11 indicates that the rules on investing or expenditures under Section 4 do not apply to a particular
12 fund, then as a practical matter the institution will probably invest the fund separately. Thus, a
13 decision by a donor to require specific expenditure rules will likely also have consequences in
14 the way the institution invests the fund.
15

16 **Retroactive Application of the Rule of Construction.** A default rule resolves an
17 ambiguity. Statutes use default rules to fill gaps when the actors involved have not clearly stated
18 their intents. In UPMIFA, the rule of construction in subsection (c) aids institutions in
19 construing the intent of donors who use words like endowment or income without specific
20 directions as to the intended meaning. Changing a default rule does not change the underlying
21 intent. Instead, a change in the rule of construction changes the way an ambiguity is resolved, in
22 an attempt to increase the likelihood of giving effect to the intent of most donors.
23

24 The Drafting Committee was also concerned that retaining the historic dollar value
25 concept for endowment funds in existence before the enactment of UPMIFA would require
26 institutions to manage endowment funds separately. For example, an institution with an
27 endowment fund for scholarships would have to create a new fund for post-enactment
28 contributions. Managing two funds would result in economic inefficiencies and greater
29 administration costs for the institution. Further, an institution with a fund created under UMIFA
30 with a value below historic dollar value might choose to invest in assets that produce trust
31 accounting income rather than appreciation. Choosing investments based on the characterization
32 of the income could reduce the long-term yield of the fund and, by doing so, contravene the
33 intent of the donors who contributed to the fund.
34

35 **Subsection (d). Rebuttable Presumption of Imprudence.** The Drafting Committee
36 debated at length whether to include a presumption of imprudence for spending above a fixed
37 percentage of the value of the fund. The Drafting Committee decided to include a presumption
38 in the Act in brackets, as an option for states to consider, and to include in these Comments a
39 discussion of the advantages and disadvantages of including a presumption in the Act.
40

41 Some who commented on the Act viewed the presumption as linked to the retroactive
42 application of the rule of construction of subsection (c). Donors who contributed to endowment
43 funds under UMIFA may have assumed that the historic dollar value of their gifts would be
44 subject to a no-spending rule under the statute. UPMIFA removes the concept of historic dollar

1 value, and the presumption of imprudence may serve to assure donors that spending from an
2 endowment fund will be limited.

3
4 Those in favor of the presumption of imprudence argued that the presumption will curb
5 the temptation a charity might have to spend endowment assets too rapidly. Although the
6 presumption would be rebuttable, and spending above the identified percentage might, in some
7 years and for some charities, be prudent, institutions will likely be reluctant to authorize
8 spending above seven percent. In addition, the presumption will give the attorney general
9 guidance in enforcing the prudence standard.

10
11 The Drafting Committee also heard arguments against including a presumption of
12 imprudence in the statute. A fixed percentage in the statute might be perceived as a safe harbor
13 and could lead institutions to spend more than is prudent. Although the provision should not be
14 read to imply that spending below seven percent will be considered prudent, some charities
15 might interpret the statute in that way. Decision makers might be pressured to spend more than
16 is prudent, or might be willing to make spending decisions without adequate analysis.

17
18 Perhaps the biggest problem with including a presumption in the statute is the difficulty
19 of picking a number that will be appropriate given the range of institutions and charitable
20 purposes and the fact that economic conditions will change over time. Under current economic
21 conditions, a spending rate of seven percent is too high for most funds, but in a period of high
22 inflation, seven percent might be too low. In making a prudent decision as to how much to spend
23 from an endowment fund, each institution must consider a variety of factors, including the
24 particular purposes of the fund, the wishes of the donors, changing economic factors, and
25 whether the fund will receive future donations.

26
27 Each enacting state should make its own determination as to whether to include the
28 presumption when the state enacts UPMIFA. And whether or not a statute includes the
29 presumption, institutions must remember that prudence controls decision making. Each
30 institution must make decisions on expenditures based on the circumstances of the particular
31 charity.

32
33 **Application of Presumption.** If a state chooses to adopt a presumption of imprudence,
34 subsection (d) provides language for that provision. Under subsection (d), a rebuttable
35 presumption of imprudence will arise if expenditures in one year exceed seven percent of the
36 assets of an endowment fund. The subsection applies a rolling average of three or more years in
37 determining the value of the fund for purposes of calculating the seven-percent amount. For
38 most endowment funds spending will typically fall below seven percent, but an institution can
39 rebut the presumption of imprudence if circumstances in a particular year make expenditures
40 above that amount prudent. The concept and the language for the presumption of imprudence
41 comes from Mass. Gen. L. ch. 180A, § 2 (2004). Massachusetts enacted this rule in 1975 as part
42 of its UMIFA statute. New Mexico adopted the same presumption in 1978. N.M.S.A. § 46-9-2
43 (C) (2004). New Hampshire has a similar provision. N.H. Rev. Stat. § 292-B:6.

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

10
11 If sufficient evidence establishes, by the preponderance of the evidence, the facts
12 necessary to raise the presumption of imprudence, then the institution will have to carry the
13 burden of production of (i.e., the burden of going forward with) other evidence that would tend
14 to demonstrate that its decision was prudent. The existence of the presumption does not shift the
15 burden of persuasion to the charity. [more needed here]

16
17 The Drafting Committee discussed the fact that expenditures from an endowment fund
18 may include distributions for charitable purposes and amounts used for the management and
19 administration of the fund, including annual charges for fundraising. The value of a fund, as
20 calculated for purposes of determining the seven percent amount, will reflect increases due to
21 contributions and investment gains and decreases due to distributions and investment losses. The
22 seven percent determination includes annual charges for fundraising and administrative expenses
23 other than investment management expenses. All costs or fees associated with an endowment
24 fund are factors that prudent decision makers consider. High costs or fees of investment
25 management could be considered imprudent regardless of whether spending exceeds seven
26 percent of the fund's value.

27
28 The presumption of imprudence does not create an automatic safe harbor. Expenditures at
29 six percent might well be imprudently high. See James P. Garland, *The Fecundity of*
30 *Endowments and Long-Duration Trusts*, *The Journal of Portfolio Management* (2005); Joel C.
31 Dobris, *Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust*
32 *and Spending Rate on Settlers, Their Advisers, and Retirees*, 40 *Real Prop. Prob. & Tr. J.* 39
33 (2005). Indeed, evidence discussed by the Drafting Committee suggests that few funds can
34 sustain spending at a rate above five percent. See Roger G. Ibbotson & Rex A. Sinquefeld,
35 *Stocks, Bonds, Bills, and Inflation: Historical Returns (1926-1987)* (Research Foundation of the
36 Institute of Chartered Financial Analysts, 1989 [cite to newer version]). And under current
37 conditions five percent may be too high. See Joel C. Dobris, *Why Five? The Strange, Magnetic,*
38 *and Mesmerizing Affect of the Five Percent Unitrust and Spending Rate on Settlers, Their*
39 *Advisers, and Retirees*, 40 *Real Prop. Prob. & Tr. J.* 39 (2005). Further, spending at a lower rate,
40 particularly in the early years of an endowment, may result in greater distributions over time.
41 See DeMarche Associates, Inc, *Spending Policies and Investment Planning for Foundations: A*
42 *Structure for Determining a Foundation's Asset Mix* (Council on Foundations: 3d ed. 1999). A
43 presumption of imprudence can serve as a reminder that spending at too high a rate will
44 jeopardize the long-term nature of an endowment fund. If an endowment fund is intended to

1 continue permanently, the institution should take special care to limit annual spending to a level
2 that protects the purchasing power of the fund.
3

4 Subsection (d) provides that the terms of the gift instrument can provide additional
5 spending authority. For example, if a gift instrument directs that an institution expend a fund
6 over a ten-year period, exhausting the fund after ten years, spending at a rate higher than seven
7 percent will be necessary.
8

9 Subsection (d) does not require an institution to spend a minimum amount each year
10 because the prudence standard and the needs of the institution will be sufficient guidance as to
11 whether accumulation rather than spending might be appropriate in a particular year.
12

13 Spending above seven percent in any one year will not necessarily be imprudent. For
14 some endowment funds fluctuating spending rates may be appropriate. Although the Act does
15 not apply the percentage for the presumption on a rolling basis (e.g., 21 percent over three years),
16 some endowment funds may prudently spend little or nothing in some years and more than seven
17 percent in other years.
18

19 For example, a charity planning a construction project might decide to spend nothing
20 from an endowment for three years and then in the fourth year might spend 20 percent of the
21 value of the fund for construction costs. The decision to accumulate in years one through three
22 and then to spend 20 percent in year four might be prudent for the charity, depending on the
23 other factors. The charity should maintain adequate records during the accumulation period and
24 should document the decision-making process in year four to be able to meet the burden of
25 production associated with the presumption. Another charity might prudently spend 20 percent
26 in year one and nothing for the following three years. That charity would also need to document
27 the decision-making process through which the decision to spend occurred and maintain records
28 explaining why the decision was prudent under the circumstances.
29

30 Another charity might establish a “capital replacement fund” designed to provide funds to
31 the institution for repair or replacement of major items of equipment. Disbursements from this
32 kind of fund will likely fluctuate, with limited expenditures in some years and then big
33 expenditures when the charity needs new equipment. The fund would not operate under a
34 relatively uniform spending rate. Indeed, an advantage of a capital replacement fund will be its
35 ability to absorb a significant capital expenditure in a single year without a negative impact on
36 the operating budget of the institution. Disbursements might average five percent per year but
37 would vary, with spending in some years more and in some years less. Even if this fund is an
38 endowment fund subject to Section 4, spending above seven percent in a particular year could
39 well be prudent. Subsection (d) does not preclude spending above seven percent.
40

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

1
2 **Institutions with Limited Investment and Spending Experience.** A number of
3 attorneys general and other state charity officials raised concerns about whether small institutions
4 would be able to adjust to a spending rule based entirely on prudence, without the bright-line
5 guidance of historic dollar value. The charity regulators who spoke with the Drafting Committee
6 agreed that large institutions have sophisticated investment strategies, access to good investment
7 advisors, and experience with spending rules that maintain purchasing power for endowment
8 funds. For these institutions, the rules of UPMIFA should work well. For smaller institutions,
9 however, the state regulators thought that additional guidance could be helpful. After discussing
10 strategies to address this concern, the Drafting Committee decided to include in these comments
11 an additional optional provision that a state could choose to include in its UPMIFA statute.
12

13 The optional provision focuses on institutions with endowment funds valued, in the
14 aggregate, at less than \$2,000,000. The number used in the provision is in brackets to indicate
15 that it could be set higher or lower. The number was chosen to try to address the concern of the
16 state regulators that small charities would be more likely to spend imprudently than large
17 charities. The Drafting Committee selected \$2,000,000 as the value that the Committee thought
18 would include most unsophisticated institutions but would not be overinclusive.
19

20 The optional provision creates a notification requirement if an institution with a small
21 endowment plans to spend below historic dollar value. If an institution subject to the provision
22 decides to appropriate an amount that would cause the value of its endowment funds to drop
23 below the aggregate historic dollar value for all of its endowment funds, then the institution will
24 have to notify the attorney general before proceeding with the expenditure. The provision does
25 not require that the institution obtain the approval of the attorney general before making the
26 distribution. Rather, the notification requirement gives the attorney general the opportunity to
27 take a closer look at the institution and the spending decision, to educate the institution on
28 prudent decision making for endowment funds, and to intervene if the attorney general
29 determined that the spending would be imprudent for the institution. Although the Drafting
30 Committee thinks that the prudence standard in UPMIFA provides adequate guidance to all
31 institutions within the scope of the Act, if a state chooses to adopt a notification provision for
32 institutions with small endowments, the Drafting Committee recommends the following
33 language:
34

35 (-) If an institution has endowment funds with an aggregate value of less than
36 [\$2,000,000], the institution shall notify the [Attorney General] at least [60 days] prior to
37 an appropriation for expenditure of an amount that would cause the value of the
38 institution's endowment funds to fall below the aggregate historic dollar value of the
39 institution's endowment funds, unless the expenditure is permitted or required under law
40 other than this [act] or the gift instrument. For purposes of this subsection, "historic
41 dollar value" means the aggregate value in dollars of (i) each endowment fund at the time
42 it became an endowment fund, (ii) each subsequent donation to the fund at the time the
43 donation is made, and (iii) each accumulation made pursuant to a direction in the
44 applicable gift instrument at the time the accumulation is added to the fund. The
45 determination of historic dollar value made in good faith by an institution is conclusive.

1 **[SECTION 5. DELEGATION OF MANAGEMENT AND INVESTMENT**

2 **FUNCTIONS.**

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

8 (1) selecting an agent;

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

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

13 (b) In performing a delegated function, an agent owes a duty to the institution to
14 exercise reasonable care to comply with the scope and terms of the delegation.

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

17 (d) By accepting delegation of a management or investment function from an
18 institution that is subject to the laws of this state, an agent submits to the jurisdiction of the
19 courts of this state in all proceedings arising from or related to the delegation or the performance
20 of the delegated function.

21 (e) An institution may delegate management and investment functions to ~~the~~ its
22 committees, officers, or employees ~~of the institution~~ as authorized by law other than this [act].]
23

Preliminary Comment

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

Section 5 incorporates the delegation rule found in UPIA § 9, updating the delegation rules in UMIFA § 5. Section 5 permits the decision makers in an institution to delegate management and investment functions to external agents if the decision makers exercise reasonable skill, care, and caution in selecting the agent, defining the scope of the delegation and reviewing the performance of the agent. Decision makers cannot delegate the authority to make decisions concerning expenditures and can only delegate management and investment functions. Subsection (c) protects decision makers who comply with the requirement for proper delegation from liability for actions or decisions of the agents. In making decisions concerning delegation, the institution must be mindful of Section 3(c)(1) of UPMIFA, the provision that directs the institution to incur only reasonable costs in managing and investing an institutional fund.

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

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

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

Subsection (e) notes that law other than this Act governs internal delegation. Section 5 of UMIFA included internal delegation as well as external delegation, due to a concern at that time that trust law concepts might govern internal delegation in nonprofit corporations. With the widespread adoption of nonprofit corporation statutes, that concern no longer exists. The

1 decision not to address internal delegation in UPMIFA does not suggest that a governing board
2 of a nonprofit corporation cannot delegate to committees, officers, or employees. Rather, a
3 nonprofit corporation must look to other law, typically a nonprofit corporation statute, for the
4 rules governing internal delegation.
5

6 **SECTION 6. RELEASE OR MODIFICATION OF RESTRICTIONS ON**
7 **MANAGEMENT, INVESTMENT, OR PURPOSE.**

8 (a) With the donor's consent in a record, an institution may release or modify, in
9 whole or in part, a restriction contained in a gift instrument on the management, investment, or
10 purpose of an institutional fund. A release or modification may not allow a fund to be used for a
11 purpose other than a charitable purpose of the institution.

12 (b) If a restriction contained in a gift instrument on the management or
13 investment of an institutional fund becomes impracticable or wasteful and impairs the
14 management or investment of the fund or if because of circumstances not anticipated by the
15 donor a modification of a restriction will further the purposes of the fund, ~~If, because of~~
16 ~~circumstances not anticipated by the donor, a modification will further the purposes of the~~
17 ~~institutional fund, or a restriction becomes impracticable or wasteful and impairs the~~
18 ~~management or investment of the fund,~~ the court, upon application of the institution, may modify
19 the restriction. ~~a restriction contained in a gift instrument on the management or investment of~~
20 ~~an institutional fund.~~ The institution shall notify the [Attorney General], who must be given an
21 opportunity to be heard. To the extent practicable, any modification must be made in accordance
22 with the donor's probable intention.

23 (c) If a particular charitable purpose or a restriction contained in a gift instrument
24 on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or
25 wasteful, the court, upon application of an institution, may modify the purpose of the fund or the

1 restriction on the use of the fund in a manner consistent with the charitable purposes expressed in
2 the gift instrument. The institution shall notify the [Attorney General], who must be given an
3 opportunity to be heard.

4 (d) If an institution determines that a restriction contained in a gift instrument on
5 the management, investment, or purpose of an institutional fund is unlawful, impracticable,
6 impossible to achieve, or wasteful, the institution, [60 days] after notification to the [Attorney
7 General], may release or modify the restriction, in whole or part, if:

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

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

11 (3) the institution uses the property in a manner the institution reasonably
12 determines, ~~in good faith~~, to be consistent with the charitable purposes expressed in the gift
13 instrument.

14 **Preliminary Comment**

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

22 Although UMIFA stated that it did not “limit the application of the doctrine of *cy pres*”,
23 UMIFA § 7(d), what that statement meant under the Act was unclear. UMIFA itself appeared to
24 permit only a release of a restriction and not a modification. That all-or-nothing approach did
25 not adequately protect donors’ intent. *See Yale Univ. v. Blumenthal*, 621 A.2d 1304 (Conn.
26 1993). By expressly including deviation and *cy pres*, UPMIFA requires an institution to seek
27 modifications that are “in accordance with the donor’s probable intention” for deviation and “in a
28 manner consistent with the charitable purposes expressed in the gift instrument” for *cy pres*.
29
30
31
32

1 **Individual Funds.** The rules on modification require that the institution, or a court
2 applying a court-ordered doctrine, review each institutional fund separately. Although an
3 institution may manage institutional funds collectively, for purposes of this Section each fund
4 must be considered individually.
5

6 **Subsection (a). Donor Release.** Subsection (a) permits the release of a restriction if the
7 donor consents. A release with donor consent cannot change the charitable beneficiary of the
8 fund. Although the donor has the power to consent to a release of a restriction, this section does
9 not create a power in the donor that will cause a federal tax problem for the donor. The gift to the
10 institution is a completed gift for tax purposes, the property cannot be diverted from the
11 charitable beneficiary, and the donor cannot redirect the property to another use by the charity.
12 The donor has no retained interest in the fund.
13

14 **Subsection (b). Equitable Deviation.** Subsection (b) applies the rule of equitable
15 deviation, modifying the language from UTC § 412 for application in this section. *See also*
16 Restatement (Third) of Trusts § 66 (2003). Under deviation, a court modifies restrictions on the
17 way an institution manages or administers a fund, doing so in a manner that furthers the purposes
18 of the fund. Deviation implements the donor’s intent. A donor may have a predominate purpose
19 for a gift and, secondarily, an intent that the purpose be carried out in a particular manner.
20 Deviation does not alter the purpose but rather modifies the means of carrying out the purpose.
21

22 Sometimes deviation is needed due to circumstances unanticipated when the donor
23 created a restriction on a gift. In other situations a restriction may impair the management or
24 investment of the fund. Modification of the restriction may permit the institution to carry out the
25 donor’s purposes in a more effective manner. A court applying deviation should attempt to
26 follow the donor’s probable intention in deciding how to modify the restriction. Consistent with
27 the doctrine of equitable deviation in trust law, subsection (b) does not require an institution to
28 notify donors of the proposed modification. Good practice dictates notifying any donors who are
29 alive and can be located with a reasonable expenditure of time and money. Consistent with the
30 doctrine of deviation under trust law, the institution must notify the attorney general who may
31 choose to participate in the court proceeding. The attorney general protects donor intent as well
32 as the public’s interest in charitable assets. Attorney general is in brackets in the Act because in
33 some states another official monitors charities.
34

35 **Subsection (c). Cy Pres.** Subsection (c) applies the rule of cy pres from trust law.
36 Under cy pres a court can modify the purpose of an institutional fund, and the focus of cy pres is
37 on the purpose of the fund rather than on the means of carrying out the purpose. The term
38 “modify” encompasses the release of a restriction as well as an alteration of a restriction and also
39 permits a court to order that the fund be paid to another institution. A court can apply the
40 doctrine of cy pres only if the restriction in question has become unlawful, impracticable,
41 impossible to achieve, or wasteful. This standard, which comes from UTC § 413, updates the
42 circumstances under which cy pres may be applied by adding “wasteful” to the usual common
43 law articulation of the doctrine. Any change must be made in a manner consistent with the
44 charitable purposes expressed in the gift instrument. *See also* Restatement (Third) of Trusts § 67
45 (2003).

1
2 Subsection (c) is intended make the case law under cy pres applicable to institutions
3 covered by UPMIFA and does not limit the doctrine of cy pres. In addition to requesting that a
4 court apply cy pres to modify a restriction, an institution may seek court assistance otherwise, for
5 example by requesting the dissolution of the institution. Consistent with the doctrine of cy pres,
6 subsection (c) does not require an institution seeking cy pres to notify donors. Good practice
7 will be to notify donors whenever possible. As with deviation, the institution must notify the
8 attorney general who must have the opportunity to be heard in the proceeding.
9

10 **Subsection (d). Modification of Small, Old Funds.** Subsection (d) permits an
11 institution to release or modify a restriction using a cy pres approach but without court approval
12 if the amount of the institutional fund involved is small and if the institutional fund has been in
13 existence for more than 20 years. The Drafting Committee determined that under some
14 circumstances a restriction may no longer make sense but the cost of a judicial cy pres
15 proceeding will be too great to warrant a change in the restriction. The Committee discussed at
16 length the parameters for allowing an institution to apply cy pres itself, without court
17 supervision. The Committee drafted subsection (d) to balance the needs of an institution to
18 operate efficiently for its charitable purposes and the need to protect donors' wishes. The
19 subsection assumes that an institutional fund with a value of \$25,000 or less is sufficiently small
20 that the cost of a judicial proceeding will be out of proportion with the need to change the
21 restriction. The Committee included a requirement that the institutional fund be in existence at
22 least 20 years because it seemed reasonable to require additional safeguards for donors' intent for
23 some period of time after the creation of the institutional fund. The 20-year period begins to run
24 from the date of inception of the fund and not from the date of each gift to the fund. The amount
25 and the number of years have been placed in brackets to signal to enacting jurisdictions that they
26 may wish to designate a higher or lower figure. Because the amount should be tied to the cost of
27 a judicial proceeding to obtain a modification, the number may be higher in some states and
28 lower in others.
29

30 As under judicial cy pres, an institution acting under subsection (d) must change the
31 restriction in a manner that is in keeping with the intent of the donor and the purpose of the fund.
32 For example, if the value of a fund is too small to justify the cost of administration of the fund as
33 a separate fund, the term "wasteful" would allow the institution to combine the fund with another
34 fund with similar purposes. If a fund had been created for nursing scholarships and the institution
35 closed its nursing school, the institution might appropriately decide to use the fund for other
36 scholarships at the institution. In using the authority granted under subsection (d), the institution
37 must determine which alternative use for the fund reasonably approximates the original intent of
38 the donor. The institution cannot divert the fund to an entirely different use. For example, the
39 fund for nursing scholarships could not be used to build a football stadium.
40

41 Subsection (d) requires an institution seeking to modify a provision in a small, old fund to
42 notify the attorney general of the planned modification. The institution must wait 60 days before
43 proceeding, and the attorney general may take action if the proposed modification appears
44 inappropriate.
45

1 **Notice to Donors.** The Drafting Committee decided not to require notification of donors
2 under subsections (b), (c), and (d). The trust law rules of equitable deviation and cy pres do not
3 require donor notification and instead depend on the court and the attorney general to protect
4 donor intent and the public’s interest in charitable assets. The Drafting Committee concluded
5 that subsections (b) and (c) should be consistent with the trust law doctrines of equitable
6 deviation and cy pres, both so that institutions would not be governed by two conflicting sets of
7 rules and because the trust rules are appropriate. Further, because donors normally lack standing
8 to bring suit against an institution, [should I include citations to articles discussing donor
9 standing here or is the topic sufficiently outside the scope of UPMIFA that I should not?]
10 providing notice to donors would have limited utility. Of course, good practice will always be to
11 notify donors who can be identified of any possible change that might affect the donors’ gifts to
12 an institution. Institutions will be concerned with maintaining good donor relations, and thus
13 have a strong incentive to notify donors whenever possible.
14

15 The Drafting Committee also concluded that subsection (d) should not require an
16 institution to give notice to donors. Subsection (d) can only be used for an old and small fund.
17 For such a fund, locating a donor who contributed to the fund more than 20 years earlier may be
18 difficult and expensive. If multiple donors each gave a small amount to create a fund 20 years
19 earlier, the task of locating all of those donors may be even more expensive. For any old fund,
20 notice by publication is not likely to be effective in providing actual notice to the donors. Again,
21 good practice dictates notifying known donors of any change considered by the institution. The
22 Drafting Committee concluded that an institution’s concern for donor relations would serve as a
23 sufficient incentive for notifying donors when donors can be located. For example, an institution
24 that received a gift from a private foundation or a single donor will probably be able to contact
25 the foundation or donor, even 20 or more years after the gift. In other circumstances, the
26 attorney general can protect the interests of donors and the public.
27

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

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

35 **SECTION 9. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND**
36 **NATIONAL COMMERCE ACT.** This [act] modifies, limits, and supersedes the Electronic

1 Signatures in Global and National Commerce Act (15 U.S.C. Section 7001 et seq.) but does not
2 modify, limit, or supersede Section 101 of that act (15 U.S.C. Section 7001(a)) or authorize
3 electronic delivery of any of the notices described in Section 103 of that act (15 U.S.C. Section
4 7003(b)).

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

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

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

10 (a) [The Uniform Management of Institutional Funds Act]