DRAFT

FOR DISCUSSION ONLY

UNIFORM

MANAGEMENT OF INSTITUTIONAL FUNDS

ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

WITH PREFATORY NOTE AND REPORTER'S NOTES

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January 29, 2004

UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

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UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

PREFATORY NOTE

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

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

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

Objectives of the Act. UMIFA (200-) conforms its investment provisions to those of UPIA. The investment standards of UPIA already apply to charitable trusts, so the changes in the Act make the application of these standards consistent regardless of whether a charitable organization is organized as a trust, as a nonprofit corporation or in some other manner. The rules governing expenditures from endowment funds have been modified to give a governing board more flexibility in making expenditure decisions, so that the board can cope with fluctuations in the value of the endowment. These rules are available to decision makers of charities organized either as charitable trusts, as nonprofit corporations, or in some other manner. The provisions governing the release of restrictions have been changed to permit more efficient management of institutional funds.

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

UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

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

SECTION 2. DEFINITIONS. In this [act]:

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

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

(3) "Gift instrument" means a record or records under which property is granted to, transferred to, or held by an institution as an institutional fund. The term includes an institutional solicitation in the form of a record from which an institutional fund results.

(4) "Institution" means any nonprofit corporation, trust, unincorporated association, or entity organized and operated exclusively for charitable purposes. The term includes a government, governmental subdivision or agency, or a governmental organization to the extent that it holds funds exclusively for a charitable purpose. A trust that has both charitable and noncharitable interests becomes organized and operated exclusively for charitable purposes after the noncharitable interest ends.

(5) "Institutional fund" means a fund held by an institution for its exclusive use, benefit, or purposes. The term includes two or more funds collectively managed. The term does not include a fund in which a beneficiary that is not an institution has an interest, other than rights that could arise upon violation or failure of the purposes of the fund.

(6) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Comment

Subsection (1). Charitable Purpose. The definition of charitable purpose uses the same formulation as that in UTC § 405 and Restatement (Third) of Trusts § 28 (2003). The definition is the standard legal definition of charitable purposes, developed from the definition of charity set forth in the English Statute of Charitable Uses, 43 Eliz. I, c. 4 (1601).

Subsection (2). Endowment fund. An endowment fund is an institutional fund or a part of an institutional fund that is not wholly expendable by the institution on a current basis. A restriction on use that makes a fund an endowment fund arises from the terms of a gift instrument. An institution may manage several funds together if the funds all have the same purpose. These funds would be considered one endowment fund for purposes of this Act.

Board-restricted funds are institutional funds but not endowment funds. The rules on expenditures and modification of restrictions in this Act do not apply to restrictions placed by an institution on an otherwise unrestricted fund held by the institution for its own benefit. The institution may be able to change these restrictions itself, subject to internal rules and to the fiduciary duties that apply to those that manage an institution. However, if an institution designates a fund as an endowment fund and then solicits additional donations to the fund, any gifts to the fund will constitute an endowment fund. If the institution commingles its own assets with assets donated to the fund, the entire fund will constitute an endowment fund. Further, if an institution gives assets designated as an endowment to another institution, then the second institution will hold that fund as an endowment fund.

Subsection (3). Gift instrument. The term gift instrument refers to the records that establish the terms of a gift. As used in this definition, "record" is an expansive concept and means a writing in any form, including electronic. The term includes a will, deed, grant, conveyance, agreement, or memorandum, and also includes writings that do not have a donative purpose. For example, under some circumstances the bylaws of the institution, minutes of the board of directors, or canceled checks could be a gift instrument or be one of several records constituting a gift instrument.

Solicitation materials may constitute a gift instrument. For example, a solicitation that suggests in writing that any gifts received pursuant to the solicitation will be held as an endowment may be integrated with other writings and may be considered part of the gift instrument. Whether the terms of the solicitation become part of the gift instrument will depend upon the circumstances of the gift and whether a subsequent writing superseded the terms of the solicitation.

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

Subsection (4). Institution. The Act applies generally to institutions organized and operated exclusively for charitable purposes, using the definition of charitable purposes from UTC § 405. The term includes charitable organizations created as nonprofit corporations, trusts, unincorporated associations, governmental subdivisions or agencies, or any form of entity, however organized, that is organized and operated for charitable purposes. As used in this definition, the term "trust" is intended to mean a trustee acting under a charitable trust. The term includes a trust organized and operated for charitable purposes, regardless of whether a charity or a noncharitable corporation such as a bank, acts as trustee.

UMIFA (1972) did not include trusts within its definition of institution. UMIFA (200-) applies to trusts, to nonprofit corporations and to all entities operated for charitable purposes regardless of their form of organization. UMIFA (200-) appropriately includes trusts because the rules for the management and investment of charitable funds should be the same regardless of the organizational structure of the institution. Many of the provisions of UMIFA (200-) come from trust law, so charitable trusts have already been subject to many of these rules.

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

Subsection (5). Institutional Fund. The term institutional fund includes any fund held by an institution for its own use, benefit or purposes, whether expendable currently or subject to restrictions.

A fund held by an institution is not an institutional fund if any beneficiary of the fund is not an institution. For example, a charitable remainder trust held by a charity as trustee for the benefit of the donor during the donor's lifetime, with the remainder interest held by the charity, is not an institutional fund. However, this subsection treats as an institution a charitable remainder trust that continues to operate for charitable purposes after the death of the income beneficiary. A charitable remainder trust that terminates on the death of the income beneficiary will not be treated as an institutional fund during the period required to complete the distribution of the trust's property. If a governing instrument provides that a fund will revert to the donor if, and only if, the institution ceases to exist or the purposes of the fund fail, then the fund will be considered an institutional fund.

Subsection (7). Record. This definition was added to clarify that the definition of instrument includes electronic records as defined in Section 2(8) of the Uniform Electronic Transactions Act (1999).

SECTION 3. PRUDENT INVESTING AND MANAGING OF INSTITUTIONAL FUNDS.

(a) An institution shall invest and manage an institutional fund as a prudent investor would and shall consider:

(1) the terms of the gift instrument;

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

(3) general economic conditions;

(4) the possible effect of inflation or deflation;

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

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

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

(8) other resources of the institution;

(9) the needs of the institution and the institutional fund to make distributions and to preserve capital;

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

instrument or to the institution; and

(11) any other relevant circumstances.

(b) An investment held by an institution to accomplish a charitable purpose of the institution and not exclusively for the production of income or the appreciation of the property may be prudent even if it does not satisfy the risk and return objectives otherwise applicable to the institution.

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

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

(e) In addition to an investment authorized by law other than this [act] or by any gift instrument, and subject to any specific limitations set forth in a gift instrument or in law other than this [act], an institution may invest in any kind of property or type of investment consistent with the standards of this section.

(f) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversifying.

(g) Within a reasonable time after receiving property, an institution shall review the property and make and implement decisions concerning the retention or disposition of the property or other assets, in order to bring the institutional fund into compliance with the purposes, terms, distribution requirements, and other circumstances of the institution and the requirements of this [act].

(h) An institution shall invest and manage an institutional fund solely in the interests of the institution.

(i) In investing and managing an institutional fund, an institution may incur costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution.

Comment

Purpose and Scope of Revisions. This section adopts the prudence standard for investment decision making. The section directs the governing board to act as a prudent investor would, using a portfolio approach in making investments and considering the risk and return objectives of the fund. The section lists the factors that commonly bear on decisions in fiduciary investing and incorporates the duty to diversify investments absent a conclusion that special circumstances make a decision not to diversify reasonable. Section 3 applies to all funds held by an institution, regardless of whether the institution obtained the funds by gift or otherwise and regardless of whether or not the funds are restricted.

Section 3 derives its concepts and language from UPIA, which updated trust investment law by adopting modern portfolio theory. *See* UPIA (1994), Prefatory Note. UPIA drew upon revised standards for prudent trust investment promulgated by the American Law Institute in its Restatement (Third) of Trusts: Prudent Investor Rule (1992). For an explanation of the Prudent Investor Act, see John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641 (1996).

The Drafting Committee discussed at great length the standard that should govern nonprofit managers. Since the decision in *Stern v. Lucy Webb Hayes National Training School for Deaconesses,* 381 F. Supp. 1003 (1974), the trend has been to hold directors of nonprofit corporations to a standard similar to the corporate standard. UMIFA (1972) states the standard as "ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision."

Courts have described the shift from a standard closer to a trust-law standard to one closer to a business-law standard as a move to hold directors liable for gross negligence and not ordinary negligence. The concern may be in part to limit personal liability of directors, so that charitable institutions will not find themselves without directors altogether. Thus, business judgment standards (or "best judgment" standards) have been applied in determining director liability. For trusts, the standards relating to trustee liability have been shifting, too. For example, UTC § 1010 limits the personal liability of trustees on contracts if the fiduciary capacity was disclosed. And although a shift toward corporate rules has occurred with respect to director liability, courts continue to apply trust rules to cy pres modifications. The Committee concluded that although courts and statutes may state that different standards exist, courts applying the standards reach the same results for both nonprofit corporations and charitable trusts. This convergence of the standards applicable to charitable institutions appears to be true in the realm of investment decision making.

Although the prudence standard adopted in UMIFA (200-) is derived from trust law, the Committee believes that the standard is consistent with the business judgment standard under corporate law, as applied to charitable institutions. That is, a manager operating a charitable organization under the business judgment rule would look to the same factors as those identified by the prudent investor rule. Trust law has influenced the evolution of the concept of prudence, and the trust law norms probably already inform managers of nonprofit corporations. The Drafting Committee decided that by adopting the language of UPIA, UMIFA (200-) could clarify that UPIA's articulation of the standards of prudent investing applies to all charitable institutions. The Committee believed that the greater precision of the prudence norms of the Restatement and UPIA, as compared with UMIFA (1972), could helpfully inform managers of charitable institutions.

UPIA applies to trusts and not to nonprofit corporations, but the Prefatory Note to UPIA explains that "the standards of the Act can be expected to inform the investment responsibilities of directors and officers of charitable corporations." Further, comment b to Restatement (Third) of Trusts: Prudent Investor Rule § 379, at 190-91 states that "absent a contrary statute or other provision, prudent investor rule applies to investment of funds held for charitable corporations." Section 3 makes clear that the investment rules that apply to charitable trusts through UPIA apply to charitable corporations as well.

Subsection (a). Prudent Decision Making. Subsection (a) takes much of its language from UPIA § 2(a) and § 2(c). In making decisions about whether to acquire or retain an asset, the institution should consider the institution's mission, its current programs, and the desire to cultivate additional donations from a donor, in addition to factors related more directly to the asset's potential as an investment. The direction in subsection (a)(1) to consider the terms of the gift instrument means that the institution must consider the donor's intent in making decisions under Section 3 but does not mean that the donor can or should control the management of the institution.

Subsection (a)(9) reflects the fact that some organizations will invest in taxable investments that may be considered unrelated business taxable income for income tax purposes.

Subsection (b). Program-related Assets. This subsection addresses the issue of property held by institution in furtherance of its purposes. An asset held by an institution for a programmatic purpose may not be a prudent investment if considered solely on the basis of projected investment return relative to investment risk. Values other than the generation of economic benefits to the institution legitimate programmatic investments.

Section 3 provides that the institution can consider the program-related use to which the asset will be put in making a decision about whether to acquire or retain the asset. Subsection (a)(10) directs the institution to consider the asset's special relationship to the purposes of the institution, and subsection (b) explains that an investment in an asset used for a charitable purpose may be prudent even if it does not satisfy the risk and return objectives otherwise applicable to the institution. The fact that an asset will be used in a programmatic way does not absolve the institution from making a determination under Section 3 but rather serves as one factor the institution should consider.

The Drafting Committee considered making UMIFA (200-) inapplicable to assets used in carrying out an institution's charitable purposes but decided against that approach because some assets serve both a program-related purpose and an investment purpose. Some members of the Committee expressed concern that assets that were only partially programmatic should not fall outside the scope of the prudence standard. If UMIFA (200-) excluded programmatic assets, an institution might attempt to justify an imprudent investment decision by arguing that the asset was related to the institution's charitable purposes. Further, a line based on whether assets were "primarily" programmatic in nature would be difficult to enforce. The Drafting Committee concluded that the best approach was to make the programmatic element one factor in the decision-making process.

The degree to which an institution uses an asset to accomplish a charitable purpose will affect the weight given that factor in a decision to acquire or retain the asset. Thus, if a university acquires residential property near the edge of campus to hold for future development, the purpose of the property is one component of the decision to acquire the property but the institution must also consider other more directly investment-related factors. A decision to acquire land on which to build the university's new science center will not be viewed as an investment for the production of a financial return but rather should be considered as an investment to accomplish a charitable purpose of the university. Assets held entirely for programmatic purposes should not be considered part of the institution's investment portfolio for purposes of risk-return analysis and for benchmarking of investment returns. To do otherwise would adversely affect investment decision-making.

Subsection (c). Portfolio Approach. This subsection, taken from UPIA § 2(b), emphasizes the use of portfolio theory in modern investment practice. UPIA and UMIFA (200-) both follow the articulation of the prudent investor standard in Restatement (Third) of Trusts: Prudent Investor Rule § 227(a) (1992).

Subsection (d). Duty to Investigate. This subsection incorporates the traditional fiduciary duty to investigate, stated in UPIA § 2(d). The subsection requires the person with authority to make investment and management decisions to investigate the accuracy of the information used in making decisions.

Subsection (e). Broad Investment Authority. This subsection uses language from UPIA §§ 1(b). Consistent with the adoption of the portfolio theory of investment, the subsection "clarifies that no particular kind of property or type of investment is inherently imprudent." UPIA § 2, cmt. The reference to investments "authorized by law other than this [act]" includes state statutes creating legal lists for investments. This statute does not contravene any other state statute that authorizes specific investments and is designed to permit investments in a broad range of investments.

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

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

Subsection (f). Duty to Diversify. This subsection derives from UPIA § 3 which took its language from Restatement (Second) of Trusts § 228 (1959). The subsection assumes that prudence requires diversification but permits an institution to determine that nondiversification is appropriate under the circumstances applicable to a fund. *See* UPIA § 3 cmt. (discussing the rationale for diversification).

Subsection (g). Disposing of Unsuitable Assets. This subsection imposes a duty on an institution to make a decision about retaining or disposing of property within a reasonable time after the institution receives the property. The language comes from UPIA § 4, which restates Restatement (Third) of Trusts: Prudent Investor Rule § 229 (1992), which itself took language from Restatement (Second) of Trusts § 231 (1959). *See* UPIA § 4 cmt.

Subsection (h). Duty of Loyalty. This subsection states the important duty of loyalty, applicable under existing laws to fiduciaries of charitable trusts and to nonprofit corporations. The duty of loyalty requires a fiduciary acting on behalf of the institution to make decisions exclusively in the interests of the institution and not in the interests of the fiduciary or a third party. The Drafting Committee decided to include this provision, even though the requirement exists elsewhere in the law, to remind decision makers at institutions of the importance of the duty, to be consistent with UPIA, and to apply to any entities for which a developed standard of the duty of loyalty does not yet exist in other law.

Subsection (i). Duty to Minimize Costs. Subsection (i) tracks the language of UPIA § 7 and requires an institution to minimize costs. An institution may prudently incur costs by hiring an investment advisor, but the costs incurred should be appropriate under the circumstances and not wasteful. *See* UPIA § 7 cmt.; Restatement (Third) of Trusts: Prudent Investor Rule § 227, cmt. M, at 58 (1992); Restatement (Second) of Trusts § 188 (1959).

A difference between UMIFA (200-) and UPIA is that UPIA imposes a duty on trustees who have special skills or expertise to use those special skills or expertise. UPIA § 2(f). The Drafting Committee concluded that imposing this higher standard on some trustees exceeded the scope of UMIFA (200-). Trustees of a charitable trust will be governed by UPIA as well as by UMIFA (200-) and, therefore, may be subject to the duty imposed by UPIA § 2(f).

UMIFA (1972) contained two provisions that authorized investments in pooled or common investment funds. UMIFA (1972) §§ 4(3), 4(4). The Drafting Committee concluded that Section 3(e) of UMIFA (200-) authorizes these investments. The decision not to include the two provisions in UMIFA (200-) does not mean that UMIFA (200-) does not permit these investments.

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

(a) A designation of a gift as an endowment, or a direction or authorization in the instrument to use only "income", "interest", "dividends", or "rents, issues, or profits", or "to preserve the principal intact", or words of similar import, does not limit the authority to make expenditures under subsection (b). The use of one of these terms without specific limitation on the authority under subsection (b), creates a long-term endowment fund. A gift instrument may limit the authority to expend funds under subsection (b) by specifically stating the limitation in the gift instrument. These rules of construction apply to gift instruments executed or in effect before or after the effective date of this [act].

(b) Subject to the terms of the gift instrument, an institution may expend so much of an endowment fund as the institution determines to be prudent for the uses, benefits, and purposes for which the endowment fund is established. In making its determinations on expenditures, the institution shall exercise reasonable care, skill, and caution and shall consider:

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

(2) general economic conditions;

(3) the possible effect of inflation or deflation;

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

(5) other resources of the institution;

(6) preservation of the purchasing power of the endowment fund;

(7) the investment policy of the institution;

(8) the duration of the endowment fund; and

(9) any other relevant circumstances.

(c) An institution may accumulate so much of the expected total return from income and the appreciation of investments of an endowment fund as the institution determines to be prudent.

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

Comment

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

Section 4 permits expenditures from an endowment fund to the extent the institution determines that the expenditures are prudent after considering the factors listed in subsection (a). These factors emphasize the importance of keeping the purposes of the institution and of the endowment fund in mind while also considering economic conditions. As under UMIFA (1972), expenditures do not depend on the characterization of assets as income or principal and are not limited to the amount of income and unrealized appreciation.

Institutions have operated effectively under UMIFA (1972) and have operated more conservatively than historic dollar value would have permitted. Institutions have no incentive to spend everything the law permits them to spend, and good practice has been to provide for modest expenditures while maintaining the purchasing power of a fund. Institutions have followed this approach even though UMIFA (1972) does not require an institution to maintain a fund's purchasing power and allows an institution to spend any amounts in a fund above historic dollar value. The

Drafting Committee concluded that eliminating historic dollar value and providing institutions with more discretion would not lead to depletion of endowment funds. Instead, UMIFA (200-) should encourage institutions to establish a spending approach that will be responsive to short-term fluctuations in the value of the fund. Section 4 allows an institution to maintain appropriate levels of distributions in times of economic downturn or economic strength. In some years, accumulation rather than spending will be prudent, and in other years an institution may appropriately make distributions even if a fund has generated no investment return that year.

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

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

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

Although prudence will dictate the amount an institution should spend, subsection (d) creates a rebuttable presumption of imprudence if expenditures in one year exceed seven percent of the assets of an endowment fund. The subsection applies a three year rolling average in determining the value of the fund for purposes of calculating the seven percent amount. Endowment spending will rarely exceed seven percent, but the institution can rebut the presumption of imprudence if circumstances in a particular year make expenditures above that amount prudent. The concept and the language for subsection (d) comes from the Massachusetts Management of Institutional Funds statute. M.G.L.A. 180A 2 (2004).

The Drafting Committee decided to include the presumption of imprudence to respond to concerns that the statute should include a bright-line rule, albeit a rebuttable one, to curb the temptation to spend endowment assets too rapidly. Subsection (d) does not mean that spending less than seven percent of the value of an endowment fund will necessarily be considered prudent. Indeed, under many circumstances expenditures in that amount would be imprudently high. Evidence discussed by the Drafting Committee suggests that few funds could sustain spending at a rate above five percent. [Citations?] Subsection (d) serves as a reminder that spending at too high a rate will jeopardize the long-term nature of an endowment fund.

Donor's intent controls in the process of making decisions to expend endowment funds. Section 4 does not allow an institution to convert an endowment fund into a non-endowment fund nor does the section allow the institution to ignore a donor's intent that a fund be maintained as an endowment. Rather, subsection (a) provides rules of construction to assist institutions in interpreting donor's intent. Subsection (a) assumes that if a donor wants an institution to spend "only the income" from a fund, the donor intends the fund to continue in perpetuity and expects the institution to expend amounts that represent a reasonable return on investments. The donor is unlikely to be concerned about designation of returns as "income" or "principal" under accounting principles. Rather the donor likely assumes that the institution will use modern investing strategies like total-return investing to generate enough funds to distribute while maintaining the long-term viability of the fund. Subsection (a) provides default rules to construe donor's intent.

If a donor indicates that the rules on investing or expenditures under Section 4 do not apply to a particular fund, then as a practical matter the institution will probably invest the fund separately. Thus, a decision to direct expenditure rules may have consequences for the way the institution invests the fund.

Endowment funds include funds that may last in perpetuity but also funds that should continue for a fixed term of years. Section 4 requires the institution to consider the intended duration of the fund in making determinations about spending. For example, if a donor directs that a fund be spent over 20 years, Section 4 will guide the institution in making distribution decisions. The institution would amortize the fund over 20 year rather than try to maintain the fund in perpetuity.

As a rule of construction, subsection (a) applies retroactively. Retroactive application is appropriate, because subsection (a) does not alter the substance of an existing contract, but rather serves as a default rule that implements donor's intent. The Colorado Supreme Court recently considered the question of retroactive application of a default statute involving the donative aspect of an insurance contract. *See* In re Estate of DeWitt, 54 P. 3d 849 (Colo. 2002). In holding that the statute did not violate the Contracts Clause, the court cited approvingly from the JEB Statement Regarding the Constitutionality of Changes in Default Rules as Applied to Pre-Existing Documents, 17 Am. Coll. Tr. & Est. Couns. 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 filed of estates, trusts, and donative transfers." JEB Statement, at 4 (citing J. Nowak & R. Rotunda, Constitutional Law § 11.8, at 394 et seq. (4th ed. 1991).

SECTION 5. DELEGATION OF INVESTMENT MANAGEMENT.

(a) Subject to any specific limitations set forth in a gift instrument or in law other than this [act], an institution may delegate to agents outside the institution investment and management functions that a prudent institution could properly delegate under the circumstances. An institution shall exercise reasonable care, skill, and caution in:

(1) selecting an agent;

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

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

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

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

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

Comment

This section incorporates into UMIFA (200-) the delegation rule found in UPIA § 9, updating the delegation rules in UMIFA (1972) § 5. Section 5 permits the decision makers in an institution to delegate investment and management 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. Subsection (d) protects decision makers who comply with the requirement for proper delegation from liability for actions or decisions of the agents.

Section 5 does not address issues of internal delegation and potential liability for internal delegation, and subsection (d) 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, Section 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 (d) 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 (d) 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.

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

(a) The donor, in a record, may release, in whole or in part, a restriction imposed by a gift instrument on the use or investment of an institutional fund. A release under this subsection may not allow a fund to be used for a purpose other than a charitable purpose of the institution affected. A release is effective only upon acceptance by the institution.

(b) Except as otherwise provided in the gift instrument, an institution may apply to the [appropriate court] for release or modification of a restriction imposed by a gift instrument on the use or investment of an institutional fund. The institution shall notify the [Attorney General], who must be given an opportunity to be heard. If the court finds that the restriction is unlawful, impracticable, impossible to achieve, or wasteful, it, by order, may release or modify the restriction, in whole or in part, in a manner consistent with the purposes expressed in the gift instrument.

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

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

(2) more than [20] years have elapsed since the inception of the fund.

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

Comment

Section 6 expands the rules on releasing or modifying restrictions that are found in Section 7 of UMIFA (1972). Subsection (a) restates the rule from UMIFA (1972) allowing the release of a restriction with donor consent. Subsection (b) describes the application of court-ordered cy pres but does not require notice to the donor as was required in UMIFA (1972). Subsection (c), a new provision, permits an institution to apply cy-pres for small funds that have existed for a substantial period of time, after giving notice to the state attorney general.

Subsection (a) permits the release of a restriction if the donor consents. A release with donor consent cannot change the charitable beneficiary of the fund. Although the donor has the power to consent to a release of a restriction, this section does not create a power in the donor that will cause a federal tax problem for the donor. The gift to the institution is a completed gift for tax purposes, the property cannot be diverted from the charitable beneficiary, and the donor has no retained interest in the fund.

Subsection (b) applies the doctrine of cy pres to institutions governed by UMIFA. The circumstances for the application of cy pres under UMIFA (200-) are the same as those in UTC § 413; cy pres may be applied if the restriction is unlawful, impracticable, impossible to achieve, or wasteful. A restriction that may have made sense when a donor made a gift, may no longer be appropriate due to unanticipated changes. Subsection (b) allows the institution to apply for modification of the restriction, in keeping with the original intent of the donor. The institution must give notice to the state attorney general, who represents the interests of the public in ensuring that the donor's charitable wishes as expressed in the gift instrument are followed. In determining the appropriate modification, the court will consider what the donor would have preferred if the donor had been aware of the unanticipated circumstances.

The Drafting Committee considered requiring notification of the donor in a cy pres application but concluded that such a requirement would make cy pres impracticable in situations involving multiple donors. Good practice dictates notifying known donors of any change considered by the institution. The Drafting Committee concluded that an institution's concern for donor relations would serve as sufficient incentive for following that practice. The interest of donors who cannot be contacted will be protected by the attorney general, the court, and the standard itself. An institution will be able to use cy pres only if there is a significant problem with complying with the restriction and only with the supervision of the attorney general and the court.

(c) Subsection (c) permits an institution to release or modify a restriction using a cy pres approach but without donor consent or court approval if the amount of the institutional fund involved is small and if the institutional fund has been in existence for more than 20 years. The Drafting Committee determined that under some circumstances a restriction may no longer make sense but the cost of a judicial cy pres proceeding will be too great to warrant a change in the restriction. The Committee discussed at length the parameters for allowing an institution to apply cy pres itself, without court supervision. The Committee drafted subsection (c) to balance the needs of an institution to operate efficiently for its charitable purposes and the need to protect donors' wishes. The subsection assumes that an institutional fund with a value of $25,000 or less is sufficiently small that the cost of a judicial proceeding will be out of proportion with the need to change the restriction. The Committee included a requirement that the institutional fund be in existence at least 20 years because it seemed reasonable to require additional safeguards for donors' intent for some period of time after the creation of the institutional fund. The 20 year period begins to run from the date of inception of the fund and not from the date of each gift to the fund. The amount and the number of years have been placed in brackets to signal to enacting jurisdictions that they may wish to designate a higher or lower figure.

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

Although UMIFA (200-) does not create standing in donors seeking to enforce restrictions on their gifts, a donor making a significant gift to an institution may include in the gift instrument a right to notice of any modification or a right to standing to enforce a gift. In addition, some states do provide for donor standing to enforce terms of a gift under certain circumstances. *See* [citation].

SECTION 7. REVIEWING COMPLIANCE. Compliance with this [act] is determined in light of the facts and circumstances existing at the time a decision is made or action is taken.

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

SECTION 9. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 10. SEVERABILITY. If any provision of this [act] or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of this [act] which can be given effect without the invalid provision or application, and to this end the provisions of the [act] are severable.

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

SECTION 12. REPEAL.

The following acts and parts of acts are repealed: