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5 **UNIFORM PRUDENT MANAGEMENT OF**
6 **INSTITUTIONAL FUNDS ACT**

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9 drafted by the

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12 NATIONAL CONFERENCE OF COMMISSIONERS
13 ON UNIFORM STATE LAWS

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41 ON UNIFORM STATE LAWS

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37 providing services that most states could not otherwise afford or duplicate.
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- 39

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2 **INSTITUTIONAL FUNDS ACT**

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

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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). The National Conference of Commissioners on Uniform State Laws approved UMIFA in 1972, and 47 jurisdictions have enacted the act. 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.”

UMIFA was drafted almost 35 years ago, and portions of it are now out of date.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 corporate and other fiduciaries that are not 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, a nonprofit corporation, or 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.”); 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.

UPMIFA provides guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations, and 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. These provisions derive from the approach taken in the Uniform Trust Code (UTC) for modifying charitable trusts. Like the UTC provisions, UPMIFA's 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 the 1972 prudence standard to investment decision making. In contrast, UPMIFA will give charities updated and more useful 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.

Among the expressly enumerated prudence factors in UPMIFA is "the preservation of the endowment fund," a standard not articulated in UMIFA.

In addition to identifying factors that a charity must consider in making management and investment decisions, UPMIFA requires a charity and those who manage and invest 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.

UMIFA did not articulate these requirements.

Thus, UPMIFA strengthens 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, consistent with the purposes of the fund, relevant economic factors, and the donor's intent that the fund continue in perpetuity. 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 prospectively to institutional funds created after enactment of the statute. Regarding the considerations motivating this treatment of the issues, see the comment to Section 4.

Endowment Spending. UPMIFA improves the endowment spending rule by eliminating the concept of historic dollar value and providing better guidance regarding the operation of the prudence standard. Under UMIFA a charity can spend amounts above historic dollar value that the charity determines to be prudent. The Act directs the charity to focus 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 endowment spending rule created numerous problems and that restructuring the rule would benefit charities, their donors, and the public. The problems include:

1. Historic dollar value fixes valuation at a moment in time, and that moment is 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. (UMIFA left uncertain what the appropriate date for valuing a testamentary gift was.) The determination of historic dollar value can vary significantly depending upon when in the market cycle the donor dies. 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 long term investment success, the value of the typical 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. 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 that is so encumbered is commonly called an “underwater” fund. Conflicting advice regarding whether an organization could spend from an underwater fund has 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 investment policy and can ultimately lead to a decline in a fund’s real value. 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 is meant to protect against spending an endowment too quickly. 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 want to include a mechanical guideline in the statute. A major drawback to any statutory percentage is that it is unresponsive to changes in the rate of inflation or deflation.

Modification of Restrictions on Charitable Funds. UPMIFA 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 statutory authority for applying these principles to nonprofit corporations would be helpful. UPMIFA permitted 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 attorney general continues to be the protector both of the donor’s intent and of the public’s interest in charitable funds.

Other Organizational Law. 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.

Relation to Trust Law. Although 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 provision for modifying a small, old fund in subsection (d) of Section 6 have no counterparts in the common law or the UTC. The Drafting Committee believes that these rules could be useful to charities organized as trusts, and the Committee recommends conforming amendments to the UTC and the Principal and Income Act to incorporate these changes into trust law.

UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Prudent 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, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community.

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

(3) “Gift instrument” means a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund.

(4) “Institution” means:

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

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

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

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

(A) program-related assets;

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

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

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

(7) “Program-related asset” means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.

(8) “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.

Kansas Comment

This section adds definitions for “charitable purpose,” “person,” “program-related asset,” and “record.” Definitions of “governing board” and “historic dollar value” have been deleted.

UTC Comment

Subsection (1). Charitable Purpose. The definition of charitable purpose follows that of UTC § 405 and Restatement (Third) of Trusts § 28 (2003). This long-familiar standard derives from the English Statute of Charitable Uses, enacted in 1601.

Some 17 states have created statutory definitions of charitable purpose for various purposes. *See, e.g.*, 10 PA. CONS. STAT. § 162.3 (2005) (defining charitable purpose within the Solicitation of Funds for Charitable Purposes Act to include “humane,” “patriotic,” social welfare and advocacy,” and “civic” purposes). The definition in subsection (1) applies for purposes of this Act and does not affect other definitions of charitable purpose.

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 that makes a fund an endowment fund arises from the terms of a gift instrument. If an institution has more than one endowment fund, under Section 3 the institution can manage and invest some or all endowment funds together. Section 4 and Section 6 must be applied to

individual funds and cannot be applied to a group of funds that may be managed collectively for investment purposes.

Board-designated funds are institutional funds but not endowment funds. The rules on expenditures and modification of restrictions in this Act do not apply to restrictions that an institution places on an otherwise unrestricted fund that the institution holds 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 the institution.

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

Subsection (3). Gift Instrument. The term gift instrument refers to the records that establish the terms of a gift and may consist of more than one document. The definition clarifies that the only legally binding restrictions on a gift are the terms set forth in writing.

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. Although the term can include any of these records, a record will only become a gift instrument if both the donor and the institution were or should have been aware of its terms when the donor made the gift. For example, if a donor sends a contribution to an institution for its general purposes, then the articles of incorporation may be used to clarify those purposes. If, in contrast, the donor sends a letter explaining that the institution should use the contribution for its “educational projects concerning teenage depression,” then any funds received in response must be used for that purpose and not for broader purposes otherwise permissible under the articles of incorporation.

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, including whether a subsequent writing superseded the terms of the solicitation. Each gift received in response to a solicitation will be subject to any restrictions indicated in the gift instrument pertaining to that gift. For example, if an initial gift establishes an endowment fund, and the charity then solicits additional gifts “to be held as part of the Charity X Endowment Fund,” those additional gifts will each be subject to the restriction that the gifts be held as part of that endowment fund.

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

The term gift instrument also 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. The term includes charitable organizations created as nonprofit corporations, unincorporated associations, governmental subdivisions or agencies, or any form of entity, however organized, that is organized and operated exclusively for charitable purposes. The term includes a trust organized and operated exclusively for charitable purposes, but only if a charity acts as trustee. This approach leaves unchanged the coverage of UMIFA. The exclusion of “individual” from the definition of institution is not intended to exclude a corporation sole.

Although UPMIFA does not apply to all charitable trusts, many of UPMIFA’s provisions derive from trust law. Prudent investor standards apply to trustees of charitable trusts in states that have adopted UPIA. Trustees of charitable trusts can use the doctrines of cy pres and deviation to modify trust provisions, and the UTC includes a number of modification provisions. The Uniform Principal and Income Act permits allocation between principal and income to facilitate total-return investing. Charitable trusts not included in UPMIFA, primarily those managed by corporate trustees and individuals, will lose the benefits of UPMIFA’s endowment spending rule and the provision permitting a charity to apply cy pres, without court supervision, for modifications to a small, old fund. Enacting jurisdictions may choose to incorporate these rules into existing trust statutes to provide the benefits to charitable funds managed by corporate trustees.

The definition of institution includes governmental organizations that hold funds exclusively for the purposes listed in the definition. A governmental entity created by state law may fall outside the definition on account of the form of organization under which the state created it. Because state arrangements are so varied, creating a definition that encompasses all charitable entities created by states is not feasible. States should consider applying the core principles of UPMIFA to such 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 charitable purposes, whether the fund is expendable currently or subject to restrictions. The term does not include a fund held by a trustee that is not an institution.

Some institutions combine assets from multiple funds for investment purposes, and some institutions invest funds from different institutions in a common fund. Typically each fund is assigned units representing the share value of the individual fund. The assets are invested collectively, permitting more efficient investment and improved diversification of the overall

portfolio. The collective fund makes annual distributions to the individual funds based on the units held by each fund. For purposes of Section 3 [and Section 5], the collective fund is considered one institutional fund. Section 4 and Section 6 apply to each fund individually and not to the collective fund.

Assets held by an institution primarily for program-related purposes rather than exclusively for investment are not subject to UPMIFA. For example, a university may purchase land adjacent to its campus for future development. The purchase might not meet prudent investor standards for commercial real estate, but the purchase may be appropriate because the university needs to build a new dormitory. The classroom buildings, administration buildings, and dormitories held by the university all have value as property, but the university does not hold those buildings as financial assets for investment purposes. The Act excludes from the prudent investor norms those assets that a charity uses to conduct its charitable activities, but does not exclude assets that have a tangential tie to the charitable purpose of the institution but are held primarily for investment purposes.

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 termination of the noncharitable interests. The Act will have only a limited effect on a charitable remainder trust that terminates after the noncharitable interest ends. During the period required to complete the distribution of the trust's property, the prudence norm will apply to the actions of the trustee, but the short timeframe will affect investment decision making.

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

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 until such contingency occurs.

Subsection (7). Program-Related Asset. Although UPMIFA does not apply to program-related assets, if program-related assets serve, in part, as investments for an institution, then the institution should identify categories for reporting those investments and should establish investment criteria for the investments that are reasonably related to achieving the institution's charitable purposes. For example, a program providing below-market loans to

inner-city businesses may be “primarily to accomplish a charitable purpose of the institution” but also can be considered, in part, an investment. The institution should create reasonable credit standards and other guidelines for the program to increase the likelihood that the loans will be repaid.

Subsection (8). 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. STANDARD OF CONDUCT IN MANAGING AND INVESTING INSTITUTIONAL FUND.

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

(b) In addition to complying with the duty of loyalty imposed by law other than this [act], each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

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

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

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

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

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

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

(A) general economic conditions;

(B) the possible effect of inflation or deflation;

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

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

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

(F) other resources of the institution;

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

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

(2) Management and investment decisions about an individual asset must be made not in isolation but rather 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.

(3) Except as otherwise provided by law other than this [act], an institution may invest in any kind of property or type of investment consistent with this section.

(4) 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 diversification.

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

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

Kansas Comment

This section combines the investment authority and standard of conduct provisions of K.S.A. 58-3604 and 58-3606. The standard of conduct is "prudence," deleting the language of "ordinary business care" found in K.S.A. 58-3606.

The Kansas drafting committee changed the UPMIFA by deleting subsection (e)(6), which provides:

"A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds."

The committee was concerned that this language might heighten the liability of volunteer board members and discourage service on charitable boards.

UTC Comment

Purpose and Scope of Revisions. This section adopts the prudence standard for investment decision making. The section directs directors or others responsible for managing and

investing the funds of an institution 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. Thus, the section follows modern portfolio theory for investment decision making. 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 the funds are restricted.

The Drafting Committee discussed extensively the standard that should govern nonprofit managers. UMIFA states the standard as “ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision.” 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 nominally similar to the corporate standard but with the recognition that the facts and circumstances considered include the fact that the entity is a charity and not a business corporation.

The language of the prudence standard adopted in UPMIFA is derived from the RMNCA and from the prudent investor rule of UPIA. 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. The standard for prudent investment set forth in Section 3 first states the duty of care as articulated in the RMNCA, but provides more specific guidance for those managing and investing institutional funds by incorporating language from UPIA. The criteria derived from UPIA are consistent with good practice under current law applicable to nonprofit corporations.

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

The Drafting Committee decided that by adopting language from both the RMNCA and UPIA, UPMIFA could clarify that common standards of prudent investing apply to all charitable institutions. Although the principal trust authorities, UPIA § (2)(a), Restatement (Third) of Trusts §337, UTC § 804, and Restatement (Second) of Trusts § 174 (prudent administration) use the phrase “care, skill and caution,” the Drafting Committee decided to use the more familiar corporate formulation as found in RMNCA. The standard also appears in Sections 3, 4 and 5 of UPMIFA. The Drafting Committee does not intend any substantive change to the UPIA standard and believes that “reasonable care, skill, and caution” are implicit in the term “care” as used in the RMNCA. The Drafting Committee included the detailed provisions from UPIA, because the Committee believed that the greater precision of the prudence norms of the

Restatement and UPIA, as compared with UMIFA, could helpfully inform managers of charitable institutions. 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), and for a discussion of the effect UPIA has had on investment decision making, see Max M. Schanzenbach & Robert H. Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?*, 50 J. L. & Econ. (forthcoming 2007).

Section 3 has incorporated the provisions of UPIA with only a few exceptions. UPIA applies to private trusts and is entirely default law. The settlor of a private trust has complete control over virtually all trust provisions. See UTC § 105. Because UPMIFA applies to charitable organizations, UPMIFA makes the duty of care, the duty to minimize costs, and the duty to investigate mandatory. The duty of loyalty is mandatory under applicable organization law, corporate or trust. Other than these duties, the provisions of Section 3 are default rules. A gift instrument or the governing instruments of an institution can modify these duties, but the charitable purpose doctrine limits the extent to which an institution or a donor can restrict these duties. In addition, subsection (a) of Section 3 reminds the decision maker that the intent of a donor expressed in a gift instrument will control decision making. Further, the decision maker must consider the charitable purposes of the institution and the purposes of the institutional fund for which decisions are being made. These factors are specific to charitable organizations; UPIA § 2(a) states the duty to consider similar factors in the private trust context.

UPMIFA does not include the duty of impartiality, stated in UPIA § 6, because nonprofit corporations do not confront the multiple beneficiaries problem to which the duty is addressed. Under UPIA, a trustee must treat the current beneficiaries and the remainder beneficiaries with due regard to their respective interests, subject to alternative direction from the trust document. A nonprofit corporation typically creates one charity. The institution may serve multiple beneficiaries, but those beneficiaries do not have enforceable rights in the institution in the same way that beneficiaries of a private trust do. Of course, if a charitable trust is created to benefit more than one charity, rather than being created to carry out a charitable purpose, then UPIA will apply the duty of impartiality to that trust.

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

The duties imposed by this section apply to those who govern an institution, including directors and trustees, and to those to whom the directors or managers delegate responsibility for investment and management of institutional funds. The standard applies to officers and employees of an institution and to agents who invest and manage institutional funds. Volunteers

who work with an institution will be subject to the duties imposed here, but state and federal statutes may provide reduced liability for persons who act without compensation. UPMIFA does not affect the application of those shield statutes.

Subsection (a). Donor Intent and Charitable Purposes. Subsection (a) states the overarching duty to comply with donor intent as expressed in the terms of the gift instrument. The emphasis in the Act on giving effect to donor intent does not mean that the donor can or should control the management of the institution. The other fundamental duty is the duty to consider the charitable purposes of the institution and of the institutional fund in making management and investment decisions. UPIA § 2(a) states a similar duty to consider the purposes of a trust in investing and managing assets of a trust.

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

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

Subsection (c)(1). Duty to Minimize Costs. Subsection (c)(1) 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. *See* UPIA § 7 cmt; Restatement (Third) of Trusts: Prudent Investor Rule § 227,

cmt. M, at 58 (1992); Restatement (Second) of Trusts § 188 (1959). The duty is consistent with the duty to act prudently under § 8.30 of the RMNCA.

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

Subsection (d). Pooling Funds. An institution holding more than one institutional fund may find that pooling its funds for investment and management purposes will be economically beneficial. The Act permits pooling for these purposes. The prohibition against commingling no longer prevents pooling funds for investment and management purposes. *See* UPIA § 3, cmt. (duty to diversify aided by pooling); UPIA § 7, cmt. (pooling to minimize costs); Restatement (Third) of Trusts: Duty to Segregate and Identify Trust Property § 84 (T.D. No. 4 2005). Funds will be considered individually for other purposes of the Act, including for the spending rule for endowment funds of Section 4 and the modification rules of Section 6.

Subsection (e)(1). Prudent Decision Making. Subsection (e)(1) takes much of its language from UPIA § 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.

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

Assets held primarily for program-related purposes are not subject to UPMIFA. The management of those assets will continue to be governed by other laws applicable to the institution. Other assets may not be held primarily for program-related purposes but may have both investment purposes and program-related purposes. Subsections (a) and (e)(1)(H) indicate that a prudent decision maker can take into consideration the relationship between an investment and the purposes of the institution and of the institutional fund in making an investment that may have a program-related purpose but not be primarily program-related. 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.

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

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

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

Subsection (e)(3) also provides that other law may limit the authority under this subsection. In addition, all of subsection (e) is subject to contrary provisions in a gift instrument, and a gift instrument may restrict the ability to invest in particular assets. 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.

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

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

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

Section 4(2) of UMIFA specifically authorized an institution to retain property contributed by a donor. The comment explained that an institution might retain property in the hope of obtaining additional contributions from the donor. Under UPMIFA the potential for developing additional contributions by retaining property contributed to the institution would be among the “other circumstances” that the institution might consider in deciding whether to retain or dispose of the property. The institution must weigh the potential for obtaining additional contributions with all other factors that affect the suitability of retaining the property in the investment portfolio.

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

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

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

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

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

(a) Subject to the intent of a donor expressed in the gift instrument [and to subsection (d)], an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. ~~Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor restricted assets until appropriated for expenditure by the institution.~~ In making a determination to appropriate or accumulate, the institution shall act in

good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

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

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

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

(1) create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund; and

(2) do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (a).

~~{(d) The appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of not less than three years immediately preceding the year in which the appropriation for expenditure was made, creates a rebuttable~~

~~presumption of imprudence. For an endowment fund in existence for fewer than three years, the fair market value of the endowment fund must be calculated for the period the endowment fund has been in existence. This subsection does not:~~

~~(1) apply to an appropriation for expenditure permitted under law other than this [act] or by the gift instrument; or~~

~~(2) create a presumption of prudence for an appropriation for expenditure of an amount less than or equal to seven percent of the fair market value of the endowment fund.]~~

Kansas Comment

This section combines the subject matter of K.S.A. 58-3602 - Appropriation of appreciation, and K.S.A. 58-3603 - Rule of construction. The rules regarding spending are substantially changed, setting forth factors to be considered. The concept of “historic dollar value” is no longer used to calculate how much of an endowment fund can be spent.

1 The Kansas drafting committee changed the UPMIFA by deleting the following sentence
2 in subsection (a): “Unless stated otherwise in the gift instrument, the assets in an endowment
3 fund are donor-restricted assets until appropriated for expenditure by the institution.”
4

5 The committee also chose not to adopt the optional subsection (d), which creates a
6 rebuttable presumption of imprudence if more than 7% of an endowment’s assets are spent in one
7 year.
8

UTC Comment

9
10
11 **Purpose and Scope of Revisions.** This section revises the provision in UMIFA that
12 permitted the expenditure of appreciation of an endowment fund to the extent the fund had
13 appreciated in value above the fund’s historic dollar value. UMIFA defined historic dollar value
14 to mean all contributions to the fund, valued at the time of contribution. Instead of using historic
15 dollar value as a limitation, UPMIFA applies a more carefully articulated prudence standard to
16 the process of making decisions about expenditures from an endowment fund. The expenditure
17 rule of Section 4 applies only to the extent that a donor and an institution have not reached some
18 other agreement about spending from an endowment. If a gift instrument sets forth specific
19 requirements for spending, then the charity must comply with those requirements. However, if
20 the gift instrument uses more general language, for example directing the charity to “hold the
21 fund as an endowment” or “retain principal and spend income,” then Section 4 provides a rule of
22 construction to guide the charity.
23

1 Prior to the promulgation of UMIFA, “income” for trust accounting purposes meant
2 interest and dividends but not capital gains, whether or not realized. Many institutions assumed
3 that trust accounting principles applied to charities organized as nonprofit corporations, and the
4 rules limited the institutions’ ability to invest their endowment funds effectively. UMIFA
5 addressed this problem by construing “income” in gift instruments to include a prudent amount
6 of capital gains, both realized and unrealized. Under UMIFA an institution could spend
7 appreciation in addition to spending income determined under trust accounting rules. This rule
8 of construction likely carried out the intent of the donor better than a rule limiting spending to
9 trust accounting income, while permitting the charity to invest in a manner that could generate
10 better returns for the fund.

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

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

33
34 **Subsection (a). Expenditure of Endowment Funds.** Subsection (a) uses the RMNCA
35 articulation of the standard of care for decision making under Section 4. The change in language
36 does not reflect a substantive change. The comment to Section 3 more fully describes that
37 standard of care.

38
39 Section 4 permits expenditures from an endowment fund to the extent the institution
40 determines that the expenditures are prudent after considering the factors listed in subsection (a).
41 These factors emphasize the importance of the intent of the donor, as expressed in a gift
42 instrument. Section 4 looks to written documents as evidence of donor’s intent and does not
43 require an institution to rely on oral expressions of intent. By requiring written evidence of
44 intent, the Act protects reliance by the donor and the institution on the written terms of a
45 donative agreement. Informal conversations may be misremembered and may be subject to

1 multiple interpretations. Of course, oral expressions of intent may guide an institution in further
2 carrying out a donor’s wishes and in understanding a donor’s intent.

3
4 The factors in subsection (a) require attention to the purposes of the institution and the
5 endowment fund, economic conditions, and present and reasonably anticipated resources of the
6 institution. As under UMIFA, determinations under Section 4 do not depend on the
7 characterization of assets as income or principal and are not limited to the amount of income and
8 unrealized appreciation. The authority in Section 4 is permissive, however, and an institution
9 organized as a trust may continue to make spending decisions under trust accounting principles
10 so long as doing so is prudent.

11
12 Institutions have operated effectively under UMIFA and have operated more
13 conservatively than the historic dollar value rule would have permitted. Institutions have little
14 incentive to maximize allowable spending. Good practice has been to provide for modest
15 expenditures while maintaining the purchasing power of a fund. Institutions have followed this
16 practice even though UMIFA (1) does not require an institution to maintain a fund’s purchasing
17 power and (2) does allow an institution to spend any amounts in a fund above historic dollar
18 value, subject to the prudence standard. The Drafting Committee concluded that eliminating
19 historic dollar value and providing institutions with more discretion would not lead to depletion
20 of endowment funds. Instead, UPMIFA should encourage institutions to establish a spending
21 policy that will be responsive to short-term fluctuations in the value of the fund. Section 4 allows
22 an institution to maintain appropriate levels of expenditures in times of economic downturn or
23 economic strength. In some years, accumulation rather than spending will be prudent, and in
24 other years an institution may appropriately make expenditures even if a fund has not generated
25 investment return that year.

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

38
39 In addition to the guidance provided by Section 4, other safeguards exist. Donors can
40 restrict gifts and can provide specific instructions to donee institutions regarding appropriate uses
41 for assets contributed. Within institutions, fiduciary duties govern the persons making decisions
42 on expenditures. Those persons must operate both with the best interests of the institution in
43 mind and in keeping with the intent of donors. If an institution diverts an institutional fund from
44 the charitable purposes of the institution, the state attorney general can enforce the charitable
45 interests of the public. By relying on these safeguards while providing institutions with adequate

1 discretion to make appropriate expenditures, the Act creates a standard that takes into
2 consideration the diversity of the charitable sector. The committee expects that accumulated
3 experience with such spending formulas will continue to inform institutional practice under the
4 Act.

5
6 **Distinguishing Legal and Accounting Standards.** Deleting historic dollar value does
7 not transform any portion of an endowment fund into unrestricted assets from a legal standpoint.
8 An endowment fund is restricted because of the donor’s intent that the fund be restricted by the
9 prudent spending rule, that the fund not be spent in the current year, and that the fund continue to
10 maintain its value for a long time. Regardless of the treatment of endowment fund from an
11 accounting standpoint, legally an endowment fund should not be considered unrestricted.
12 Subsection (a) states that endowment funds will be legally restricted until the institution
13 appropriates funds for expenditure. The UMIFA statutes in Utah and Maine contain similar
14 language. 13 Me. Rev. Stat. Ann. tit. 13 § 4106 (West 2005); Utah Code Ann. 1953 § 13-29-3
15 (2005). *See, also*, advisory published by Mass. Attorney General, “The Attorney General’s
16 Position on FASB Statement of Financial Accounting Standards No. 117, ¶ 22 and Related
17 G.L.C. 180A Issues” (January 2004) <http://www.ago.state.ma.us/filelibrary/fasb.pdf> (last visited
18 May 22, 2006) (concerning the treatment of endowments as legally restricted assets).

19
20 The term “endowment fund” includes funds that may last in perpetuity but also funds that
21 are created to last for a fixed term of years or until the institution achieves a specified objective.
22 Section 4 requires the institution to consider the intended duration of the fund in making
23 determinations about spending. For example, if a donor directs that a fund be spent over 20
24 years, Section 4 will guide the institution in making distribution decisions. The institution would
25 amortize the fund over 20 years rather than try to maintain the fund in perpetuity. For an
26 endowment fund of limited duration, spending at a rate higher than rates typically used for
27 endowment spending will be both necessary and prudent.

28
29 **Subsection (c). Rule of Construction.** Donor’s intent must be respected in the process
30 of making decisions to expend endowment funds. Section 4 does not allow an institution to
31 convert an endowment fund into a non-endowment fund nor does the section allow the institution
32 to ignore a donor’s intent that a fund be maintained as an endowment. Rather, subsection (c)
33 provides rules of construction to assist institutions in interpreting donor’s intent. Subsection (c)
34 assumes that if a donor wants an institution to spend “only the income” from a fund, the donor
35 intends that the fund both support current expenditures and be preserved permanently. The
36 donor is unlikely to be concerned about designation of particular returns as “income” or
37 “principal” under accounting principles. Rather the donor is more likely to assume that the
38 institution will use modern total-return investing techniques to generate enough funds to
39 distribute while maintaining the long-term viability of the fund. Subsection (c) is an intent
40 effectuating provision that provides default rules to construe donor’s intent.

41
42 As subsection (b) explains, a donor who wants to specify particular spending guidelines
43 can do so. For example, a donor might require that a charity spend between three and five
44 percent of an endowed gift each year, regardless of investment performance or other factors.
45 Because the charity agrees to the restriction in accepting the gift, the restriction will govern

1 spending decisions by the charity. Another donor might want to limit expenditures to trust
2 accounting income and not want the institution to be able to expend appreciation. An instruction
3 to “pay only the income” will not be specific enough, but an instruction to “pay only interest and
4 dividend income earned by the fund and not to make other distributions of the kind authorized by
5 Section 4 of UPMIFA” should be sufficient. If a donor indicates that the rules on investing or
6 expenditures under Section 4 do not apply to a particular fund, then as a practical matter the
7 institution will probably invest the fund separately. Thus, a decision by a donor to require fund
8 specific expenditure rules will likely also have consequences in the way the institution invests
9 the fund.

10
11 **Retroactive Application of the Rule of Construction.** A constructional rule resolves an
12 ambiguity, in this case, because donors use words like endowment or income without specific
13 directions regarding the intended meaning. Changing a statutory constructional rule does not
14 change the underlying intent, and instead changes the way an ambiguity is resolved, in an
15 attempt to increase the likelihood of giving effect to the intent of most donors.

16
17 If a donor has stated in a gift instrument specific directions as to spending, then the
18 institution must respect those wishes, but many donors do not give precise instructions about
19 how to spend endowment funds. In Section 4 UPMIFA provides guidance for giving effect to a
20 donor’s intent when the donor has not been specific. Like Section 3 of UMIFA, Section 4 of
21 UPMIFA is a rule of construction, so it does not violate either donor intent or the Constitution.

22
23 The issue of whether to apply a rule of construction retroactively was considered in
24 connection with UMIFA. When the New Hampshire legislature considered UMIFA, the Senate
25 asked the New Hampshire Supreme Court for an opinion regarding whether UMIFA, if adopted,
26 would violate a provision of the state constitution prohibiting retrospective laws, and also
27 whether the statute would encroach on the functions of the judicial branch. The opinion
28 answered no to both questions. Opinion of the Justices, Request of the Senate No. 6667, 113
29 N.H. 287, 306 A.2d 55 (1973).

30
31 More recently the Colorado Supreme Court considered the retroactive application of
32 another constructional statute, one that deems the designation of a spouse as the beneficiary of a
33 life insurance policy to be revoked in a case in which the marriage was dissolved after the
34 naming of the spouse as beneficiary. *In re Estate of DeWitt*, 54 P. 3d 849 (Colo. 2002). In
35 holding that retroactive application of the statute did not violate the Contracts Clause, the court
36 cited approvingly from a statement prepared by the Joint Editorial Board for Uniform Trusts and
37 Estates Acts (JEB). JEB Statement Regarding the Constitutionality of Changes in Default Rules
38 as Applied to PreExisting Documents, 17 Am. Coll. Tr. & Est. Couns. Notes 184 app. II (1991).

39
40 The JEB Statement explains that the purpose of the anti-retroactivity norm is to protect a
41 transferor who relies on existing rules of law. By definition, however, rules of construction
42 apply only in situations in which a transferor did not spell out his or her intent and hence did not
43 rely on the then-current rule of construction. *See also In re Gardner's Trust*, 266 Minn. 127,
44 132, 123 N.W. 2d 69, 73 (1963) (“[I]t is doubtful whether the testatrix had any clear intention in
45 mind at the time the will was executed. It is equally plausible that if she had thought about it at

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

3
4 Non-retroactivity would produce serious practical problems: If the Act were not
5 retroactive, a charity would need to keep two sets of books for each endowment fund created
6 before the enactment of UPMIFA, if new funds were added after the enactment. The burden that
7 such a rule would impose is out of proportion to the benefit sought.

8
9 **Subsection (d). Rebuttable Presumption of Imprudence.** The Drafting Committee
10 debated at length whether to include a presumption of imprudence for spending above a fixed
11 percentage of the value of the fund. The Drafting Committee decided to include a presumption
12 in the Act in brackets, as an option for states to consider, and to include in these Comments a
13 discussion of the advantages and disadvantages of including a presumption in the Act.

14
15 Some who commented on the Act viewed the presumption as linked to the retroactive
16 application of the rule of construction of subsection (c). A donor who contributed to an
17 endowment fund under UMIFA may have assumed that the historic dollar value of the gift would
18 be subject to a no-spending rule under the statute. Because UPMIFA removes the concept of
19 historic dollar value, the bracketed presumption of imprudence would assure the donor that
20 spending from an endowment fund will be so limited.

21
22 Those in favor of the presumption of imprudence argued that the presumption would curb
23 the temptation that a charity might have to spend endowment assets too rapidly. Although the
24 presumption would be rebuttable, and spending above the identified percentage might, in some
25 years and for some charities, be prudent, institutions would likely be reluctant to authorize
26 spending above seven percent. In addition, the presumption would give the attorney general a
27 benchmark of sorts.

28
29 A variety of considerations cut against including a presumption of imprudence in the
30 statute. A fixed percentage in the statute might be perceived as a safe harbor that could lead
31 institutions to spend more than is prudent. Although the provision should not be read to imply
32 that spending below seven percent will be considered prudent, some charities might interpret the
33 statute in that way. Decision makers might be pressured to spend up to the percentage, and in
34 doing so spend more than is prudent, without adequate review of the prudence factors as required
35 under the Act.

36
37 Perhaps the biggest problem with including a presumption in the statute is the difficulty
38 of picking a number that will be appropriate in view of the range of institutions and charitable
39 purposes and the fact that economic conditions will change over time. Under recent economic
40 conditions, a spending rate of seven percent is too high for most funds, but in a period of high
41 inflation, seven percent might be too low. In making a prudent decision regarding how much to
42 spend from an endowment fund, each institution must consider a variety of factors, including the
43 particular purposes of the fund, the wishes of the donors, changing economic factors, and
44 whether the fund will receive future donations.

1 Whether or not a statute includes the presumption, institutions must remember that
2 prudence controls decision making. Each institution must make decisions on expenditures based
3 on the circumstances of the particular charity.
4

5 **Application of Presumption.** For a state wishing to adopt a presumption of imprudence,
6 subsection (d) provides language. Under subsection (d), a rebuttable presumption of imprudence
7 will arise if expenditures in one year exceed seven percent of the assets of an endowment fund.
8 The subsection applies a rolling average of three or more years in determining the value of the
9 fund for purposes of calculating the seven-percent amount. An institution can rebut the
10 presumption of imprudence if circumstances in a particular year make expenditures above that
11 amount prudent. The concept and the language for the presumption of imprudence comes from
12 Mass. Gen. L. ch. 180A, § 2 (2004). Massachusetts enacted this rule in 1975 as part of its
13 UMIFA statute. New Mexico adopted the same presumption in 1978. N.M.S.A. § 46-9-2 (C)
14 (2004). New Hampshire has a similar provision. N.H. Rev. Stat. § 292-B:6.
15

16 The period that a charity uses to calculate the presumption (three or more years) and the
17 frequency of valuation (at least quarterly) will be binding in any determination of whether the
18 presumption applies. For example, if a charity values an endowment fund on a quarterly basis
19 and averages the quarterly values over three years to determine the fair market value of the fund
20 for purposes calculating seven percent of the fund, the charity's choices of three years as a
21 smoothing period and quarterly as a valuation period cannot be challenged. If the charity makes
22 an appropriation that is less than seven percent of this value, then the presumption of imprudence
23 does not arise even if the appropriation would exceed seven percent of the value of the fund
24 calculated based on monthly valuations averaged over five years.
25

26 If sufficient evidence establishes, by the preponderance of the evidence, the facts
27 necessary to raise the presumption of imprudence, then the institution will have to carry the
28 burden of production of (i.e., the burden of going forward with) other evidence that would tend
29 to demonstrate that its decision was prudent. The existence of the presumption does not shift the
30 burden of persuasion to the charity.
31

32 Expenditures from an endowment fund may include distributions for charitable purposes
33 and amounts used for the management and administration of the fund, including annual charges
34 for fundraising. The value of a fund, as calculated for purposes of determining the seven percent
35 amount, will reflect increases due to contributions and investment gains and decreases due to
36 distributions and investment losses. The seven percent figure includes charges for fundraising
37 and administrative expenses other than investment management expenses. All costs or fees
38 associated with an endowment fund are factors that prudent decision makers consider. High
39 costs or fees of investment management could be considered imprudent regardless of whether
40 spending exceeds seven percent of the fund's value.
41

42 The presumption of imprudence does not create an automatic safe harbor. Expenditures at
43 six percent might well be imprudently high. See James P. Garland, *The Fecundity of*
44 *Endowments and Long-Duration Trusts*, *The Journal of Portfolio Management* (2005). Evidence
45 reviewed by the Drafting Committee suggests that at present few funds can sustain spending at a

1 rate above five percent. *See* Roger G. Ibbotson & Rex A. Sinquefeld, *Stocks, Bonds, Bills, and*
2 *Inflation: Historical Returns (1926-1987)* (Research Foundation of the Institute of Chartered
3 *Financial Analysts, 1989)*. Indeed, under current conditions five percent can be too high. *See*
4 *Joel C. Dobris, Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent*
5 *Unitrust and Spending Rate on Settlers, Their Advisers, and Retirees*, 40 *Real Prop. Prob. & Tr.*
6 *J.* 39 (2005). Further, spending at a lower rate, particularly in the early years of an endowment,
7 may result in greater distributions over time. *See* DeMarche Associates, Inc, *Spending Policies*
8 *and Investment Planning for Foundations: A Structure for Determining a Foundation’s Asset*
9 *Mix* (Council on Foundations: 3d ed. 1999). A presumption of imprudence can serve as a
10 reminder that spending at too high a rate will jeopardize the long-term nature of an endowment
11 fund. If an endowment fund is intended to continue permanently, the institution should take
12 special care to limit annual spending to a level that protects the purchasing power of the fund.
13

14 Subsection (d) provides that the terms of the gift instrument can provide additional
15 spending authority. For example, if a gift instrument directs that an institution expend a fund
16 over a ten-year period, exhausting the fund after ten years, spending at a rate higher than seven
17 percent will be necessary.
18

19 Subsection (d) does not require an institution to spend a minimum amount each year.
20 The prudence standard and the needs of the institution will supply sufficient guidance regarding
21 whether to accumulate rather than to spend in a particular year.
22

23 Spending above seven percent in any one year will not necessarily be imprudent. For
24 some endowment funds fluctuating spending rates may be appropriate. Although the Act does
25 not apply the percentage for the presumption on a rolling basis (e.g., 21 percent over three years),
26 some endowment funds may prudently spend little or nothing in some years and more than seven
27 percent in other years. For example, a charity planning a construction project might decide to
28 spend nothing from an endowment for three years and then in the fourth year might spend 20
29 percent of the value of the fund for construction costs. The decision to accumulate in years one
30 through three and then to spend 20 percent in the fourth year might be prudent for the charity,
31 depending on the other factors. The charity should maintain adequate records during the
32 accumulation period and should document the decision-making process in the fourth year to be
33 able to meet the burden of production associated with the presumption. Another charity might
34 prudently spend 20 percent in year one and nothing for the following three years. That charity
35 would also need to document the decision-making process through which the decision to spend
36 occurred and maintain records explaining why the decision was prudent under the circumstances.
37

38 A charity might establish a “capital replacement fund” designed to provide funds to the
39 institution for repair or replacement of major items of equipment. Disbursements from such a
40 fund will likely fluctuate, with limited expenditures in some years and big expenditures in others.
41 The fund would not exhibit a uniform spending rate. Indeed, an advantage of a capital
42 replacement fund is the ability to absorb a significant capital expenditure in a single year without
43 a negative impact on the operating budget of the institution. Disbursements might average five
44 percent per year but would vary, with spending in some years more and in some years less. Even
45 if this fund is an endowment fund subject to Section 4, spending above seven percent in a

1 particular year could well be prudent. Subsection (d) does not preclude spending above seven
2 percent.
3

4 A charity creating a capital replacement fund or a building fund might chose to adopt
5 spending rules for the fund that would not be subject to UPMIFA. Specific donor intent can
6 supersede the rules of UPMIFA. If the charity creates a gift instrument that establishes
7 appropriate rules on spending for the fund, and if donors agree to those restrictions, then the
8 UPMIFA rules on spending, including the bracketed presumption, will not apply.
9

10 **Institutions with Limited Investment and Spending Experience.** Several attorneys
11 general and other charity officials raised concerns about whether small institutions would be able
12 to adjust to a spending rule based solely on prudence, without the bright-line guidance of historic
13 dollar value. Some charity regulators who spoke with the Drafting Committee noted that large
14 institutions have sophisticated investment strategies, access to good investment advisors, and
15 experience with spending rules that maintain purchasing power for endowment funds. For these
16 institutions, the rules of UPMIFA should work well. For smaller institutions, however, the state
17 regulators thought that additional guidance could be helpful. After discussing strategies to
18 address this concern, the Drafting Committee decided to include in these comments an additional
19 optional provision that a state could choose to include in its UPMIFA statute.
20

21 The optional provision focuses on institutions with endowment funds valued, in the
22 aggregate, at less than \$2,000,000. The number is in brackets to indicate that it could be set
23 higher or lower. The number was chosen to address the concern of the state regulators that some
24 small charities might be more likely to spend imprudently than large charities. The Drafting
25 Committee selected \$2,000,000 as the value that might include most unsophisticated institutions
26 but would not be overinclusive.
27

28 The optional provision creates a notification requirement for an institution with a small
29 endowment that plans to spend below historic dollar value. If an institution subject to the
30 provision decides to appropriate an amount that would cause the value of its endowment funds to
31 drop below the aggregate historic dollar value for all of its endowment funds, then the institution
32 will have to notify the attorney general before proceeding with the expenditure. The provision
33 does not require that the institution obtain the approval of the attorney general before making the
34 distribution. Rather, the notification requirement gives the attorney general the opportunity to
35 take a closer look at the institution and its spending decision, to educate the institution on
36 prudent decision making for endowment funds, and to intervene if the attorney general
37 determines that the spending would be imprudent for the institution. Although the Drafting
38 Committee thinks that the prudence standard in UPMIFA provides adequate guidance to all
39 institutions within the scope of the Act, if a state chooses to adopt a notification provision for
40 institutions with small endowments, the Drafting Committee recommends the following
41 language:
42

43 (-) If an institution has endowment funds with an aggregate value of less than
44 [\$2,000,000], the institution shall notify the [Attorney General] at least [60 days] prior to
45 an appropriation for expenditure of an amount that would cause the value of the

1 institution's endowment funds to fall below the aggregate historic dollar value of the
2 institution's endowment funds, unless the expenditure is permitted or required under law
3 other than this [act] or in the gift instrument. For purposes of this subsection, "historic
4 dollar value" means the aggregate value in dollars of (i) each endowment fund at the time
5 it became an endowment fund, (ii) each subsequent donation to the fund at the time the
6 donation is made, and (iii) each accumulation made pursuant to a direction in the
7 applicable gift instrument at the time the accumulation is added to the fund. The
8 institution's determination of historic dollar value made in good faith is conclusive.
9

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

11 **FUNCTIONS.**

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

17 (1) selecting an agent;

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

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

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

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

26 (d) By accepting delegation of a management or investment function from an institution
27 that is subject to the laws of this state, an agent submits to the jurisdiction of the courts of this

1 state in all proceedings arising from or related to the delegation or the performance of the
2 delegated function.

3 (e) An institution may delegate management and investment functions to its committees,
4 officers, or employees as authorized by law of this state other than this [act].]

5
6
7

Kansas Comment

8 This section contains the subject matter of K.S.A. 58-3605 - Delegation of investment
9 management, but where that statute simply says that delegation is allowed, this section
10 establishes standards to be followed.

11
12
13

UTC Comment

14 The prudent investor standard in Section 4 presupposes the power to delegate. For some
15 types of investment, prudence requires diversification, and diversification may best be
16 accomplished through the use of pooled investment vehicles that entail delegation. The Drafting
17 Committee decided to put Section 5 in brackets because many states already provide sufficient
18 authority to delegate authority through other statutes. If such authority exists, then an enacting
19 state should enact UPMIFA without Section 5. Enacting delegation rules that duplicate existing
20 rules could be confusing and might create conflicts. For charitable trusts, UPIA provides the
21 same delegation rules as those in Section 5. For nonprofit corporations, nonprofit corporation
22 statutes often provide comparable rules. A state enacting UPMIFA must be certain that its laws
23 authorize delegation, either through other statutes or by enacting Section 5.

24
25
26

27 Section 5 incorporates the delegation rule found in UPIA § 9, updating the delegation
28 rules in UMIFA § 5. Section 5 permits the decision makers in an institution to delegate
29 management and investment functions to external agents if the decision makers exercise
30 reasonable skill, care, and caution in selecting the agent, defining the scope of the delegation and
31 reviewing the performance of the agent. In some circumstances, the scope of the delegation may
32 include redelegation. For example, an institution may select an investment manager to assist
33 with investment decisions. The delegation may include the authority to redelegate to investment
34 managers with expertise in particular investment areas. All decisions to delegate require the
35 exercise of reasonable care, skill, and caution in selecting, instructing, and monitoring agents.
36 Further, decision makers cannot delegate the authority to make decisions concerning
37 expenditures and can only delegate management and investment functions. Subsection (c)
38 protects decision makers who comply with the requirement for proper delegation from liability
39 for actions or decisions of the agents. In making decisions concerning delegation, the institution
40 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.

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

8
9 The language of subsection (c) is similar to that of UPIA § 9(c) and RMNCA § 8.30(d).
10 The decision not to include the terms “beneficiaries” or “members” in subsection (c) does not
11 indicate a decision that this section does not create immunity from claims brought by
12 beneficiaries or members. Instead, a decision maker who complies with section 5 will be
13 protected from any liability resulting from actions or decisions made by an external agent.

14
15 Subsection (d) creates personal jurisdiction over the agent. This subsection is not a choice
16 of law rule.

17
18 Subsection (e) notes that law other than this Act governs internal delegation. Section 5 of
19 UMIFA included internal delegation as well as external delegation, due to a concern at that time
20 that trust law concepts might govern internal delegation in nonprofit corporations. With the
21 widespread adoption of nonprofit corporation statutes, that concern no longer exists. The
22 decision not to address internal delegation in UPMIFA does not suggest that a governing board
23 of a nonprofit corporation cannot delegate to committees, officers, or employees. Rather, a
24 nonprofit corporation must look to other law, typically a nonprofit corporation statute, for the
25 rules governing internal delegation.

26
27 **SECTION 6. RELEASE OR MODIFICATION OF RESTRICTIONS ON**
28 **MANAGEMENT, INVESTMENT, OR PURPOSE.**

29 (a) If the donor consents in a record, an institution may release or modify, in whole or in
30 part, a restriction contained in a gift instrument on the management, investment, or purpose of an
31 institutional fund. A release or modification may not allow a fund to be used for a purpose other
32 than a charitable purpose of the institution.

33 (b) The court, upon application of an institution, may modify a restriction contained in a
34 gift instrument regarding the management or investment of an institutional fund if the restriction
35 has become impracticable or wasteful, if it impairs the management or investment of the fund, or

1 if, because of circumstances not anticipated by the donor, a modification of a restriction will
2 further the purposes of the fund. The institution shall notify the [Attorney General] of the
3 application, and the [Attorney General] must be given an opportunity to be heard. To the extent
4 practicable, any modification must be made in accordance with the donor's probable intention.

5 (c) If a particular charitable purpose or a restriction contained in a gift instrument on the
6 use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful,
7 the court, upon application of an institution, may modify the purpose of the fund or the
8 restriction on the use of the fund in a manner consistent with the charitable purposes expressed in
9 the gift instrument. The institution shall notify the [Attorney General] of the application, and the
10 [Attorney General] must be given an opportunity to be heard.

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

15 (1) the institutional fund subject to the restriction has a total value of less than
16 ~~[\$25,000]~~ [\$50,000];

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

18 (3) the institution uses the property in a manner consistent with the charitable
19 purposes expressed in the gift instrument.

20 (e) The dollar amount specified in subsection (d)(1) shall be adjusted to reflect changes in
21 the Consumer Price Index for All Urban Consumers, as published by the Bureau of Labor
22 Statistics of the Department of Labor (the "Index"), using 2007 as the base year, as follows:

1 (1) The dollar amount shall be adjusted as of January 1st of each year, if the cumulative
2 percentage of change in the Index, from the base year or from a later year that was the
3 basis of an adjustment of this amount pursuant to this subsection, rounded to the nearest
4 whole percentage point, is in excess of 10 percent.

5 (2) The amount of any adjustment shall be rounded to the nearest \$5,000.

6 (3) The dollar amount in subsection (d)(1) shall not be reduced below ~~\$25,000~~ \$50,000.

7 (4) No adjustment to this amount shall occur before January 1, 2009.

8 9 **Kansas Comment**

10
11 This section provides more detailed guidance than K.S.A. 58-3607 - Release of
12 restriction on use or investments, and also extends to modifications.

13
14 Subsection (d) sets forth three factors that must be met before a restriction can be
15 released or modified on the basis that it is unlawful, impracticable, impossible to achieve, or
16 wasteful. The Kansas drafting committee modified the amount in subsection (d)(1), raising from
17 \$25,000 to \$50,000 the maximum value of an institutional fund subject to the release or
18 modification of the restriction. The Committee also modified (d)(2), reducing to 10 years the
19 requirement that “more than 20 years have elapsed since the fund was established.”

20
21 The committee also added a new subsection (e) that ties the dollar amount in subsection
22 (d)(1) to the Consumer Price Index for All Urban Consumers.

23 24 **UTC Comment**

25
26 Section 6 expands the rules on releasing or modifying restrictions that are found in
27 Section 7 of UMIFA. Subsection (a) restates the rule from UMIFA allowing the release of a
28 restriction with donor consent. Subsections (b) and (c) make clear that an institution can always
29 ask a court to apply equitable deviation or *cy pres* to modify or release a restriction, under
30 appropriate circumstances. Subsection (d), a new provision, permits an institution to apply *cy*
31 *pres* on its own for small funds that have existed for a substantial period of time, after giving
32 notice to the state attorney general.

33
34 Although UMIFA stated that it did not “limit the application of the doctrine of *cy pres*”,
35 UMIFA § 7(d), what that statement meant under the Act was unclear. UMIFA itself appeared to
36 permit only a release of a restriction and not a modification. That all-or-nothing approach did
37 not adequately protect donor intent. *See Yale Univ. v. Blumenthal*, 621 A.2d 1304 (Conn. 1993).
38 By expressly including deviation and *cy pres*, UPMIFA requires an institution to seek

1 modifications that are “in accordance with the donor’s probable intention” for deviation and “in a
2 manner consistent with the charitable purposes expressed in the gift instrument” for cy pres.
3

4 **Individual Funds.** The rules on modification require that the institution, or a court
5 applying a court-ordered doctrine, review each institutional fund separately. Although an
6 institution may manage institutional funds collectively, for purposes of this Section each fund
7 must be considered individually.
8

9 **Subsection (a). Donor Release.** Subsection (a) permits the release of a restriction if the
10 donor consents. A release with donor consent cannot change the charitable beneficiary of the
11 fund. Although the donor has the power to consent to a release of a restriction, this section does
12 not create a power in the donor that will cause a federal tax problem for the donor. The gift to the
13 institution is a completed gift for tax purposes, the property cannot be diverted from the
14 charitable beneficiary, and the donor cannot redirect the property to another use by the charity.
15 The donor has no retained interest in the fund.
16

17 **Subsection (b). Equitable Deviation.** Subsection (b) applies the rule of equitable
18 deviation, adapting the language of UTC § 412 to this section. *See also* Restatement (Third) of
19 Trusts § 66 (2003). Under the deviation doctrine, a court may modify restrictions on the way an
20 institution manages or administers a fund in a manner that furthers the purposes of the fund.
21 Deviation implements the donor’s intent. A donor commonly has a predominating purpose for a
22 gift and, secondarily, an intent that the purpose be carried out in a particular manner. Deviation
23 does not alter the purpose but rather modifies the means in order to carry out the purpose.
24

25 Sometimes deviation is needed on account of circumstances unanticipated when the
26 donor created the restriction. In other situations the restriction may impair the management or
27 investment of the fund. Modification of the restriction may permit the institution to carry out the
28 donor’s purposes in a more effective manner. A court applying deviation should attempt to
29 follow the donor’s probable intention in deciding how to modify the restriction. Consistent with
30 the doctrine of equitable deviation in trust law, subsection (b) does not require an institution to
31 notify donors of the proposed modification. Good practice dictates notifying any donors who are
32 alive and can be located with a reasonable expenditure of time and money. Consistent with the
33 doctrine of deviation under trust law, the institution must notify the attorney general who may
34 choose to participate in the court proceeding. The attorney general protects donor intent as well
35 as the public’s interest in charitable assets. Attorney general is in brackets in the Act because in
36 some states another official enforces the law of charities.
37

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

1 expressed in the gift instrument. *See also* Restatement (Third) of Trusts § 67 (2003). Consistent
2 with the doctrine of cy pres, subsection (c) does not require an institution seeking cy pres to
3 notify donors. Good practice will be to notify donors whenever possible. As with deviation, the
4 institution must notify the attorney general who must have the opportunity to be heard in the
5 proceeding.
6

7 **Subsection (d). Modification of Small, Old Funds.** Subsection (d) permits an
8 institution to release or modify a restriction according to cy pres principles but without court
9 approval if the amount of the institutional fund involved is small and if the institutional fund has
10 been in existence for more than 20 years. The rationale is that under some circumstances a
11 restriction may no longer make sense but the cost of a judicial cy pres proceeding will be too
12 great to warrant a change in the restriction. The Drafting Committee discussed at length the
13 parameters for allowing an institution to apply cy pres without court supervision. The Committee
14 drafted subsection (d) to balance the needs of an institution to serve its charitable purposes
15 efficiently with the policy of enforcing donor intent. The Committee concluded that an
16 institutional fund with a value of \$25,000 or less is sufficiently small that the cost of a judicial
17 proceeding will be out of proportion to its protective purpose. The Committee included a
18 requirement that the institutional fund be in existence at least 20 years ,as a further safeguard for
19 fidelity to donor intent. The 20-year period begins to run from the date of inception of the fund
20 and not from the date of each gift to the fund. The amount and the number of years have been
21 placed in brackets to signal to an enacting jurisdiction that it may wish to designate a higher or
22 lower figure. Because the amount should reflect the cost of a judicial proceeding to obtain a
23 modification, the number may be higher in some states and lower in others.
24

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

36 An institution seeking to modify a provision under subsection (d) must notify the attorney
37 general of the planned modification. The institution must wait 60 days before proceeding; the
38 attorney general may take action if the proposed modification appears inappropriate.
39

40 **Notice to Donors.** The Drafting Committee decided not to require notification of donors
41 under subsections (b), (c), and (d). The trust law rules of equitable deviation and cy pres do not
42 require donor notification and instead depend on the court and the attorney general to protect
43 donor intent and the public’s interest in charitable assets.
44

1 With regard to subsection (d), the Drafting Committee concluded that an institution
2 should not be required to give notice to donors. Subsection (d) can only be used for an old and
3 small fund. Locating a donor who contributed to the fund more than 20 years earlier may be
4 difficult and expensive. If multiple donors each gave a small amount to create a fund 20 years
5 earlier, the task of locating all of those donors would be harder still. The Drafting Committee
6 concluded that an institution's concern for donor relations would serve as a sufficient incentive
7 for notifying donors when donors can be located.
8

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

12 **Kansas Comment**

13 This section is new.
14

15 **SECTION 8. APPLICATION TO EXISTING INSTITUTIONAL FUNDS.** This
16 [act] applies to institutional funds existing on or established after [the effective date of this act].
17 As applied to institutional funds existing on [the effective date of this act] this [act] governs only
18 decisions made or actions taken on or after that date.

19 **Kansas Comment**

20 This section is new.
21

22 **SECTION 9. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND**
23 **NATIONAL COMMERCE ACT.** This [act] modifies, limits, and supersedes the Electronic
24 Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not
25 modify, limit, or supersede Section 101 of that act, 15 U.S.C. Section 7001(a), or authorize

1 electronic delivery of any of the notices described in Section 103 of that act, 15 U.S.C. Section
2 7003(b).

3 **Kansas Comment**

4 This section is new.

5

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

9

Kansas Comment

10 This section is substantially similar to K.S.A. 58-3609.

11

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

13

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

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