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**UPMIFA:
Endowment Management in the Modern Age**

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UPMIFA:
Endowment Management in the Modern Age

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UPMIFA Generally

The Uniform Prudent Management of Institutional Funds Act, or “UPMIFA,” is a model act promulgated by the Uniform Law Commission.² It has been adopted by the District of Columbia and all states other than Pennsylvania.³ In most states, UPMIFA displaced that state’s version of the prior uniform law in this sphere, the Uniform Management of Institutional Funds Act, or “UMIFA.”

What Is Covered by UPMIFA?

Broadly speaking, UPMIFA addresses three main topics:

- (1) management and investment of “institutional funds”
 - (2) appropriations from “endowment funds”
 - (3) release of donor restrictions on institutional funds.
- “Institution”: The term “institution” generally includes not-for-profit corporations organized and operated exclusively for charitable purposes, a government or

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² See “Uniform Prudent Management of Institutional Funds Act with Prefatory Note and Comments,” National Conference of Commissioners on Uniform State Laws (“UPMIFA Text with Comments”) (available at http://www.uniformlaws.org/shared/docs/prudent%20mgt%20of%20institutional%20funds/upmifa_final_06.pdf) (last viewed on December 14, 2013).

³ In New York, UPMIFA was adopted in 2010 (with numerous modifications) as the New York Prudent Management of Institutional Funds Act, or “NYPMIFA.” See Article 5-A, N.Y. Not-for-Profit Corporation Law (“NPCL”). The New York State Attorney General’s office (the “NYAG”) is the author of guidance that addresses both the New York-specific modifications and the more general application of UPMIFA. See “A Practical Guide to the New York Prudent Management of Institutional Funds Act,” Attorney General Eric T. Schneiderman, New York Charities Bureau (“NYAG Guidance”) (available at <http://www.charitiesnys.com/pdfs/NYPMIFA-Guidance-March-2011.pdf>) (last viewed on December 14, 2013). NYPMIFA and the NYAG Guidance represent the most extensive effort by any state to grapple with UPMIFA. Even though some NYPMIFA provisions are best viewed as unique to New York, other aspects of NYPMIFA as well as commentary contained in the NYAG Guidance may inform the broader discussion of UPMIFA and how institutions might wish to think about the implications of the uniform act. Hence, this outline cites frequently to NYPMIFA and the NYAG Guidance.

governmental subdivision, agency or instrumentality to the extent it holds funds exclusively for a charitable purpose, and a trust such as a charitable remainder trust after the non-charitable interests have terminated. UPMIFA's definition of "institution" does not appear to extend to charitable lead trusts, charitable remainder trusts before the non-charitable interest has terminated, pooled income funds, or to those wholly charitable trusts whose trustees are individuals or corporate fiduciaries. Trusts of that nature continue to be governed by trust law with respect to such issues as prudent investing and the expenditure of principal. However, UPMIFA's drafters did intend the uniform law to apply to wholly charitable trusts of which a charity acts as trustee.⁴ With regard to state universities, the UPMIFA drafters stated that "[b]ecause state arrangements are so varied, creating a definition [of institution] that encompasses all charitable entities created by states is not feasible." The drafters continued:

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.⁵

- "Institutional Fund": This term is defined broadly as a "fund held by an institution exclusively for charitable purposes."⁶ However, there are exclusions:
 - program-related assets (*e.g.*, buildings or facilities being used by the institution or an institution's collections or archives).
 - a fund held for an institution by a trustee that is not itself an institution (*i.e.*, a charitable trust with an individual, bank, or trust company as trustee).
 - a fund in which a beneficiary that is not an institution has an interest (*e.g.*, a charitable gift annuity fund or a pooled income fund).⁷
- "Endowment Fund": An "endowment fund" is an institutional fund (or part thereof) that under the terms of the gift instrument⁸ is "not wholly expendable on a current basis,"

⁴ UPMIFA Text and Comments at 9. This aspect of UPMIFA is made explicit in the definition of "institutional fund" (discussed below).

⁵ *Id.*

⁶ UPMIFA Section 2(5).

⁷ The exclusion for funds with a non-institutional beneficiary is not applicable if the beneficiary's interest is one that "could arise upon violation or failure of the purposes of the fund." See UPMIFA section 2(5)(C). Thus, the existence of a non-charity's gift-over or reversionary interest in the event of violation of the terms of the gift instrument would not cause a fund that is otherwise wholly charitable in nature to fall outside the definition of institutional fund.

which means that the donor has placed a restriction of some kind on the amount that may be spent from the fund.⁹ Thus, a fund that is restricted only as to purposes, but not as to the amount that may be spent, would be an institutional fund but not an endowment fund. Also, a board-designated endowment fund is not an endowment fund because it is not *donor* restricted.

The technical definition of “endowment fund” is significant because many institutions – including most private foundations – do not have endowment funds in the technical sense, which means that they will not be subject to the law’s requirements concerning endowment fund appropriations. However, private foundations and other funders (including individual philanthropists) may take an increasing interest in the UPMIFA endowment appropriation rules, both for purposes of structuring endowment grants and evaluating the endowment-related appropriation and accumulation practices of grantees that do have endowment funds. On the other hand, all institutions, even those without endowment funds in the technical sense, are subject to the other aspects of UPMIFA, in particular the new rules governing how they manage and invest their institutional funds.

Management and Investment of Institutional Funds

UPMIFA updates prior law to bring it in line with more current conceptions of prudent investing. The duty of care imposed on those who are responsible for investment of institutional funds remains essentially the same (though the language has been slightly modified) – the care of “an ordinarily prudent person in a like position under similar circumstances.” Notably, this standard now applies to “each person” responsible for managing and investing an institutional fund (including delegates such as investment managers).¹⁰ UPMIFA also establishes detailed guidelines concerning how the duty of care must be exercised.

- Factors: When managing and investing an institutional fund, an institution must consider the purposes of the institution and the purposes of the institutional fund.¹¹ Subject to the intent of a donor expressed in a gift instrument, an institution must consider, if relevant:
 - (1) general economic conditions;
 - (2) the possible effect of inflation or deflation;
 - (3) the expected tax consequences, if any, of investment decisions or strategies;

⁸ The term “gift instrument” means “a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institutional as an institutional fund.” UPMIFA Section 2(3).

⁹ UPMIFA Section 2(2).

¹⁰ See UPMIFA Section 3(b).

¹¹ UPMIFA Section 3(a).

- (4) the role that each investment or course of action plays within the overall investment portfolio of the fund;
- (5) the expected total return from income and the appreciation of investments;
- (6) other resources of the institution;
- (7) the needs of the institution and the fund to make distributions and to preserve capital; and
- (8) an asset's special relationship or special value, if any, to the purposes of the institution.¹²

The New York Approach

Evidently taking a cue from the requirement (discussed below) that an institution making an endowment fund appropriation consider, if relevant, the institution's investment policy, NYPMIFA goes the additional step of requiring that there *be* an investment policy. "Each institution shall adopt a written investment policy setting forth guidelines on investments and delegation of management and investment functions in accord with the standards" of NYPMIFA.¹³

- Appropriate Decision-Making in Context: An institution must make management and investment decisions about an asset in the context of the overall portfolio as part of an overall strategy that takes into consideration risk and return objectives appropriate to the institution.¹⁴
- Costs and Verification of Facts. The management costs incurred must also be reasonable and appropriate in relation to the assets of the institution, its purposes, and the skills available to it, and an institution must make reasonable efforts to verify facts relevant to the management and investment of the fund.¹⁵
- Types of Assets, Diversification and Portfolio Rebalancing: An institution may pool institutional funds for investment purposes¹⁶ and may invest in any kind of property or investment (unless a gift instrument says otherwise),¹⁷ but the

¹² UPMIFA Section 3(e)(1).

¹³ NPCL Section 552(f). It is something of a curiosity that neither UPMIFA nor NYPMIFA requires that those making investment management decisions take into account an institution's investment policy, although presumably this is also expected.

¹⁴ UPMIFA Section 3(e)(2).

¹⁵ UPMIFA Section 3(c).

¹⁶ UPMIFA Section 3(d).

¹⁷ UPMIFA Section 3(e)(3).

institution must diversify a fund's investments unless it prudently determines that because of special circumstances the purposes of the fund are better served without diversification. Within a reasonable time after receiving property an institution is obligated to make and carry out decisions concerning its retention or disposition 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 UPMIFA.¹⁸

The New York Approach

Under NYPMIFA, a decision not to diversify must be revisited at least once a year.¹⁹ As a practical matter, it appears that each decision not to diversify should be documented.

- Special Skills: A person with special skills or expertise has a duty to use his or her skills or expertise in managing and investing institutional funds.²⁰
- Delegation of Investment Management: An institution may delegate the management and investment function to an external agent – and will not be liable for the decisions or actions of the agent – so long as the institution exercises prudence in (a) selecting, continuing, or terminating the agent; (b) establishing the scope and terms of the delegation; and (c) monitoring the agent. An institution may also delegate these functions to its committees, officers, or employees. An external agent with delegated authority has a fiduciary duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation. UPMIFA further provides that by accepting delegation of a management or investment function from an institution subject to the laws of a state, an agent “submits to the jurisdiction of the courts of [the] state in all proceedings arising from or related to the delegation or the performance of the delegated function.” In UPMIFA, this delegation section is in brackets, because the drafters noted that many states already have other statutes permitting delegation of this authority. The drafters also noted that the prudent investor standard contained in the act “presupposes the power to delegate.”²¹

The New York Approach

The NYAG, in its comments on NYPMIFA, stated that boards must be diligent in assessing the independence of an outside investment agent both before and after retaining the agent, as an outside investment agent should be selected based on the agent's competence, experience, past performance, and proposed compensation and “not on any business or personal relationships between the agent and board members or other insiders.” The NYAG also recommended that boards adopt policies that “require full disclosure of relationships with outside agents and

¹⁸ UPMIFA Section 3(e)(5).

¹⁹ See NPCL Section 552(c)(4) (second sentence).

²⁰ UPMIFA Section 3(e)(6).

²¹ See UPMIFA Text and Comments at 30.

implement practices that ensure objective oversight by the board.”²² An institution’s existing conflict of interest policy may already be adequate to address this concern, but should nonetheless be reviewed to confirm that it is.

Endowment Spending

UPMIFA was adopted by the National Conference of Commissioners on Uniform State Laws in 2006. UPMIFA grew out of the economic downturn of 2001 and was designed to address precisely the type of situation that many institutions faced after the economic crisis of 2008, namely, underwater endowment funds. As the drafters of UPMIFA explained in their prefatory comments, UPMIFA was intended to modernize the law and also to give greater flexibility to institutions coping with fluctuations in the value of endowment funds.²³

- Elimination of Historic Dollar Value. For most institutions, the most noteworthy change introduced by UPMIFA is the elimination of the concept that historic dollar value – that is, the original dollar value of the fund plus any amounts added by the donor – may not be appropriated for expenditure. In making this change, the drafters cited, among other reasons, the rule’s arbitrariness in fixing value at the time of the gift, its lack of consideration of issues surrounding inflation, and its meaninglessness as a benchmark for endowments that have grown significantly.²⁴ In place of historic dollar value, UPMIFA enhances the articulation of the prudence standard (described below), giving boards more guidance when making decisions to expend endowment funds.
- The Standard of Prudence for Endowment Fund Appropriations. When making a determination to appropriate or accumulate with respect to existing endowment funds, an institution must “act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances” and 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

²² See NYAG Guidance at 14-15.

²³ See UPMIFA Text and Comments at 2.

²⁴ *Id.* at 3-4.

(7) the investment policy of the institution.²⁵

According to the UPMIFA drafters, these factors emphasize the importance of the intent of the donor, *i.e.*, the donor intent “as expressed in the gift instrument,” rather than the wishes expressed by the donor at the time the expenditure is made by the institution.²⁶ Note that any express restrictions contained in the gift instrument – including a prohibition on spending historic dollar value – must be honored; the parameters on expenditure set forth by UPMIFA remain default rules.

Note that the drafters of UPMIFA included the following statement in their official commentary: “Although [UPMIFA] does not require that a specific amount be set aside as “principal,” [UPMIFA] assumes that the institution will act to preserve the “principal” (*i.e.*, to maintain the purchasing power of the amounts contributed to the fund) while spending “income” (*i.e.*, making a distribution each year that represents a reasonable spending rate, given investment performance and general economic conditions).²⁷ Thus, an institution should monitor principal in an accounting sense, identifying the original value of the fund (the historic dollar value) and the increases in value necessary to maintain the purchasing power of the fund.” This indicates that historic dollar value is of continuing relevance in UPMIFA’s prudence analysis.

The New York Approach

NYPMIFA added an additional prudence factor to the above list: institutions must also consider, “where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the institution.”²⁸ The NYAG stated that this unique factor was intended to ensure that boards do not “automatically decide” to appropriate from endowment funds when circumstances warrant considering other reasonable alternatives. Alternatives cited by the NYAG “might include, where appropriate,” fundraising efforts, expense reductions, sale of non-essential assets or reductions in non-essential staff. “The board might also consider whether certain expenditures can prudently be deferred.”²⁹

Additionally, New York requires that for each determination to make an appropriation from an endowment fund, there must be a contemporaneous record describing the consideration given to

²⁵ UPMIFA Section 4(a).

²⁶ See UPMIFA Text and Comments at 22.

²⁷ UPMIFA Text and Comments at 21.

²⁸ NPCL Section 553(a)(7).

²⁹ See NYAG Guidance at 12.

each of the various factors.³⁰ The NYAG opined that funds appropriated for expenditure “need not be spent immediately; such funds may be appropriated on one date and spent at a later date or over a period of time.”³¹

Perhaps most notably, the NYAG addressed the issue of how to conduct the fund-by-fund appropriation analysis when an institution has multiple endowment funds. “In this Office’s view, the governing board of an institution may make a single decision to appropriate from multiple endowment funds, and this decision may be documented in a single contemporaneous record, *provided that the endowment funds are similarly situated*” (emphasis added). The NYAG said a governing board “should develop written procedures” for determining that multiple endowment funds are similarly situated and that the determination may be based on factors such as the purposes of the funds, the duration of the funds, spending restrictions on the funds, and the financial condition of the funds. The NYAG explained that a decision to group funds should be made with care to ensure that the prudence analysis could be sustained if the appropriation prudence factors were applied to each fund individually.³²

Whereas UPMIFA treats all endowment funds the same, NYPMIFA creates three statutory categories of endowment fund, each category subject to a different spending regime: (A) funds governed by a gift instrument executed before September 17, 2010 (“existing funds”) whose donor is no longer available and existing funds received as part of a general institutional solicitation; (B) existing funds whose donor is still available; and (C) “new funds,” or funds governed by a gift instrument executed after September 17, 2010.³³ “Available” donors are donors who are living, or in existence and conducting activities if not a natural person, and who are able to be identified and located with reasonable efforts.³⁴

For Category A (existing funds with unavailable donors), New York gives these funds the full flexibility envisioned by UPMIFA, and an institution may appropriate a prudent portion of such

³⁰ NPCL Section 553(a) (flush left language). See NYAG Guidance at 12-13 (“...it is not sufficient to state in a conclusory fashion that the board considered a particular factor; rather, the record should describe the substance of the consideration given to each factor”).

³¹ See NYAG Guidance at 3.

³² NYAG Guidance at 11-12. Texas addressed the issue of pooling differently in its version of UPMIFA, sometimes referred to as “TUPMIFA.” “If an institution pools the assets of individual endowment funds for collective investment, this section [on endowment fund appropriation] applies to the pooled fund and does not apply to individual endowment funds, including individual endowment funds for which the nature of the underlying asset or donor restrictions preclude inclusion in a pool but which are managed by the institution in accordance with a collective investment policy.” Section 163.003(g), Title 10, Texas Property Code. This provision appears to beg the prudence question. How can the purpose of a particular endowment fund be taken into account at a pooled level, unless the pooling itself was based at least in part on the board’s determination that there was congruity of purpose among all the endowment funds within the pool? Or is it possible that the Texas Legislature did not envision appropriations (or investment) being made based on a true fund-by-fund analysis?

³³ See NPCL Section 553(e).

³⁴ See NYAG Guidance at 4.

funds based on the standard of prudence discussed below. For Category B (existing funds with available donors), New York created a novel “opt in, opt out” feature, requiring an institution to send a form of notice to the donor at least 90 days before making an appropriation under NYPMIFA, asking the donor to either permit or forbid the institution to spend below the fund’s historic dollar value. If the donor gives permission or does not respond, the institution can avail itself of NYPMIFA’s rules for making appropriations from the fund.³⁵ (Notice is not required where the gift instrument expressly permits spending below historic dollar value.) For Category C (new funds), New York adopted UPMIFA’s rebuttable presumption of imprudence, discussed further below.

Evidently because of a concern that New York donors would not understand the impact of eliminating the traditional reliance on historic dollar value to establish the level below which an endowment fund could not be appropriated, NYPMIFA contains a provision mandating that charitable solicitations for endowment funds include a statement that, unless the donor otherwise restricts under the terms of the gift instrument, the institution may spend so much of an endowment fund as it deems prudent after considering the eight prudence factors set forth in NYPMIFA.³⁶

Rebuttable Presumption of Imprudence

UPMIFA contains an optional provision creating a rebuttable presumption that an appropriation from an endowment fund in any year greater than 7% of its fair market value (calculated on the basis of a quarterly average value over a period of not less than three years) is imprudent. Most states elected not to include this presumption, and states were, of course, free to establish presumptions other than 7%.³⁷ One important caveat about the presumption of imprudence: There is no “safe harbor” of prudence for appropriations of 7% or less,³⁸ so institutions should

³⁵ See NPCL Section 553(e)(1).

³⁶ See N.Y. Executive Law Section 174-b(2).

³⁷ TUPMIFA may contain the nation’s most elaborate set of provisions implementing the rebuttable presumption. First, there is a rebuttable presumption of imprudence for appropriations in excess of a 7% *threshold*, but only for an endowment fund with an “aggregate value” of \$1,000,000 or more. Second, for an institution with an endowment fund with an “aggregate value” of less than \$1 million, there is a presumption of imprudence for appropriations in excess of a 5% *threshold*. Third, for a university system, as defined by Section 61.003(10) of the Texas Education Code, with an endowment fund having an “aggregate value” of \$450 million or more, there is a presumption of imprudence for appropriations in excess of a 9% *threshold*. See Sections 163.003(d), (e) and (f), Title 10, Texas Property Code. From the context, it appears that the term “endowment fund” is being used to apply to the aggregate of all of an institution’s endowment funds, which may mean that expenditures from a particular endowment fund (*i.e.*, a fund established by one donor among many) might exceed the stated percentage but result in no presumption of imprudence *as to that fund* if the appropriation in the *aggregate* for all endowment funds remains within the threshold. This aspect of TUPMIFA and Section 163.003(g) (cited above) suggest that the Texas Legislature may have envisioned less of a fund-by-fund application of UPMIFA than the drafters of the Uniform Act or the legislators and NYAG officials responsible for NYPMIFA.

³⁸ See UPMIFA Section 4(d)(2).

not assume that the prudence of an appropriation decision is established simply by making appropriations at or below the 7% level.

The drafters of UPMIFA indicated that the presumption does not shift the burden of persuasion to the institution. Rather, if sufficient evidence establishes, by a preponderance of the evidence, the facts necessary to raise the presumption, then the institution would have only *the burden of production* of other evidence that would tend to demonstrate that its decision was prudent.³⁹ If state courts adopt the approach advanced by the drafters of UPMIFA, state Attorneys General would still bear *the burden of persuasion* in a case alleging that a board had acted imprudently in making an appropriation in excess of the 7% level.

The New York Approach

With respect to calculating fair market value of those endowment funds subject to the presumption of imprudence (Category C, above), the NYAG has noted that, although fair market value for purposes of the presumption should be calculated over a period of at least *five* years, an institution's spending policy may be based on the fair market value of endowment funds averaged over a shorter period. Hence, the NYAG has advised that "[a]ll spending policies should be reviewed to determine how they interact with the presumption of imprudence. If necessary, institutions must perform a separate calculation, averaging the fund's fair market value over at least the preceding five years, in order to determine whether a proposed appropriation [under the spending policy] would be presumptively imprudent."⁴⁰

The presumption of imprudence does not apply to an appropriation permitted under the gift instrument. For example, the presumption will not apply to a gift instrument that permits an appropriation in any year in excess of a state's presumption-of-imprudence threshold under certain specified conditions. Institutions may wish to consider whether there are circumstances where endowment gift agreements should specifically mandate appropriations in excess of a state's presumption-of-imprudence threshold or otherwise state the donor's intention that some greater appropriation would be in keeping with the donor's wishes.

Use of Expenditures

The comments to UPMIFA note that "expenditures from an endowment fund may include...amounts used for the management and administration of the fund, including annual charges for fundraising," in addition to distributions for charitable purposes.⁴¹

New Accounting Considerations Under UPMIFA

UPMIFA and its prudence standard occasioned important changes in nonprofit accounting rules. Institutions with bond or other covenants premised on maintaining a certain amount of

³⁹ See UPMIFA Text and Comments at 25-26.

⁴⁰ See NYAG Guidance at 13.

⁴¹ See UPMIFA Text and Comments at 26.

“unrestricted” assets may face particular issues, because endowment appreciation that was “unrestricted” under the old accounting rules may now be treated as “temporarily restricted.”

Release of Restrictions

UPMIFA permits an institution’s board to release an endowment restriction upon consent of the donor, and articulates in manner different from UMIFA the circumstances under which judicial modification of the restriction is appropriate.⁴²

In addition, UPMIFA introduces a provision that permits an institution to release or modify a restriction on an institutional fund without court approval, upon notice to the Attorney General, in instances where the fund’s value is less than \$25,000, more than 20 years have elapsed since its establishment, and the property will be used consistently with the gift’s charitable purposes.⁴³ For these “small, old funds” – funds older than 20 years whose total value is less than \$25,000 – the UPMIFA commentary notes that donor notification is not required. However, institutions may wish to attempt notification in order to smooth the restriction elimination process.

The New York Approach

With respect to petitions for judicial release of restrictions, the NYAG recommends that institutions submit a draft petition to the NYAG for review and discussion before filing the petition with the court in order to help resolve potential issues and expedite the process.⁴⁴ Additionally, for small, old funds, if a donor is available, the NYAG requires that an institution attempt to obtain the donor’s consent before notifying the NYAG of its intent to release or modify restrictions.⁴⁵ In New York, funds as large as \$100,000 qualify for the simplified modification procedure for “small, old funds.”

⁴² See UPMIFA Section 6(b)-(c).

⁴³ See UPMIFA Section 6(d).

⁴⁴ See NYAG Guidance at 15.

⁴⁵ *Id.* at 15-16.