Mendrygal Law PLLC

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Proud Member of Texas Bar College
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Genevra brings an insider's perspective to her client's issues. Prior to entering private practice, she was the sole in-house attorney for a prominent community foundation in Dallas, Texas, where she managed all issues related to legal compliance, board governance, and risk management. While in this role, she trained in-house staff, worked with ultra-high-net-worth donors, and consulted internal stakeholders on development and planned giving topics.

Genevra's law practice focuses exclusively on the representation of tax-exempt organizations on a wide range of matters including governance, tax compliance, endowments, executive compensation, complex gifts, fiscal sponsorship structures, intellectual property issues, and employment matters. She has counseled private foundations, public charities, supporting organizations, community foundations, churches, and other religious organizations on a wide range of issues. In 2022, Genevra was selected to the Texas Super Lawyers list (a Thompson Reuters publication).

Prior to becoming a lawyer, Genevra worked in development in both for-profit and non-profit institutions, specializing in fundraising-related data evaluation and modeling.

Education
J.D., *cum laude*, SMU Dedman School of Law, 2010
B.B.A., *cum laude,* University of Iowa, 2001

Professional Experience
Attorney, Mendrygal Law, PLLC (2016-Present)
Associate, Weycer, Kaplan, Pulaski & Zuber, P.C. (2014-2016)
Associate Legal Counsel, The Dallas Foundation (2011-2014)
Law Clerk to the Honorable Justice Douglas S. Lang, Fifth Court of Appeals of Texas (2010-2011)

Selected Professional, Community and Business Activities
- Inclusion in Texas Super Lawyers (2022) and Rising Stars for Nonprofit Organizations (2020)
- Communities Foundation of Texas Advisory Council (2018-Present)
- TEGE Exempt Organizations Council (2020-Present)
- Texas Bar CLE Governance of Nonprofit Organizations Conference, Planning Committee (2015, 2023)
- Texas Bar College (2021-Present)
- Dallas Council of Charitable Gift Planners (formerly the Partnership for Philanthropic Planning, North Texas Chapter) Board of Directors (2013-2016)
- The Dallas Foundation, Advisory Council (2014-2016)
- The Dallas Foundation, Women's Philanthropy Institute (2019-2020)
- Dallas Bar Nonprofit Study Group (2012-Present)
- State Bar of Texas, Taxation Section Member (2014-Present)
- American Bar Association, Section of Taxation Member (2019-Present); Section of Business Law Member (2021 – Present)
- Dallas Association of Young Lawyers, Member (2011-2016)
- Dallas Estate Planning Council, Member (2012-2016)
- Girl Scouts of North East Texas, Volunteer (2013-Present)
- Maharishi School, Advisory Director (2017-2019); Executive Committee Member (2018-2020); Development Committee (Chair 2018-2020; Member 2018-2020)
- Armstrong-Bradfield Preschool Association Member (2013-Present); Home Tour Committee (2013)

Presentations
- "Fiscal Sponsorship: Doing it Right for the Right Reasons," 2022 TXCPA Nonprofit Organizations Conference, May 23, 2022 (co-presenter)
- "What Every Director Needs to Know about IRS Form 990," UT Dallas Executive Certificate in Nonprofit Governance, March 2, 2022 and October 6, 2022

- "Nonprofit Compliance 101," Power Tools for Nonprofits Conference 2021, CenterPoint Energy, United Way of Greater Houston, and UH Downtown, November 2021
- "Fiscal Sponsorships," State Bar of Texas 19th Annual Governance of Nonprofit Organizations Conference, August 2021
- "Nonprofit Compliance 101," Nonprofit Law Institute, United Way Nonprofit Connection and Houston Young Lawyers Association, March 2021 (co-presenter)
- "Texas State Tax and Regulatory Compliance for Nonprofits: Legal Perspective," 2020 Nonprofit Organizations Conference (TXCPA), May 2020 (co-presenter)
- "Creating Efficiencies and Sustainability for Future Growth in the Non-Profit Sector" Capital One, October 2019 (panelist)
- "Compliance 101" It's Lonely at the Top, May 2019 (co-presenter)
- "Asked and Answered: Nonprofits 101" Dallas Bar Nonprofit Group, March 2017 (co-presenter)
- "Gift Acceptance Policy Bootcamp" Dallas Council of Charitable Gift Planners (formerly the Partnership for Philanthropic Planning – North Texas Chapter), December 2015
- "New Overtime Rules for Employees: Complying with the FLSA in 2015 and Beyond," The Church Network Dallas Chapter, November 2015
- "Using Community Foundations" Alliance for Greater Works Ultimate Financial and Legal Conference, October 2015
- "Legal and Fiduciary Responsibilities" Center for Nonprofit Management Board Member Bootcamp, March 2015 (co-presenter)
- "Launching a 501(c)(3) Webinar" Alliance for Greater Works, March 2015 (co-presenter)
- "Donee Beware" Partnership for Philanthropic Planning – North Texas Chapter, February 2015 (co-presenter)
- "Gift Planning on the Run: Establishing the Program" Partnership for Philanthropic Planning – North Texas Chapter, November 2014 (co-presenter)
- "Gifts with Hair" Association of Fundraising Professionals Philanthropy in Action Conference, June 2014 (co-presenter)
- "The Role of a Community Foundation" Texas Society of Certified Public Accountants Nonprofit Organizations Conference, May 2014 (co-presenter)
- "Fiscal Sponsorship Overview" Dallas Bar Association Nonprofit Group, November 2013
- "Demystifying Private Company Valuation" Association of Professional Researchers for Advancement-Southwest Conference Dallas, May 2009

Select Publications

- "Corporate Philanthropy: The Charity's Point of View" Dallas Bar Association Headnotes, February 2015 (co-author with Jonathan Blum)
- "Survey of Recent Mandamus Decisions of the Texas Supreme Court," 64 SMU L. REV. 393 (2011) (co-author with The Honorable Justice Douglas Lang and Pamela S. Kohler)

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Endowment Funds from a Legal Perspective: Structure, Rules and Development Considerations

Genevra M. Williams, Mendrygal Law, PLLC

1

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Overview

- Endowment Structure; Related Issues
- Donor Intent
- UPMIFA; Investment, Management and Spending Considerations

2

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Endowment Structure

- Internal Fund
- Separate 501(c)(3)
  - "Stand-alone" public charity
    - Public support test
  - Private foundation
  - Supporting organization
    - Types I, II and III
- Fiscal Sponsorship or Fund with Local Community Foundation
- Charitable Trust vs. Nonprofit Corporation
- Supporting organizations for 501(c)(4) and 501(c)(6)

3

3

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Legal and Governance Implications of Structure

- Donor comfort/request
  - Prevent Board oversight
  - Limit to specific project or area of operations
  - Prevent use for general operations
  - Creditor protection
- Credit Protection (Charity, Take II)
- Operational
- Tax consequences
- Compliance burden
- Other implications of structure
- Related considerations
  - Control by operating nonprofit

4

4

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Legal Status of Endowment – Initial Questions

- How is the endowment held
  - A fund within the institution?
  - Separate entity with 501(c)(3) status?
    - Nonprofit corporation or trust?
    - Texas or elsewhere?
    - Governing documents?
  - Funds held by other institutions or individuals, including donor advised funds
- How is it managed
  - Board of Directors?
  - Investment/Financial or Endowment Committee?

5

5

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Initial Questions, cont.

- Purposes of the operating charity
- Purposes of the endowment entity
- Investment, spending, and related policies
- Underlying "sub-funds" held within the endowment fund
  - Documentation?
- Control or impact/oversight/other rights of the operating charity

6

6

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Regulatory and Legal Framework

- Federal/IRS
  - Completed gift
  - Charitable deduction
  - Quid pro quo rules
  - Conditional "get it back" restrictions
  - Impact on 501(c)(3) status
  - Private benefit
  - Private foundation rules (i.e., self-dealing)

7

7

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Regulatory/Legal Framework, cont.

- State
  - Donor intent
  - UPMIFA
  - Attorney General/Charities Bureau
  - Other issues
  - Private litigation

8

8

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Other Issues

- Over- or under-funding of endowment compared to operating entity
- Borrowing from an endowment
- Involvement of legal department in development processes
- Policy-making should involve legal, finance/tax, marketing, and development/gift planning
- Consider conflicts of interest where a donor also holds a significant position with the endowment
- Drafting issues:
  - Protection of the charity, flexibility in naming, expiration or lapse of naming rights, flexibility if donor defaults, force majeure, Board variance power.

9

9

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Donor Intent – Related Issues

- Donor relations
- "Court of Public Opinion"
- Media/Public relations
- Sophisticated donors asking for more
- Charities and development staff becoming more creative
- Legal implications

10

10

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What can go wrong?

- Reputational risk
- Donor relations
- Change in culture or values over time
- Change in circumstances
- Conflicts of Interest
- Donor actions/reputation
- Donor default on payment
- Restrictions or requirements the charity cannot handle
- Lack of clarity around provisions
- State regulatory enforcement
- Private donor enforcement (or attempts)
- Charitable pledges

11

11

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Related Issues

- Donor privacy issues
  - Policy
  - Form 990, Schedule B
  - Employees
- Donor expectations

12

12

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Gift Acceptance Policy

- Process oriented
- Who can accept?
- Who can act timely?
- Who has signature authority?
- Gift acceptance committee

13

13

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Education/Training Issues

- Acceptance – when and how
- Applicable approval thresholds
- Importance of record-keeping
- Documenting conversations regarding intent, restrictions, and conditions
- Guidelines for communications with donors
- Checklists for potential issues
- Consider print and online solicitations also
- Periodic review and revisit existing restrictions
- Internal tracking of spending/investments

14

14

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UPMIFA - Overview of Terms

- UPMIFA – Uniform Prudent Management of Institutional Funds Act
- TUPMIFA – Texas Uniform Prudent Management of Institutional Funds Act
- Superseded Rules:
  - UMIFA - Uniform Management of Institutional Funds Act
  - TUMIFA - Texas Uniform Management of Institutional Funds Act

15

15

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Donor Intent – Interaction with UPMIFA

- Primary focus of TUPMIFA: protecting donor intent and laying out the rules related to it
- Donor intent trumps
  - "Subject to the intent of a donor, . .."
  - "Unless stated otherwise in the gift instrument …"
- Specific exceptions where TUPMIFA has provided flexibility
  - i.e., terms designating a gift as "endowment"; use only "income," interest," or "dividends" or "rents, issues, or profits"; or "preserve the principal intact"
  - i.e., release and modification provisions

16

16

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Gift Agreement Provisions

- No "one size fits all"
- Key is to accurately reflect the intent of both parties, and provide necessary flexibility for the future

17

17

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Common Myth: "Accountants and lawyers speak the same language"

- Restrictions for legal purposes vs. accounting purposes
- Significant area of confusion
- What do lawyers mean?
- What do accountants mean?

18

18

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UPMIFA (Texas) Definition – Institutional Fund

- "Institutional fund" – a fund held by an **institution** exclusively for **charitable purposes**
- "Institution" – Includes:
  - A person (other than an individual) **organized and operated exclusively for charitable purposes**
  - A government or governmental subdivision, agency, or instrumentality, to the extent it holds funds exclusively for charitable purposes
  - A trust that had both charitable and non-charitable interests, after all non-charitable interests have expired

19

19

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What is Not an Institutional Fund?

Excludes:

- Program-related asset – an asset held by an institution primarily to accomplish a charitable purpose and not primarily for investment.
- A fund held for an institution by a trustee who is not an institution (e.g., an individual or commercial corporate trustee.
  - But note limitation here
- A fund in which a non-institution (non-charitable) beneficiary has an interest

20

20

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Examples

- Nearly all funds held by a charity will be "institutional funds"
- Examples:
  - Operating bank account
  - An endowment held within your charity for a specific purpose, such as scholarships
  - Development fund to pay for a new building
- Not institutional funds:
  - A fund held by an individual to benefit a local charity
  - A fund held by a for-profit company, even if it is for charitable purposes (i.e., Company X raises funds from its employees to benefit the March of Dimes)

21

21

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UPMIFA (Texas) Definition – Endowment Fund

- Under TUPMIFA, an institutional fund (or any part) that, **under the terms of a gift instrument, is not wholly expendable by the institution on a current basis.**
  - So .. there is a legal restriction on the timing of the expenditure
- Does not include board-designated aka quasi-endowments since there is no gift instrument.
- Significant difference between the legal definition of an "endowment fund" under TUPMIFA and the accounting definition, which is generally broader (a fund to provide income for the maintenance of a nonprofit).

22

22

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UPMIFA – General Approach

- UPMIFA takes a two-tier approach – its provisions apply to "Institutional Funds" (the duties and factors related to management and investment) and a portion (the expenditure/appropriation/spending rules) only apply to "Endowment Funds"
- So, whether (and how) UPMIFA applies to you depends on **whether you have an institutional fund or endowment fund**
- UPMIFA potentially applies to all charitable entities regardless of form (e.g. non-profit corporations, non-profit associations, limited liability companies, trusts)

23

23

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Gift Instruments – UPMIFA

- Donor gift document in whatever form available.
- Expansive definition
- Can include:
  - Electronic writing
  - Will, deed, grant, or conveyance
  - Agreement or memorandum
  - Articles/Certificate or Bylaws (where gift is made for general purposes)
  - Minutes of meetings
  - Canceled checks
  - Institutional solicitation (where gift is made in response)

24

24

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Gift Instrument, cont.

- For this purpose, a "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 …. So, anything in hard copy or electronic format.
- Opportunity for increased education among the gift planning community as to the impact of their documents and the importance of document retention.
  - Opt out/opt in to TUPMIFA provisions
  - Full picture of donor intent
  - Institutional memory and its impact on accounting and financial statements

25

25

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UPMIFA Protections and Duties

- Delegation of Management & Investment Functions
- Duty of Loyalty
- Duty of Care
- Duty to Diversity
- Duty to Manage Costs and Verify Facts

26

26

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UPMIFA Factors - Managing and Investing

- General economic condition
- The possible effect of inflation or deflation
- The expected tax consequences, if any, of investment decisions or strategies
- The role that each investment or course of action plays within the overall investment portfolio of the fund
- The expected total return from income and the appreciation of investments
- Other resources of the institution
- The need of the institution and of the fund to make distributions and preserve capital
- An asset's special relationship or special value, if any, to the charitable purposes of the institution

27

27

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Endowment Spending Rules

- TUPMIFA eliminated the historic dollar value or "HDV" spending floor, but its not that simple.
- May appropriate so much of an endowment fund as ***deem prudent for uses, benefits, purposes, and duration for which the fund is established.***
  - "Subject to the intent of a donor expressed in a gift instrument…"
  - Broad flexibility

28

28

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Endowment Spending Rules, cont.

- However,..
  - Specific expenditure rules/standards (donor intent) in gift instrument control.
  - Spending is also subject to organization's spending policy, as amended from time to time.
- Note:
  - To limit the TUPMIFA appropriation authority, a gift instrument must specifically state the limitation
    - Not enough – terms designating a gift as "endowment"; use only "income," interest," or "dividends" or "rents, issues, or profits"; or "preserve the principal intact" or words of similar import
    - Again, an education opportunity for development staff and advisors

29

29

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Endowment Spending Rules - Appropriation

- Assets in an endowment fund are donor-restricted until appropriated for expenditure by the institution
- In making the determination to appropriate, an institution shall:
  - Act in good faith
  - Act with the care that an ordinarily prudent person in a like position would exercise under similar circumstances
  - Consider the listed factors

30

30

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Endowment Appropriation Factors ….“We know how to record Board and committee minutes…”

Seven criteria/factors to guide Board regarding endowment spending:

1. Duration and preservation of the endowment fund
2. Purposes of the institution and the endowment fund
3. General economic conditions
4. Effect of inflation or deflation
5. Expected total return from income and the appreciation of investments
6. Other resources of the institution
7. Investment policy of the institution

31

31

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“As long as we don’t spend below HDV, we are compliant…”

- UPMIFA eliminated the bright-line test (or “HDV”) in favor of multi-faceted prudence standards.
  - No longer can a Board spend any amount so long as it doesn’t affect HDV.
  - Allows spending from an underwater endowment (FMV < amount restricted by the donor) if the board determines it is prudent.

32

32

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Then what is required to be maintained..?

33

33

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"If we don't spend more than the percentages, no one will come knocking…"

- **Common misconception that this is a safe harbor.**
- Applies to expenditures from endowment funds, but not institutional funds
- ***Imprudence is presumed*** if endowment fund spending exceeds certain thresholds:
  - Funds > $1MM – presumption at 7% FMV
  - University systems > $450MM – 9% FMV
  - Funds < $1MM – presumption at 5% FMV
- FMV determined quarterly and averaged over a 3-year period (or if in existence less than 3 years, for the period since inception).

34

34

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Presumption of Imprudence

- Presumption is rebuttable if facts and circumstances dictate that an endowment fund expenditure was prudent.
- For example, a fund for a major construction project may have no expenditures for 3 years and then spend 20% in year 4.
- Charity has the burden to prove that the expenditure was prudent.

35

35

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Spending Policies

- Myriad terms for endowments, but there are two commonly seen endowments
  - Income only
  - Calculated spending rate
  - Tiered spending rates
  - Board discretion
  - Spread the spending rate calculation over a multi-year period
  - Flexibility to invade within limitations
  - Emergency invasion provisions
- Periodic review

36

36

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Modification & Release – UPMIFA

- Permits release or modification of restrictions by donor, charity, or court in specific instances
- Small/Old Funds – if restriction is unlawful, impracticable, impossible to achieve, or wasteful, an institution may release or modify a restriction without donor consent or court approval if all of these conditions are met:
  - Institutional fund < $25,000
  - Institutional fund is more than 20 years old
  - Will be used consistent with charitable purposes
  - Requires Attorney General notice
- Example – $15,000 fund set up in 1973 for the cure of polio – with AG notice, can release restriction and use for a purpose consistent with original purpose (i.e. cure of other children's diseases)

37

37

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Modification of Restrictions – Outside of UPMIFA

- What if the UPMIFA modification provisions don't apply?
- Does the gift agreement address?
- Can donor consent?
- Court Action
- Attorney General Approval

38

38

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Questions?

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39

39

Restricted Gifts and Endowment Funds

Corpus Christi Estate Planning Council
September 21, 2023

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RESTRICTED GIFTS AND ENDOWMENT FUNDS
CONTENTS

I. Introduction.

This article is intended to provide an overview of the basic rules and issues related to restricted gifts and endowment funds. The article will focus primarily on the state of the law in Texas, but it will occasionally note key differences in other states as well.

II. Uniform Prudent Management of Institutional Funds Act.

A. Purpose. The Uniform Prudent Management of Institutional Funds Act (the "***Uniform Act***") was approved in 2006 by the National Conference of Commissioners on Uniform State Laws ("***NCCUSL***") and recommended for enactment by the states. The Uniform Act was intended to provide necessary updates to the outdated investment, management, and spending standards of the prior act, the Uniform Management of Institutional Funds Act or "***UMIFA***".[1] The Uniform Act aimed to remove the uncertainty regarding applicable prudence standards, adopt a modern prudence standard, modernize the expenditure rules in order to provide more guidance and flexibility to institutions, and update provisions related to the release and modification of fund restrictions.

B. Adoption. At the time of this writing, the Uniform Act has been adopted in 49 states, with Pennsylvania being the only state that has not adopted at this time.[2] Texas adopted the Uniform Act with a few changes in 2007, and it is located in Chapter 163 of the Texas Property Code.[3] UPMIFA went into effect in Texas on September 1, y. The discussion in this article will focus on the Uniform Act as adopted in Texas ("***UPMIFA***"). All future references to UPMIFA in this article will refer to the Texas Uniform Prudent Management of Institutional Funds Act unless otherwise noted.

C. Application. In Texas, UPMIFA applies to institutions that are managing institutional funds or endowment funds. The effect of UPMIFA depends on whether an organization manages one or more institutional funds or endowment funds, as defined by UPMIFA. Certain management and investment rules apply to all institutional funds, and additional expenditure and spending rules apply only to endowment funds.

D. Donor Intent. Any conversation about restricted gifts and endowment funds necessarily brings up the issue of donor intent. The drafters of the Uniform Act intended to give special importance to a donor's intent as it is expressed in a gift instrument. Many UPMIFA provisions are "subject to the intent of the donor expressed in the gift

[1] *See* Unif. Prudent Mgmt. of Institutional Funds Act with Prefatory Note and Comments (2006), which is attached as Exhibit A to this article and available on the National Conference of Commissioners on Uniform State Laws website at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=d88fe964-fa49-9b1e-e197-2389fcc49990&forceDialog=0 ; *see also* Tex. Prop. Code § 163.002.

[2] *See* Uniform Law Commission, Prudent Management of Institutional Funds Act Enactment Map, https://www.uniformlaws.org/committees/community-home?communitykey=043b9067-bc2c-46b7-8436-07c9054064a3&tab=groupdetails (last visited March 19, 2022).

[3] Chapter 163 of the Texas Property Code is attached as Exhibit B to this article.

instrument," leaving most UPMIFA provisions as default provisions. To the extent the gift instrument conflicts with UPMIFA, the instrument will typically control.[4]

The question of donor intent is an extremely important consideration from an institution's point of view. Questions about donor intent have been in the public eye frequently over the last number of years due to a growing number of law suits and media stories in which a variety of institutions have been accused of disregarding or misconstruing a donor's intentions regarding the use or treatment of funds or donated assets. Conflicts related to donor intent can have significant implications for a charity from a legal and financial perspective, but—perhaps even more importantly—can have disastrous implications for both donor and public relations.

For example, in 2008, Princeton University settled a long legal battle over accusations that the university's use of an endowment providing funding for the Woodrow Wilson School of International and Public Affairs was contrary to the donor's intent. The suit attracted significant media attention. A settlement was reached in which the university agreed to pay out almost $100 million in combined legal costs and funds to a new organization created to carry out the specific intentions of the donor.[5] While both sides in the Princeton case claimed victory following the settlement, and the university claimed that annual giving had increased since the suit began,[6] a number of universities have received negative press related to a growing concern that universities are increasingly and particularly likely to disregard donor intent as they feel inclined.[7]

Conflicts related to donor intent are not exclusive to university endowment funds. A variety of charitable organizations, such as museums, parks, and centers for the arts, have had to navigate donor intent issues in recent years.[8] It is important to note that donor intent

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[4] Certain duties enumerated by UPMIFA, such as the duty of care, are mandatory and cannot be altered or eliminated by a gift instrument or donor. *See* Unif. Prudent Mgmt. of Institutional Funds Act § 3 cmt. on purpose and scope, *supra* note 1.

[5] *See* Princeton University Robertson Lawsuit Overview, https://www.princeton.edu/news/2008/12/10/understanding-robertson-v-princeton-settlement#:~:text=In%20July%202002%2C%20descendants%20of,of%20Princeton%20University%20in%201961.

[6] *See* W. Raymond Ollwerther, *Robertson Lawsuit Settled*, PRINCETON ALUMNI WEEKLY, Jan. 28, 2009, https://paw.princeton.edu/article/robertson-lawsuit-settled.

[7] *See, e.g.*, Nina Shapiro, *UW Returns $5M to Donor After Disagreement Over Professor's Views on Israel*, THE SEATTLE TIMES, March 5, 2022, https://www.seattletimes.com/seattle-news/uw-returns-5m-to-israel-studies-donor-unhappy-with-professors-views/; Anne D. Neal, *Will Hopkins Respect Its Donor's Wishes?*, THE BALTIMORE SUN, Oct. 16, 2013, https://www.baltimoresun.com/opinion/op-ed/bs-ed-university-donations-20131016-story.html; Kelsey Bray, *Donor Aims to Block Ranch Sale by UW, CSU*, WYOMING EAGLE TRIBUNE, Oct. 18, 2012; Katherine Mangan, *Tulane U. Wins Donor-Intent Lawsuit Over Closing of Women's College*, THE CHRONICLE OF HIGHER EDUCATION, Feb. 21, 2011, https://www.chronicle.com/article/Tulane-U-Wins-Donor-Intent/126465; Charles Huckabee, *Ray Charles Foundation Wants $3-Million Back From Albany State U.*, THE CHRONICLE OF HIGHER EDUCATION, Feb. 15, 2012, https://www.chronicle.com/blogs/ticker/ray-charles-foundation-wants-3-million-back-from-albany-state-u/40535.

[8] *See, e.g.*, Patricia Cohen, *Museums Grapple With the Strings Attached to Gifts*, N.Y. TIMES, Feb. 4, 2013, https://www.nytimes.com/2013/02/05/arts/design/museums-grapple-with-onerous-restrictions-on-donations.html; Robin Pogrebin, *Lincoln Center to Rename Avery Fisher Hall*, N.Y. TIMES, Nov. 13, 2014, https://www.nytimes.com/2014/11/14/arts/music/lincoln-center-to-rename-avery-fisher-hall.html; Lisa Foderaro, *A*

conflicts are not only arising on the biggest stages with millions of dollars at stake. These issues are also arising for smaller, local organizations. For example, a New Jersey no-kill animal shelter collected funds for the express purpose of a facilities expansion project that would allow the shelter to house larger and older animals. A few years after collecting the donations, the shelter announced that it would not proceed with the expansion project, telling donors that it would be merging with a charitable foundation and building a smaller facility in a nearby town. One of the donors brought a lawsuit to obtain a refund of his donations, and in 2013 a New Jersey appellate court affirmed that the shelter must return the donor's $50,000 gift.[9]

E. Additional Guidance in Texas. Guidance interpreting UPMIFA in Texas is limited. For this reason, the NCCUSL prefatory comments are relevant from time to time. The Uniform Code and prefatory comments are attached as exhibits to this article. Also attached as Exhibit C are the Texas House and Senate Committee Reports on Bill Analyses.

III. Institutional Funds Under UPMIFA.

A. Identifying an Institution. The first step in determining the application of UPMIFA is to identify whether or not an organization is an "institution," as defined by UPMIFA. An "institution" is defined to include (i) a person, other than an individual, organized and operated exclusively for charitable purposes; (ii) a government or governmental subdivision, agency, or instrumentality, to the extent it holds funds exclusively for charitable purposes; and (iii) a trust that has both charitable and non-charitable interests, after all non-charitable interests have expired.[10] Under the above definition, "person" includes a corporation, association, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.[11] Most charities will qualify as institutions under UPMIFA.

B. Identifying an Institutional Fund. An institutional fund is a fund held by an institution exclusively for charitable purposes.[12] Under UPMIFA, the term institutional fund does not include (i) program-related assets; (ii) a fund held for an institution by a trustee who is not an institution;[13] or (iii) a fund in which a beneficiary that is not an

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Monument to Roosevelt, on the Eve of Dedication, Is Mired in a Dispute With Donors, N.Y. TIMES, Oct. 15, 2012, https://www.nytimes.com/2012/10/16/nyregion/fdr-monument-mired-in-a-legal-dispute-over-placement-of-donors-names.html?mtrref=www.google.com&gwh=279E728A12AC6B6B4420DE8A79CADF64&gwt=pay;

[9] *Adler v. SAVE*, Docket No. A-0643-10T3, Superior Court of New Jersey, Appellate Division (August 8, 2013); *see also* Philanthropy News Digest, *New Jersey Nonprofit Ordered to Return Gift After Not Honoring Donor's Intent*, Aug. 9, 2013, https://philanthropynewsdigest.org/news/new-jersey-nonprofit-ordered-to-return-gift-after-not-honoring-donor-s-intent. Another issue that frequently comes up in donor intent litigation is the question of standing to bring a lawsuit to enforce a donor's intentions. A full discussion of this issue is outside of the scope of this paper, but for further discussion on this topic please see Kathryn Miree and Winton Smith, *The Unraveling of Donor Intent: Lawsuits and Lessons*, May 18, 2011, https://www.pgdc.com/pgdc/unraveling-donor-intent-lawsuits-and-lessons.

[10] Tex. Prop. Code § 163.003(4).

[11] *Id.* § 163.003(6).

[12] *Id.* § 163.003(5).

[13] Note that this exclusion is an unsettled area under Texas law. The exclusion applicable to charitable trusts with individual trustees can be interpreted several ways. Moreover, the application of the exception can be surprising in

institution has an interest.[14] Under the above, a program-related asset is an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.[15] Most funds held by a charity will be institutional funds. For example, an operating bank account, an endowment, and a development fund to pay for a new building would all be institutional funds under UPMIFA. By contrast, a fund held by an individual to benefit a charity or a fund held by a for-profit company for charitable purposes (i.e. funds collected by a law firm for distribution to a local school) are not institutional funds, and therefore, are not governed by UPMIFA.

C. Duties Related to the Management and Investment of Institutional Funds. Section 163.004 of UPMIFA lays out the standards of conduct and duties required in managing and investing institutional funds. In the exercise of those duties, an institution is required to consider the charitable purposes of the institution and the purposes of the institutional fund.[16] The following are the duties set forth in UPMIFA for the management and investment of institutional funds:

1. Duty of Care. UPMIFA requires that each person responsible for the management and investment of an institutional fund shall manage and invest the fund "with the care an ordinarily prudent person in a like position would exercise under similar circumstances."[17] In addition, unless otherwise provided by the gift instrument, if someone responsible for the management or investment of a fund has special skills or expertise, they must use those skills or expertise as they make decisions regarding the management or investment of the fund.[18]

2. Duty of Loyalty. UPMIFA reminds institutions that, in addition to the duty of loyalty imposed by other law, each person responsible for managing and investing an institutional fund shall do so in good faith.[19]

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many instances. The definition of an institutional fund excludes "a fund held for an institution by a trustee that is not an institution." NCCUSL comments address this verbiage as intentional, but it results in distinguishing between an endowment in trust form and one in another form, even if both are institutionally managed. Few charities establish endowments with the charity named and acting as a trustee; this is for asset protection reasons as well as donor relations reasons. On the face of the statute, endowments held in trust form by individual trustees could be excluded from both the duties and protections of UPMIFA. However, understanding that the goal of and intent of UPMIFA is consistency, many advisers take the approach of advising such trust clients to assume that the duties and obligations of MIFA apply, while not relying on the protections set forth therein. Ultimately, the proper interpretation may rely on the construction of whether the exclusion (i) modifies the definition of an institutional fund ("a fund held by an institution exclusively for charitable purposes") by excepting such a fund with individual trustees, or (ii) clarifies the definition by referring to a fund that is not really held by an institution at all but rather for an institution (i.e. if a donor sets up a trust today that benefits Charity X, but does not seek charitable status).

Interestingly, NCCUSL comments mention that states might consider adopting corollary rules to specifically apply to charitable trusts with corporate trustees not covered under UPMIFA.

[14] *Id*.
[15] *Id.* § 163.003(7).
[16] *Id.* § 163.004(a).
[17] *Id.* § 163.004(b).
[18] *Id.* § 163.004(e)(6).
[19] *See id.* § 163.004(b); for example, the duty of loyalty under nonprofit corporation law.

3. Duty to Manage Costs and Verify Facts. When managing and investing an institutional fund, the institution must only incur costs that are appropriate and reasonable. To determine whether costs are appropriate and reasonable, the institution should take into account the costs in relation to the fund's assets, the purposes of the institution, and the skills available to the institution.[20] The institution must also make a reasonable effort to verify any facts that are relevant to the management and investment of a fund.[21]

4. Duty to Diversify Investments; Modern Portfolio Theory. Except as otherwise provided in a gift instrument, an institution should develop an investment strategy that includes risk and return objectives that are reasonably suited to the fund and the institution.[22] This strategy must include the diversification of investments unless special circumstances exist that cause the purposes of the fund to be better served without diversification.[23] Investment or management decisions about an individual asset must be made as a part of this investment strategy and in the context of the fund's portfolio of investments as a whole.[24] Unless otherwise prohibited by law outside of UPMIFA, an institution may invest in any kind of property or type of investment that is consistent with the duties required under UPMIFA.[25] When an institution receives a piece of property, it must decide within a reasonable length of time whether to retain or dispose of the property, taking into account the fund's investment strategy and the requirements under UPMIFA.[26] For the purpose of managing and investing assets, an institution may pool two or more institutional funds.[27]

D. Management and Investment Factors. In addition to setting out the various duties discussed above, UPMIFA also provides a list of factors that an institution must consider when managing and investing an institutional fund. An institution is only required to consider the following factors if they are relevant to the institutional fund and to the extent not otherwise provided in a gift instrument[28]:

1. General economic condition;
2. Possible effect of inflation or deflation;
3. Expected tax consequences of investment strategies;
4. Role of each investment or action within the overall investment portfolio of the fund;
5. Expected total return from income and appreciation of investments;

[20] *Id.* § 163.004(c)(1).
[21] *Id.* § 163.004(c)(2).
[22] *Id.* § 163.004(e)(2). New York has taken the issue of investment strategies a step further, and the New York statute includes the requirement that an institution must adopt a written investment policy "setting forth guidelines on investments and delegation of management and investment functions." N.Y. Not-for-Profit Corp. Law § 552(f).
[23] *Id.* § 163.004(e)(4).
[24] *Id.* § 163.004(e)(2).
[25] *Id.* § 163.004(e)(3).
[26] *Id.* § 163.004(e)(5).
[27] *Id.* § 163.004(d).
[28] *Id.* § 163.004(e)(1).

6. Other resources of the institution;
7. Needs of the institution and fund to make distributions and to preserve capital; and
8. An asset's special relationship or value to the charitable purposes of institution.

E. Donor Intent with Respect to the Management and Investment of Institutional Funds. According to NCCUSL's Prefatory Note included with the Uniform Act, the Uniform Act intentionally gives special importance to the intent of the donor as it is expressed in the gift agreement.[29] Charities and those making management and investment decisions should give primary consideration to donor intent as all decisions are made. Further, as noted above, most of the management and investment duties and requirements imposed by UPMIFA specifically state that they are subject to the intent of the donor as expressed in the gift instrument. A donor may expressly supersede many of the UPMIFA default rules with a clear statement in a gift instrument.

IV. Endowment Funds Under UPMIFA.

A. Identifying an Endowment Fund. While the standards of conduct discussed in Section III above apply to all institutional funds, UPMIFA contains a separate group of rules applicable only to endowment funds. Under UPMIFA, an endowment fund is an institutional fund (or any part) that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis.[30] Because this definition requires the existence of a gift instrument, board-designated endowments are not subject to the endowment rules set forth under UPMIFA. In addition, it is worth note that the definition of an endowment for accounting purposes does not align with the definition under UPMIFA.

B. Identifying a Gift Instrument. Under UPMIFA, a gift instrument is defined as a record or records, including an institutional solicitation, by which property is granted to, transferred to, or held by an institution as an institutional fund.[31] A record is defined as information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.[32] Thus, a gift instrument can be in hard copy or electronic format, and can encompass a large number of items including, without limitation, a will, a deed of gift, a bill of sale, gift or pledge agreements, a response to a solicitation, etc.

It is worth note that the term "gift instrument" is broadly defined to give maximum effect to donor intent, and includes items that may not typically be considered by a layman to be controlling. The breadth of the definition requires institutions to be thoughtful in educating development staff and to ensure strong record-keeping and periodic review procedures as they relate to donor communications and institutional solicitations.

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[29] *See* Prefatory Note, Unif. Prudent Mgmt. of Institutional Funds, *supra* note 1.
[30] Tex. Prop. Code § 163.003(2).
[31] *Id.* § 163.003(3).
[32] *Id.* § 163.003(8).

C. Endowment Fund Spending Rules aka the "Appropriation Power". According to Section 163.005(a) of UPMIFA, subject to donor intent as expressed in a gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent. In making this determination the institution must consider the uses, benefits, purposes, and duration of the endowment fund. In addition, the institution must act in good faith with the care that an ordinarily prudent person in a similar position would use under similar circumstances.[33] UPMIFA also sets out a list of factors that must be considered when making the decision to appropriate or accumulate. These factors, listed below, are very similar to the factors that govern the management and investment of institutional funds discussed in Section III above, and similarly, these are considered as relevant to the institution:

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.

The author typically recommends that these factors be assessed and documented in instances where the appropriation power is exercised and further often recommends that the factors be institutionalized in the organization's spending policy.

D. Rebuttable Presumptions of Imprudence. UPMIFA sets out guidelines that create a presumption of imprudence if endowment fund spending in a given year is above a certain percentage of the fund's fair market value determined over the previous three years. The percentage varies based on the size of the fund. UPMIFA, as adopted in Texas, varies slightly from the Uniform Act which includes the presumption of imprudence as a single, optional section that uses the same percentage for all endowment funds irrespective of size.[34] In both acts, the presumptions are rebuttable, meaning that an institution can spend above the percentage limits, but the burden of proof is on the charity to provide evidence that such spending was prudent under the circumstances. However, spending less than the applicable percentages does not create a safe harbor or act as a presumption of prudence.[35] It is worth note that this is a common misconception. In other words, an institution may spend less than the given percentage and still be acting imprudently under the circumstances.

1. Endowment Funds of $1 Million or More. For endowment funds with aggregate value greater than $1,000,000, if more than 7% of the fair market value

[33] *Id.* § 163.005(a).
[34] The provision creating a rebuttable presumption of imprudence is an optional provision in the Uniform Act, so not all states have included this provision when adopting the Uniform Act. For example, Delaware's version of the Uniform Act excludes the rebuttable presumption provision.
[35] Tex. Prop. Code §§ 163.005(d)(2), (e)(2), and (f)(2).

of the endowment fund is spent in any year, a rebuttable presumption of imprudence applies. The fair market value is calculated on the basis of market values determined at least quarterly and averaged over a period of a minimum of the previous three years. For endowment funds that have not yet been in existence for three years, the fair market value of the fund must be calculated for the period of the fund's existence.[36]

2. Endowment Funds of Less than $1 Million. For endowment funds with less than $1,000,000, if more than 5% of the fair market value of the endowment fund is spent in any year, a rebuttable presumption of imprudence applies.[37] The fair market value of the fund is determined in the same manner as described above.

3. University Systems. UPMIFA contains a special rule applicable only to university systems holding endowment funds with an aggregate value of $450 million or more. If more than 9% of the fair market value of the endowment fund is spent in any year, a rebuttable presumption of imprudence is created.[38] The fair market value of the fund is determined in the same manner as for funds of $1 million or more.

E. Special Pooling Rule for Endowment Funds. Texas has created a unique rule with respect to endowment funds that are pooled for collective investment. The UPMIFA provision states that when endowment funds are pooled, the rules governing expenditure and accumulation are applied to the pooled fund as a whole rather than the individual endowment funds.[39] This varies from the Uniform Act, which allows for the pooling of funds, but states that the pooled funds must be considered individually under the rules related to spending and modification of restrictions.[40] The UPMIFA provision is potentially problematic because some of the factors governing expenditure and accumulation decisions are fund-specific.[41] For example, an institution must consider both the purposes and the duration of a fund when deciding whether to appropriate or accumulate funds, and that is arguably impossible when looking at a group of pooled funds as a whole.[42] Although institutions have adopted reasonable positions in pooling related funds (including grouping funds into reasonable categories with similar but not identical restrictions), this remains an unsettled area under Texas law.

F. Donor Intent with Respect to Endowment Fund Spending. As noted in Section C above, an institution's ability to appropriate or accumulate funds is subject to the intent of the donor. The gift instrument may provide a limitation that restricts an institution's authority to appropriate for expenditure or accumulate.[43] However, this limitation must be specifically stated, and the fact that a gift instrument uses language that creates an

[36] *Id.* § 163.005(d).
[37] *Id.* § 163.005(e).
[38] *Id.* § 163.005(f).
[39] *Id.* § 163.005(g).
[40] Unif. Prudent Mgmt. of Institutional Funds Act § 3(d) cmt., Subsection (d). *supra* note 1.
[41] *See* Johnny Rex Buckles, *Unanswered Questions Under TUPMIFA*, January 13, 2011.
[42] *See* Tex. Prop. Code § 163.005(a).
[43] *Id.* § 163.005(b).

endowment does not create this limitation on authority.[44] It is not sufficient to merely designate the gift as an "endowment" or to direct that the institution may use only "income," "interest," "dividends," or "rents, issues, or profits" or use words of "similar import." If a donor intends to prohibit the ability to exercise the appropriation power under Section 163.005 of UPMIFA, the clearest route is to expressly state this prohibition by reference to the statute. In the author's view, this is one of the most commonly overlooked issues in drafting gift agreements.

V. Delegation of Management and Investment Functions. Subject to any specific limitation in the gift agreement, UPMIFA authorizes the delegation of management and investment decisions to external agents to the extent that the delegation is prudent under the circumstances.[45]

A. Standard of Conduct for Institutions. When delegating management and investment authority, an institution must act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances.[46] This standard applies when selecting an agent, when establishing the scope of the delegation, and when reviewing the agent's actions to periodically monitor performance and compliance.[47] An institution that acts in good faith for all of the above will not be liable for the decisions or actions of an agent.[48]

B. Standard of Conduct for Agents. Agents owe a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.[49] By accepting a delegation, the agent submits to the jurisdiction of the Texas courts in any proceeding connected with the delegation or with performance of the delegated function.[50]

VI. Release and Modification of a Gift Restriction or Endowment.

A. Release or Modification by Donor Consent. If the donor consents in writing, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. However, the fund must still be used for a charitable purpose of the institution.[51]

B. Release of Modification by Others. A factor in drafting gift agreements is whether additional parties should be given the right to consent to the release or modification of restrictions. While such an addition can provide flexibility for a charity, it can also muddy the waters—donors' relatives do not always share the same values and charitable goals as the original donor. Another possibility is to name a committee to assess and consider any request for a release or modification; the committee could serve as a self-perpetuating body

[44] *Id.* § 163.005(c).
[45] *Id.* § 163.006(a).
[46] *Id.*
[47] *Id.*
[48] *Id.* § 163.006(c).
[49] *Id.* § 163.006(b).
[50] *Id.* § 163.006(d).
[51] *Id.* § 163.007(a).

to offer insight on an ongoing basis and help to ensure that funds are not mired in controversy or legal fees while remaining relevant and useful to the charity.

C. Release or Modification by a Court under UPMIFA. On application by an institution, a court may modify a restriction regarding the management or investment of an institutional fund (i) if the restriction has become impracticable or wasteful, (ii) if it impairs the management or investment of the fund, or (iii) if, because of circumstances not anticipated by the donor, a modification would further the purposes of the fund. Where practicable, any modification should be made in accordance with the donor's probable intention.[52]

A court can also modify the purpose of a fund or a restriction on the use of the fund if the charitable purpose or restriction has become unlawful, impracticable, impossible to achieve, or wasteful. This modification must be made in a manner consistent with the charitable purposes expressed in the gift instrument.[53]

D. Cy Pres and Equitable Deviation; Court Modification. The modifications allowed in Sections 163.007(b) and (c) are codifications of the trust law principles of cy pres and equitable deviation and ensure their application to nonprofit corporation or other entity forms. Courts have applied these trust law rules to nonprofit corporations in the past, but the drafters of the Uniform Act "believed that statutory authority for applying these principles to nonprofit corporations would be helpful."[54] Note that the UPMIFA provisions generally do not supplant existing common law provisions otherwise related to cy pres and equitable deviation.

E. Release or Modification of Small, Old Funds. If an institution determines that a restriction found in the gift instrument is unlawful, impracticable, impossible to achieve, or wasteful, the institution may release or modify a restriction without donor consent or court approval if all of the following conditions are met:

1. The institutional fund is less than $25,000;
2. The fund is more than 20 years old;
3. The money will be used with consistent charitable purposes; and
4. 60 days have passed since the Attorney General received notice of the release or modification.[55]

VII. Regulatory Enforcement of UPMIFA.

A. Role of Attorney General in Texas. The Office of the Attorney General or "OAG" represents the public interest in charities and acts to protect that interest. According to the OAG website, Texas has more than 80,000 active charitable organizations and countless

[52] *Id.* § 163.007(b).
[53] *Id.* § 163.007(c).
[54] Prefatory Note, Unif. Prudent Mgmt. of Institutional Funds, supra note 1.
[55] Tex. Prop. Code § 163.007(d). The rule regarding small, old funds varies among states. For example, in New York, funds must be worth less than $100,000 and more than 20 years old to modify without a judicial proceeding. N.Y. Not-for-Profit Corp. Law § 555(d)(1).

trust entities over which the OAG retains oversight authority. Some examples of the ways in which the Attorney General exercises this authority include:

1. Investigating and initiating legal action against charitable organizations and their managerial officials to ensure that charitable donations are lawfully solicited and that assets held by the charitable organization are properly managed, invested, and expended;
2. Reviewing legal proceedings involving charitable trusts pursuant to Chapter 123 of the Texas Property Code, which requires notice to the Attorney General of such proceedings, recognizes the Attorney General's standing to intervene, and prescribes consequences for failure to comply;
3. Initiating proceedings to distribute charitable assets left unattended or obtained through legal action; and
4. Reviewing transactions involving the conversion of nonprofit, charitable entities to for-profit entities, including sales, transfers, or mergers of healthcare organizations.

The Attorney General also enforces UPMIFA and ensures that charities comply with donor intent.[56]

B. Specific Role of Attorney General with Respect to Court Release or Modification. Chapter 123 of the Texas Property Code governing proceedings involving charitable trusts is also applicable to a court release or modification of an institutional fund under UPMIFA.[57] Chapter 123 indicates that, due to the interest of the general public in charitable institutions, the Attorney General is a proper party and may intervene in a proceeding involving an institutional fund.[58] The chapter requires that the Attorney General must receive notice when an institution makes an application to the court for the modification or release of a restriction on the management, investment, or purpose of an institutional fund.[59] Notice must be given by sending, by registered or certified mail, a true copy of the petition initiating the proceeding. This notice must be sent within 30 days of filing with the court, but no less than 25 days prior to a hearing in the proceeding. If the Attorney General is not properly given notice, a release or modification is voidable on motion of the Attorney General.[60]

As noted in Section VI above, the Attorney General must also be given notice if an institution wants to release or modify a restriction on an institutional fund that is valued at less than $25,000 and more than 20 years old. The notice to the Attorney General must be accompanied by a copy of the gift instrument and a statement of facts sufficient to evidence compliance with the requirements for the release or modification of small, old funds.[61]

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[56] The role of the Attorney General's office varies significantly from state to state. For example, in New York, the Attorney General Charities Bureau that focuses exclusively on issues relating to charitable institutions. *See* John Sare, *Making Them and Breaking Them: The Life Cycle of Restricted Gifts*, January 2017.
[57] Tex. Prop. Code §§ 163.007(b) and 163.007(c).
[58] *See* Tex. Prop. Code § 123.002; *see also* § 163.002(a)(1).
[59] *Id.* § 123.003(a).
[60] *See id.* § 123.004.
[61] *Id.* § 163.007(e).

VIII. Issues to Consider When Creating a Gift Agreement. When entering into a gift agreement, either as the donor or as the donee, there are a number of terms to consider and negotiate. Even though a charitable institution and a prospective donor may have similar end goals in mind, they also have different perspectives. A charitable donee may aim for maximum flexibility in administration and spending, while a donor may want to impose careful restrictions to ensure that his or her specific purposes are carried out. Typically, longer and more detailed gift agreements tend to favor the donor's interest, whereas less detail in the agreement may give the charitable donee more flexibility, subject to the UPMIFA default provisions discussed above. The following list is intended to briefly highlight some of the key provisions to consider when negotiating a gift instrument, but this list is not exhaustive.

A. Donor Intent, Generally. Because the emphasis under UPMIFA and in state regulatory enforcement is on donor intent, both the donor and donee should give careful consideration to clarity in all terms related to the donor's intent.

B. Amount and Timing of Gift. In addition to the amount of a gift, a donee must decide whether to make a gift as a lump sum or spread over a period of years. As applicable, the gift agreement should clearly specify when the first payment will be made, the intervals between payments, the amount of each payment, and the total number of payments that will be made.

C. Form of Gift. When discussing the form of the gift, some donors may know exactly what they want to give, but others may need some guidance to help them determine which asset would be the best choice. The donor should consider the potential tax benefits of different types of gifts, but the charity (and its development staff and leadership) should be careful not to provide tax advice to the donor.

There are also important factors that the donee should consider before deciding whether or not to accept a particular gift. For example, is the property marketable, and how much time, expense, diligence, and manpower will be required in order to sell the property? Further, the donee should consider the potential for unrelated business taxable income and the financial risk or financial or other obligations involved in owning and selling the property.

D. Valuation. For non-cash gifts, an agreement may dictate how and when the value of the donation will be determined.

E. Conditions to Payment. Donors may decide to make gifts conditional on the donee meeting certain requirements. For example, the gift agreement could require that the donee must break ground on a building project or that the donee must receive a certain amount of matching funds before the gift amount is paid. An agreement may also require periodic reports as to progress or use, tied to the approval of additional payments. If the gift instrument places a fund matching condition on the gift, the agreement should also lay out in detail what will count as matching funds and any related exclusions. Further, for any gift payable at a future point, the agreement should establish how and when such amount is established (i.e. by the passage of time versus an outside circumstances or occurrence).

F. Binding Obligation. A gift agreement can be structured as a binding agreement, as a non-binding statement of intent, or as something else, such as a revocable enforceable pledge. A binding agreement is beneficial to the donee because the donee can rely on the gift for future planning purposes, and the donee will have recourse if the donor does not fulfill his or her obligation. However, donors may not prefer to establish a binding obligation. If the agreement is binding, the donee and its board of directors may have a fiduciary duty to enforce the agreement, but many charities are reticent to enforce such pledges in the spirit of donor—and public—relations.[62]

In order to create a gift agreement that will likely be enforceable as binding, the agreement should clearly state any consideration that the donee will give in exchange for the donor's gift. For example, a promise to name a building or scholarship after the donor can be used as consideration for the gift, even though, as discussed below for federal tax purposes, this is considered an incidental benefit that will not impact the donor's deduction. In addition to the stated consideration, the gift agreement should also list any actions the donee intends to take in reliance on the donor's pledge. Reliance on a pledge further supports enforceability. The donee may plan to incur obligations in reliance on the pledge, may rely on the pledge to induce other donors to give, or may rely on the pledge to start producing a program or planning or building a facility.

If a donor has reservations about a binding agreement, a revocable enforceable pledge is an alternative. This is an agreement that is revocable until it becomes enforceable upon the occurrence of a specific event such as the due date of the payment or the death of the donor.

G. Consequences for Breach of Gift Agreement. If the gift agreement is binding, then the instrument should specify what happens if there is a breach by either party. If the donee breaches between payments by the donor, does the breach cancel the donor's obligation to make the remainder of the payments? Will the donee be given the opportunity to cure the breach? If the donor breaches the agreement, does the donee retain the right to file a lawsuit, or does the agreement specify that disputes must be resolved in another manner? Is specific performance desired?

H. Restrictions. Some donors wish to make gifts for specific, restricted purposes. When deciding whether to accept such a gift, a donee must consider whether the stated purpose will be consistent with the donee's charitable purposes; whether the amount of the gift is enough to achieve the stated purpose of the gift; whether the gift restriction could hinder the donee's ability to obtain gifts from other sources or give the donee negative publicity in any way; and whether the restrictions would place any sort of burden, financial or otherwise, on the donee. When negotiating the restrictions on a gift, the donee may wish to preserve the right to reallocate the gift under certain circumstances such as if more money is raised than necessary for the stated purpose or if there is not sufficient funding to complete the project for which the funds were restricted.

I. Requirements Imposed on Donee. A donor may want to impose specific requirements on the donee. For example, the donor may want to require that the donee send

[62] Self-dealing concerns may arise if a private foundation forgives the binding pledge of a disqualified person.

the donor annual reports regarding the use of the gift or that the donee allow the donor to inspect its books and records at a reasonable time when requested. If the gift instrument will include such requirements, they should be clearly stated in the instrument along with the consequences for the donee's failure to comply.

J. Benefits to Donor. For tax purposes, the amount of the donor's charitable deduction will be reduced by the value of any goods or services provided to the donor in exchange for the contribution. However, certain incidental benefits will not impact the donor's deduction. For example, when a contribution improves the reputation of the donor, that is deemed an incidental benefit. It is also considered an incidental benefit when something such as a building or a scholarship is named after a donor in exchange for a contribution.

K. Application of UPMIFA. As referenced above, UPMIFA's default rules will apply unless the gift instrument states otherwise. Both the donor and donee should carefully consider the potential impact of these default rules, in particular those related to the application of the appropriation power under Section 163.005 as discussed above.

IX. Additional Issues to Consider When Creating an Endowment. In addition to the above considerations related to drafting a gift instrument, when structuring a restricted gift as an endowment, there are additional decisions to make such as how spending will be restricted and the structure of the fund.

A. Spending Restrictions on the Fund. Myriad options exist when structuring the spending of an endowment fund and the likelihood is that an endowment's governing documents will act as a starting place while various subsequent donor gift agreements may place additional restrictions.

B. UPMIFA Appropriation. One important factor to consider is whether the UPMIFA appropriation power (described above) will apply to a fund.

X. Structure of Endowment Fund. There are a number of alternatives when deciding how to structure an endowment fund. An endowment can be held as an internal fund, established as a separate entity (whether in trust or corporate form), or set up as a fund at a communities foundation. A separate entity will also have its own board of directors who will owe fiduciary duties to the endowment entity rather than to the operating charity. Also at issue is the question of choice of entity, including a charitable trust, a nonprofit corporation, or some other alternative.

Additionally, there are considerations related to the tax-exempt status of an endowment established as a separate entity, including whether it can qualify as a public charity, whether its fundraising or operations would be stymied by classification as a private foundation, and whether it can justify supporting organization status under Section 509(a)(3) of the Code and, if so, what type. An endowment can be established as a Type I, II, or III supporting organization. Each of these different structures will have unique federal tax implications and compliance requirements to consider, and the determination will depend on the type of support anticipated, the organization's need to avoid private foundation status, and its ability to comply with requisite requirements. To the extent the operating charity is involved in establishing an endowment, there is often an extended balancing

act ensuring the charity is comfortable with the degree of control (if any) or influence it has, while also ensuring the desired separation to accomplish organizational goals.

An internal fund avoids the added expense and administrative burden of establishing a separate entity. However, an internal fund offers limited asset protection. Further (and often more importantly), donors often believe that an endowment fund established as a separate entity is preferable because the endowment is subject to oversight and management of a separate governing body (i.e., its board of directors), is less likely to be invaded for general overhead or operating costs, or donor restrictions are more likely to be followed with an internal fund. Some donors also appreciate that a separate entity could continue after the failure, bankruptcy, or dissolution of an operating entity, remaining available to fund a "Phase II" of the operating entity.

EXHIBIT A – UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT WITH PREFATORY NOTE AND COMMENTS (2006)

UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-FIFTEENTH YEAR
HILTON HEAD, SOUTH CAROLINA

July 7-14, 2006

WITH PREFATORY NOTE AND COMMENTS

November 8, 2007

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The **National Conference of Commissioners on Uniform State Laws** (NCCUSL), now in its 115th year, provides states with non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law.

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UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

TABLE OF CONTENTS

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. UMIFA 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; or

(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.

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.

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 is 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.]

Comment

Purpose and Scope of Revisions. This section revises the provision in UMIFA that permitted the expenditure of appreciation of an endowment fund to the extent the fund had

appreciated in value above the fund's historic dollar value. UMIFA defined historic dollar value to mean all contributions to the fund, valued at the time of contribution. Instead of using historic dollar value as a limitation, UPMIFA applies a more carefully articulated prudence standard to the process of making decisions about expenditures from an endowment fund. The expenditure rule of Section 4 applies only to the extent that a donor and an institution have not reached some other agreement about spending from an endowment. If a gift instrument sets forth specific requirements for spending, then the charity must comply with those requirements. However, if the gift instrument uses more general language, for example directing the charity to "hold the fund as an endowment" or "retain principal and spend income," then Section 4 provides a rule of construction to guide the charity.

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

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

UPMIFA requires the persons making spending decisions for an endowment fund to focus on the purposes of the endowment fund as opposed to the purposes of the institution more generally, as was the case under UMIFA. When the institution considers the purposes and duration of the fund, the institution will give priority to the donor's general intent that the fund be maintained permanently. Although the Act does not require that a specific amount be set aside as "principal," the Act assumes that the charity will act to preserve "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). 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.

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

Section 4 permits expenditures from an endowment fund to the extent the institution determines that the expenditures are prudent after considering the factors listed in subsection (a). These factors emphasize the importance of the intent of the donor, as expressed in a gift instrument. Section 4 looks to written documents as evidence of donor's intent and does not require an institution to rely on oral expressions of intent. By requiring written evidence of intent, the Act protects reliance by the donor and the institution on the written terms of a donative agreement. Informal conversations may be misremembered and may be subject to multiple interpretations. Of course, oral expressions of intent may guide an institution in further carrying out a donor's wishes and in understanding a donor's intent.

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

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

Several levels of safeguard exist to prevent an institution from depleting an endowment fund or diverting assets from the purposes for which the fund was created. In comparison with UMIFA, UPMIFA provides greater direction to the institution with respect to making a prudent determination about spending from an endowment. UMIFA told the decision maker to consider "long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions." UPMIFA

clarifies that in making spending decisions the institution should attempt to ensure that the value of the fund endures while still providing that some amounts be spent for the purposes of the endowment fund. In UPMIFA prudent decision making emphasizes the endowment aspect of the fund, rather than the overall purposes or needs of the institution.

In addition to the guidance provided by Section 4, other safeguards exist. Donors can restrict gifts and can provide specific instructions to donee institutions regarding appropriate uses for assets contributed. Within institutions, fiduciary duties govern the persons making decisions on expenditures. Those persons must operate both with the best interests of the institution in mind and in keeping with the intent of donors. If an institution diverts an institutional fund from the charitable purposes of the institution, the state attorney general can enforce the charitable interests of the public. By relying on these safeguards while providing institutions with adequate discretion to make appropriate expenditures, the Act creates a standard that takes into consideration the diversity of the charitable sector. The committee expects that accumulated experience with such spending formulas will continue to inform institutional practice under the Act.

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

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

Subsection (c). Rule of Construction. Donor's intent must be respected in the process of making decisions to expend endowment funds. Section 4 does not allow an institution to convert an endowment fund into a non-endowment fund nor does the section allow the institution to ignore a donor's intent that a fund be maintained as an endowment. Rather, subsection (c) provides rules of construction to assist institutions in interpreting donor's intent. Subsection (c)

assumes that if a donor wants an institution to spend "only the income" from a fund, the donor intends that the fund both support current expenditures and be preserved permanently. The donor is unlikely to be concerned about designation of particular returns as "income" or "principal" under accounting principles. Rather the donor is more likely to assume that the institution will use modern total-return investing techniques to generate enough funds to distribute while maintaining the long-term viability of the fund. Subsection (c) is an intent effectuating provision that provides default rules to construe donor's intent.

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

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

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

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

More recently the Colorado Supreme Court considered the retroactive application of another constructional statute, one that deems the designation of a spouse as the beneficiary of a life insurance policy to be revoked in a case in which the marriage was dissolved after the

naming of the spouse as beneficiary. In re Estate of DeWitt, 54 P. 3d 849 (Colo. 2002). In holding that retroactive application of the statute did not violate the Contracts Clause, the court cited approvingly from a statement prepared by the Joint Editorial Board for Uniform Trusts and Estates Acts (JEB). JEB Statement Regarding the Constitutionality of Changes in Default Rules as Applied to PreExisting Documents, 17 Am. Coll. Tr. & Est. Couns. Notes 184 app. II (1991).

The JEB Statement explains that the purpose of the anti-retroactivity norm is to protect a transferor who relies on existing rules of law. By definition, however, rules of construction apply only in situations in which a transferor did not spell out his or her intent and hence did not rely on the then-current rule of construction. *See also In re Gardner's Trust*, 266 Minn. 127, 132, 123 N.W. 2d 69, 73 (1963) ("[I]t is doubtful whether the testatrix had any clear intention in mind at the time the will was executed. It is equally plausible that if she had thought about it at all she would have desired to have the dividends go where the law required them to go at the time they were received by the trustee.") (Uniform Principal and Income Act).

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

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

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

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

A variety of considerations cut against including a presumption of imprudence in the statute. A fixed percentage in the statute might be perceived as a safe harbor that could lead institutions to spend more than is prudent. Although the provision should not be read to imply that spending below seven percent will be considered prudent, some charities might interpret the statute in that way. Decision makers might be pressured to spend up to the percentage, and in

doing so spend more than is prudent, without adequate review of the prudence factors as required under the Act.

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

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

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

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

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

Expenditures from an endowment fund may include distributions for charitable purposes and amounts used for the management and administration of the fund, including annual charges

for fundraising. The value of a fund, as calculated for purposes of determining the seven percent amount, will reflect increases due to contributions and investment gains and decreases due to distributions and investment losses. The seven percent figure includes charges for fundraising and administrative expenses other than investment management expenses. All costs or fees associated with an endowment fund are factors that prudent decision makers consider. High costs or fees of investment management could be considered imprudent regardless of whether spending exceeds seven percent of the fund's value.

The presumption of imprudence does not create an automatic safe harbor. Expenditures at six percent might well be imprudently high. S*ee* James P. Garland, *The Fecundity of Endowments and Long-Duration Trusts*, The Journal of Portfolio Management (2005). Evidence reviewed by the Drafting Committee suggests that at present few funds can sustain spending at a rate above five percent. *See* Roger G. Ibbotson & Rex A. Sinquefield, Stocks, Bonds, Bills, and Inflation: Historical Returns (1926-1987) (Research Foundation of the Institute of Chartered Financial Analysts, 1989). Indeed, under current conditions five percent can be too high. *See* Joel C. Dobris, *Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust and Spending Rate on Settlors, Their Advisers, and Retirees*, 40 Real Prop. Prob. & Tr. J. 39 (2005). Further, spending at a lower rate, particularly in the early years of an endowment, may result in greater distributions over time. *See* DeMarche Associates, Inc, Spending Policies and Investment Planning for Foundations: A Structure for Determining a Foundation's Asset Mix (Council on Foundations: 3d ed. 1999). A presumption of imprudence can serve as a reminder that spending at too high a rate will jeopardize the long-term nature of an endowment fund. If an endowment fund is intended to continue permanently, the institution should take special care to limit annual spending to a level that protects the purchasing power of the fund.

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

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

Spending above seven percent in any one year will not necessarily be imprudent. For some endowment funds fluctuating spending rates may be appropriate. Although the Act does not apply the percentage for the presumption on a rolling basis (e.g., 21 percent over three years), some endowment funds may prudently spend little or nothing in some years and more than seven percent in other years. For example, a charity planning a construction project might decide to spend nothing from an endowment for three years and then in the fourth year might spend 20 percent of the value of the fund for construction costs. The decision to accumulate in years one through three and then to spend 20 percent in the fourth year might be prudent for the charity, depending on the other factors. The charity should maintain adequate records during the accumulation period and should document the decision-making process in the fourth year to be able to meet the burden of production associated with the presumption. Another charity might

prudently spend 20 percent in year one and nothing for the following three years. That charity would also need to document the decision-making process through which the decision to spend occurred and maintain records explaining why the decision was prudent under the circumstances.

A charity might establish a "capital replacement fund" designed to provide funds to the institution for repair or replacement of major items of equipment. Disbursements from such a fund will likely fluctuate, with limited expenditures in some years and big expenditures in others. The fund would not exhibit a uniform spending rate. Indeed, an advantage of a capital replacement fund is the ability to absorb a significant capital expenditure in a single year without a negative impact on the operating budget of the institution. Disbursements might average five percent per year but would vary, with spending in some years more and in some years less. Even if this fund is an endowment fund subject to Section 4, spending above seven percent in a particular year could well be prudent. Subsection (d) does not preclude spending above seven percent.

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

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

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

The optional provision creates a notification requirement for an institution with a small endowment that plans to spend below historic dollar value. If an institution subject to the provision decides to appropriate an amount that would cause the value of its endowment funds to drop below the aggregate historic dollar value for all of its endowment funds, then the institution will have to notify the attorney general before proceeding with the expenditure. The provision does not require that the institution obtain the approval of the attorney general before making the

distribution. Rather, the notification requirement gives the attorney general the opportunity to take a closer look at the institution and its spending decision, to educate the institution on prudent decision making for endowment funds, and to intervene if the attorney general determines that the spending would be imprudent for the institution. Although the Drafting Committee thinks that the prudence standard in UPMIFA provides adequate guidance to all institutions within the scope of the Act, if a state chooses to adopt a notification provision for institutions with small endowments, the Drafting Committee recommends the following language:

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

[SECTION 5. DELEGATION OF MANAGEMENT AND INVESTMENT FUNCTIONS.

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

(1) selecting an agent;

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

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

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

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

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

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

Comment

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

Section 5 incorporates the delegation rule found in UPIA § 9, updating the delegation rules in UMIFA § 5. Section 5 permits the decision makers in an institution to delegate management and investment functions to external agents if the decision makers exercise reasonable skill, care, and caution in selecting the agent, defining the scope of the delegation and reviewing the performance of the agent. In some circumstances, the scope of the delegation may include redelegation. For example, an institution may select an investment manager to assist with investment decisions. The delegation may include the authority to redelegate to investment managers with expertise in particular investment areas. All decisions to delegate require the exercise of reasonable care, skill, and caution in selecting, instructing, and monitoring agents. Further, decision makers cannot delegate the authority to make decisions concerning expenditures and can only delegate management and investment functions. Subsection (c)

protects decision makers who comply with the requirement for proper delegation from liability for actions or decisions of the agents. In making decisions concerning delegation, the institution must be mindful of Section 3(c)(1) of UPMIFA, the provision that directs the institution to incur only reasonable costs in managing and investing an institutional fund.

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

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

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

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

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

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

(b) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The institution shall notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard. To the extent practicable, any modification must be made in accordance with the donor's probable intention.

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

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

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

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

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

Comment

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

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

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

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

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

Sometimes deviation is needed on account of circumstances unanticipated when the donor created the restriction. In other situations the restriction may impair the management or investment of the fund. Modification of the restriction may permit the institution to carry out the donor's purposes in a more effective manner. A court applying deviation should attempt to follow the donor's probable intention in deciding how to modify the restriction. Consistent with the doctrine of equitable deviation in trust law, subsection (b) does not require an institution to

notify donors of the proposed modification. Good practice dictates notifying any donors who are alive and can be located with a reasonable expenditure of time and money. Consistent with the doctrine of deviation under trust law, the institution must notify the attorney general who may choose to participate in the court proceeding. The attorney general protects donor intent as well as the public's interest in charitable assets. Attorney general is in brackets in the Act because in some states another official enforces the law of charities.

Subsection (c). Cy Pres. Subsection (c) applies the rule of cy pres from trust law, authorizing the court to modify the purpose of an institutional fund. The term "modify" encompasses the release of a restriction as well as an alteration of a restriction and also permits a court to order that the fund be paid to another institution. A court can apply the doctrine of cy pres only if the restriction in question has become unlawful, impracticable, impossible to achieve, or wasteful. This standard, which comes from UTC § 413, updates the circumstances under which cy pres may be applied by adding "wasteful" to the usual common law articulation of the doctrine. Any change must be made in a manner consistent with the charitable purposes expressed in the gift instrument. *See also* Restatement (Third) of Trusts § 67 (2003). Consistent with the doctrine of cy pres, subsection (c) does not require an institution seeking cy pres to notify donors. Good practice will be to notify donors whenever possible. As with deviation, the institution must notify the attorney general who must have the opportunity to be heard in the proceeding.

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

As under judicial cy pres, an institution acting under subsection (d) must change the restriction in a manner that is in keeping with the intent of the donor and the purpose of the fund. For example, if the value of a fund is too small to justify the cost of administration of the fund as a separate fund, the term "wasteful" would allow the institution to combine the fund with another fund with similar purposes. If a fund has been created for nursing scholarships and the institution closes its nursing school, the institution might appropriately decide to use the fund for other

scholarships at the institution. In using the authority granted under subsection (d), the institution must determine which alternative use for the fund reasonably approximates the original intent of the donor. The institution cannot divert the fund to an entirely different use. For example, the fund for nursing scholarships could not be used to build a football stadium.

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

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

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

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

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

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

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

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

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

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

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

EXHIBIT B – CHAPTER 163 OF THE TEXAS PROPERTY CODE

PROPERTY CODE

TITLE 10. MISCELLANEOUS BENEFICIAL PROPERTY INTERESTS

SUBTITLE B. FIDUCIARIES

CHAPTER 163. MANAGEMENT, INVESTMENT, AND EXPENDITURE OF INSTITUTIONAL FUNDS

Sec. 163.001. SHORT TITLE. This chapter may be cited as the Uniform Prudent Management of Institutional Funds Act.

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.002. LEGISLATIVE FINDINGS AND PURPOSE. (a) The legislature finds that:

(1) institutions organized and operated exclusively for a charitable purpose perform essential and needed services in the state;

(2) uncertainty exists regarding the prudence standards for the management and investment of charitable funds and for endowment spending by institutions described by Subdivision (1); and

(3) the institutions, their officers, directors, and trustees, and the citizens of this state will benefit from removal of the uncertainty regarding applicable prudence standards and by permitting endowment funds to be invested for the long-term goals of achieving growth and maintaining purchasing power without adversely affecting the availability of funds for current expenditure.

(b) The purpose of this chapter is to provide guidance and authority through modern articulations of prudence standards for the management and investment of charitable funds and for endowment spending by institutions organized and operated exclusively for a charitable purpose in order to provide uniformity and remove uncertainty regarding those standards.

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989. Amended by Acts 1993, 73rd Leg., ch. 240, Sec. 1, eff. May 22, 1993.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.003. DEFINITIONS. In this chapter:

(1) "Charitable purpose" means the promotion of a scientific, educational, philanthropic, or environmental purpose, social welfare, the arts and humanities, or another civic or public purpose described by Section 501(c)(3) of the Internal Revenue Code of 1986.

(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.

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989. Amended by Acts 1993, 73rd Leg., ch. 240, Sec. 2, eff. May 22, 1993.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.004. 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 chapter, 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 chapter, 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 chapter.

(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.

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989. Amended by Acts 1993, 73rd Leg., ch. 240, Sec. 3, eff. May 22, 1993; Acts 2001, 77th Leg., ch. 1158, Sec. 88, 89, eff. June 15, 2001.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.005. 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 Subsections (d) and (e), 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) Except as provided in Subsection (f), appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund with an aggregate value of $1 million or more, 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 chapter 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.

(e) For an institution with an endowment fund with an aggregate value of less than $1 million, a rebuttable presumption of imprudence is created if more than five percent of the fair market value of the endowment fund is appropriated for expenditure in any year, 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. 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 chapter 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 five percent of the fair market value of the endowment fund.

(f) This subsection applies only to a university system, as defined by Section 61.003(10), Education Code. The appropriation for expenditure in any year of any amount greater than nine percent

of the fair market value of an endowment fund with an aggregate value of $450 million or more, 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 chapter 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 nine percent of the fair market value of the endowment fund.

(g) If an institution pools the assets of individual endowment funds for collective investment, this section 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.

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.006. DELEGATION OF MANAGEMENT AND INVESTMENT FUNCTIONS. (a) Subject to any specific limitation set forth in a gift instrument or in law other than this chapter, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances. An institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in:

(1) selecting an agent;

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

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

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

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

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

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

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.007. RELEASE OR MODIFICATION OF RESTRICTIONS ON MANAGEMENT, INVESTMENT, OR PURPOSE. (a) If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. A

release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

(b) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. Chapter 123 applies to a proceeding under this subsection. To the extent practicable, any modification must be made in accordance with the donor's probable intention.

(c) If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument. Chapter 123 applies to a proceeding under this subsection.

(d) If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of

an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, 60 days after receipt of notice by the attorney general, may release or modify the restriction, in whole or part, if:

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

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

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

(e) The notification to the attorney general under Subsection (d) must be accompanied by a copy of the gift instrument and a statement of facts sufficient to evidence compliance with Subsections (d)(1), (2), and (3).

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.008. REVIEWING COMPLIANCE. Compliance with this chapter is determined in light of the facts and circumstances

existing at the time a decision is made or action is taken, and not by hindsight.

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.009. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This chapter modifies, limits, and supersedes the provisions of the Electronic Signatures in Global and National Commerce Act (15 U.S.C. Section 7001 et seq.) but does not modify, limit, or supersede Section 101 of that Act (15 U.S.C. Section 7001(a)) or authorize electronic delivery of any of the notices described in Section 103 of that Act (15 U.S.C. Section 7003(b)).

Added by Acts 1989, 71st Leg., ch. 213, Sec. 1, eff. May 26, 1989.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.010. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this chapter, consideration must be given

to the need to promote uniformity of the law with respect to the subject matter of this chapter among states that enact a law substantially similar to this chapter.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Sec. 163.011. APPLICABILITY OF OTHER PARTS OF CODE. Chapters 116 and 117 do not apply to any institutional fund subject to this chapter.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 834 (H.B. 860), Sec. 1, eff. September 1, 2007.

Acts 2017, 85th Leg., R.S., Ch. 62 (S.B. 617), Sec. 14, eff. September 1, 2017.

EXHIBIT C – TEXAS HOUSE AND SENATE COMMITTEE REPORT BILL ANALYSES

BILL ANALYSIS

C.S.H.B. 860
By: Paxton
State Affairs
Committee Report (Substituted)

BACKGROUND AND PURPOSE

The Uniform Management of Institutional Funds Act (UMIFA) was adopted by the Texas Legislature in 1989. UMIFA was developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1972. This law has provided guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations.

This bill replaces UMIFA with the Uniform Prudent Management of Institutional Funds Act (UPMIFA) which was adopted by the NCCUSL in 2006. Because prudence norms have evolved since the 1970s, UPMIFA provides modern articulations of the prudence standards for the management and investment of charitable funds and for endowment spending.

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. 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.

Highlights of UPMIFA include the following:

1.) It expressly enumerates factors a charity should consider in making investment decision, including preservation of the endowment fund.
2.) It improves the protection of donor intent.
3.) It improves the endowment spending rule by eliminating the concept of historic dollar value and providing better guidance regarding the operation of the prudence standard.
4.) It includes a presumption of imprudence if a charity spends more than seven percent of the endowment in any one year or more than five percent for small endowments. The presumption is meant to protect against spending an endowment too quickly.
5.) It 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 but gives charities broader authority to modify restrictions on a fund that is both old and small permitting the charity to make appropriate modifications and avoid the expense of a court hearing. In all instances the attorney general continues to be the protector both of the donor's intent and of the public's interest in charitable funds.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

SECTION 1 strikes Chapter 163, Property Code, and inserts a new chapter.

Sec. 163.001 establishes the name of the chapter.

Sec. 163.002 states legislative findings and purpose.

Sec. 163.003 defines (1) “charitable purpose," (2) “endowment fund,” (3) “gift instrument,” (4) “institution,” (5) “institutional fund,” (6) “person,” (7) “program-related asset,” and (8) “record.”

Sec. 163.004 adopts the prudence standard for investment decision making, using a portfolio approach and considering the risk and return objectives of the fund.

Sec, 163.004(a) expresses the overarching duty to comply with donor intent while requiring the consideration of the charitable purposes of the institution.

Sec. 163.004(b) reminds fund managers that the duty of loyalty will apply to their actions while requiring fund managers to manage and invest in good faith and with the care of an ordinarily prudent person.

Sec. 163.004(c) authorizes an institution to minimize costs and to investigate the accuracy of the information used in making management decisions.

Sec. 163.004(d) authorizes an institution to pool funds for management and investment purposes.

Sec. 163.004(e) provides that a set of criteria be considered if an institutional fund is to be managed and invested. Provides that the context of the institutional fund's portfolio of investments as a whole or as a part of an overall investment strategy be considered if a decision about an individual asset is to be made. Authorizes an institution to invest in any kind of property or investment in accordance with the law. Requires an institution to diversify the investment fund unless the purposes of the fund are better served without diversification. Requires an institution to make a decision on whether to retain or rebalance the institutional fund portfolio within a reasonable time when receiving property. States that a managing and investing person has a duty to use their skills and expertise.

Sec. 163.005 replaces the existing prudence standard which relied on the historic dollar value of the fund. Instead, this section applies a prudence standard which would generate sufficient gains in the fund to be able to make ongoing distributions from the fund while at the same time preserving the purchasing power of the fund. Determining spending would be based on the total assets of the endowment fund.

Sec. 163.005(a), subject to the intent of a donor and the established rebuttable presumption of imprudence depending on the funds value, authorizes an institution to appropriate or accumulate funds and requires the consideration of certain prudence factors while acting in good faith and with care. Assumes that all endowment funds are donor-restricted unless a gift states otherwise.

Sec. 163.005(b) provides that fund managers are authorized to determine expenditure and accumulation levels as they determine are prudent if the gift instrument has not specifically stated a limitation.

Sec. 163.005(c) provides rules of construction to assist institutions in interpreting donor’s intent.

Sec. 163.005(d) establishes a rebuttable presumption of imprudence for funds over $1 million if an institution spends more than seven percent (7%) of the fair market value of the fund as determined from the immediately preceding three years. Provides that the fair market value of the endowment fund be calculated for the period the fund has been in existence if it has been in existence for less than three years.

Sec. 163.005(e) establishes a rebuttable presumption of imprudence for funds under $1 million if an institution spends more than five percent (5%) of the fair market value of the fund as determined from the immediately preceding three years. Provides that the fair market value of the endowment fund be calculated for the period the fund has been in existence if it has been in existence for less than three years.

Sec. 163.005(f) stipulates that Sec. 163.005 would not apply to individual funds in a pooled fund or to funds managed under a collective investment policy. Rather, the prudence standards and the presumption of imprudence would apply to the entire pool or collective investment policy.

Sec. 163.006 establishes guidelines for the delegation of management and investment functions.

Sec. 163.006(a) authorizes an institution to delegate management and investment functions to external agents. Requires an institution to exercise reasonable skill, care, and caution in selecting the agent, defining the scope of the delegation, and reviewing the performance of the agent.

Sec. 163.006(b) provides that an agent performing a delegated function exercise reasonable care to comply with the scope and terms of the delegation.

Sec. 163.006(c) provides that an institution exercising reasonable skill, care, and caution in selecting the agent, defining the scope of the delegation, and reviewing the performance of the agent, is not liable for the decisions or actions of an agent.

Sec. 163.006(d) provides that an agent accepting a delegated function submits to the jurisdiction of the courts of this state in all proceedings arising from or related to the delegated function.

Sec. 163.006(e) Authorizes an institution to delegate management and investment functions to its committees, officers, and employees.

Sec. 163.007 expresses the releasing or modifying restrictions placed on a trust.

Sec. 163.007(a) authorizes an institution to modify a restriction with donor consent. Prohibits a release or modification for non-charitable purposes of the institution.

Sec. 163.007(b) authorizes a court to modify restrictions contained in a gift instrument without donor consent through a court order when trust restrictions become impractical or wasteful. Provides that the modification be made in accordance with the donor's probable intention. Applies the attorney general's participation in proceedings involving charitable trusts.

Sec. 163.007(c) authorizes a court to modify the purpose of a gift instrument if the purpose becomes unlawful, impracticable, impossible to achieve, or wasteful. Applies the attorney general's participation in proceedings involving charitable trusts.

Sec. 163.007(d) authorizes an institution to modify a restriction contained in a gift instrument that becomes unlawful, impracticable, impossible to achieve, or wasteful, after appropriate notice has been given to the attorney general if the fund's value is less than $25,000, is more than 20 years old, and is used in the manner expressed in the gift instrument.

Sec. 163.007(e) provides that a copy of the gift instrument and a statement of facts showing that the fund's value is less than $25,000, is more than 20 years old, and is used in the manner expressed in the gift instrument, accompany notification of the attorney general.

Sec. 163.008 does not allow hindsight to replace facts and circumstances in determining compliance with the management, investment, and expenditure of institutional funds.

Sec. 163.009 establishes the applicability of the provisions of the Electronic Signatures in Global and National Commerce Act (15 U.S.C. Section 7001).

Sec. 163.010 provides that the promotion of uniformity of the law be considered in applying the act if other states have similar statutes.

Sec. 163.011 exempts funds subject to this chapter from the provisions of Subtitle B, Title 9 (the Texas Trust Code).

SECTION 2 amends the Education Code to make the terms conform to the language of the Chapter 163, Property Code. Authorizes the State Board of Education to delegate investment authority to the same extent as an institution.

SECTION 3 amends the Education Code to make the terms conform to the language of the Chapter 163, Property Code. Authorizes the State Board of Education to delegate investment authority to the same extent as an institution.

SECTION 4 amends the Education Code to make the terms conform to the language of the Chapter 163, Property Code. Defines "institution" and "institutional fund."

SECTION 5 applies the changes made by the Act to institutional funds existing on or established after the effective date. Applies the changes made by the Act to an action taken or decision made after August 31, 2007, for an institutional fund existing on the effective date.

SECTION 6 makes the Act effective September 01, 2007

EFFECTIVE DATE

September 1, 2007.

COMPARISON OF ORIGINAL TO SUBSTITUTE

The substitute is identical to the original bill except for the insertion of Sec. 163.005(d), (e), and (f), which establish the 'bright line standard' of the rebuattable presumption of imprudence at 7% for large funds and 5% for small funds. Additionally, this insertion of language applies Sec. 163.005 to an entire pool or collective investment policy of funds rather than to individual funds within a pool or collective investment policy.

BILL ANALYSIS

Senate Research Center

H.B. 860
By: Paxton, Cook, Byron (Williams)
State Affairs
5/18/2007
Committee Report (Amended)

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

The Uniform Management of Institutional Funds Act (UMIFA) was adopted by the Texas Legislature in 1989. It was developed by the National Conference of Commissioners on Uniform State Laws (conference) in 1972 and has provided guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations.

H.B. 860 replaces the UMIFA with the Uniform Prudent Management of Institutional Funds Act, adopted by the conference in 2006, in order to provide modern articulations of the prudence standards for the management and investment of charitable funds and for endowment spending. The bill also provides guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations and provides for additional duties for individuals who manage and invest such funds.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Chapter 163, Property Code, as follows:

CHAPTER 163. MANAGEMENT, INVESTMENT, AND EXPENDITURE OF INSTITUTIONAL FUNDS

Sec. 163.001. SHORT TITLE. Provides that this chapter may be cited as the Uniform Prudent Management of Institutional Funds Act.

Sec. 163.002. LEGISLATIVE FINDINGS AND PURPOSE. (a) Provides that the legislature finds that institutions organized and operated exclusively for a charitable purpose perform essential and needed services in the state, uncertainty exists regarding the prudence standards for the management and investment of charitable funds and for endowment spending by such institutions, and those institutions, their officers, directors, and trustees, and the citizens of this state will benefit from removal of the uncertainty regarding applicable prudence standards and by permitting endowment funds to be invested for the long-term goals of achieving growth and maintaining purchasing power without adversely affecting the availability of funds for current expenditure.

(b) Provides that the purpose of this chapter is to provide guidance and authority through modern articulations of prudence standards for the management and investment of charitable funds and for endowment spending by institutions organized and operated exclusively for a charitable purpose in order to provide uniformity and remove uncertainty regarding those standards.

Sec. 163.003. DEFINITIONS. Defines "charitable purpose," "endowment fund," "gift instrument," "institution," "institutional fund," "person," "program-related asset," and "record."

Sec. 163.004. STANDARD OF CONDUCT IN MANAGING AND INVESTING INSTITUTIONAL FUND. (a) Requires an institution, in managing and investing an

institutional fund, to consider the charitable purposes of the institution and the purposes of the institutional fund, subject to the intent of a donor expressed in a gift instrument.

(b) Requires each person responsible for managing and investing an institutional fund to 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, in addition to complying with the duty of loyalty imposed by law other than this chapter.

(c) Authorizes an institution, in managing and investing an institutional fund, to 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 requires the institution to make a reasonable effort to verify facts relevant to the management and investment of the fund.

(d) Authorizes an institution to pool two or more institutional funds for purposes of management and investment.

(e) Provides that, except as otherwise provided by a gift instrument, rules set forth in this subsection apply to the management of and investment in an institutional fund.

Sec. 163.005. APPROPRIATION FOR EXPENDITURE OR ACCUMULATION OF ENDOWMENT FUND; RULES OF CONSTRUCTION. (a) Authorizes an institution, subject to the intent of a donor expressed in the gift instrument and to Subsections (d) and (e), to 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. Provides that, unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. Requires the institution, in making a determination to appropriate or accumulate, to act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and to consider, if relevant, certain factors set forth in this subsection.

(b) Requires a gift instrument to specifically state the limitation in order to limit the authority to appropriate for expenditure or accumulate under Subsection (a).

(c) Provides that certain language in a gift instrument creates an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund and do not otherwise limit the authority to appropriate for expenditure or accumulate under Subsection (a).

(d) Provides that the appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund with an aggregate value of $1 million or more, 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. Requires the fair market value for an endowment fund in existence for fewer than three years to be calculated for the period the fund has been in existence. Provides that this subsection does not apply to an appropriation for expenditure permitted under law other than this chapter or by the gift instrument or 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.

(e) Provides that, for an institution with an endowment fund with an aggregate value of less than $1 million, a rebuttable presumption of imprudence is created if more than five percent of the fair market value of the endowment fund is appropriated for expenditure in any year, 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. Requires the fair market value for an endowment fund in existence for fewer than three years to be calculated for the period the fund has been in existence. Provides that this subsection does not apply to an appropriation for expenditure permitted under law other than this chapter or by the gift instrument or create a presumption of prudence for an appropriation for expenditure of an amount less than or equal to five percent of the fair market value of the endowment fund.

(f) Provides that, if an institution pools the assets of individual endowment funds for collective investment, this section 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.

Sec. 163.006. DELEGATION OF MANAGEMENT AND INVESTMENT FUNCTIONS. (a) Authorizes an institution to delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances, subject to any specific limitation set forth in a gift instrument or in law other than this chapter. Requires an institution to act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in taking certain actions set forth in this subsection.

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

(c) Provide that an institution complying with Subsection (a) is not liable for the decisions or actions of an agent to which the function was delegated.

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

(e) Authorizes an institution to delegate management and investment functions to its committees, officers, or employees as authorized by law of this state other than this chapter.

Sec. 163.007. RELEASE OR MODIFICATION OF RESTRICTIONS ON MANAGEMENT, INVESTMENT, OR PURPOSE. (a) Authorizes an institution to release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund if the donor consents in a record. Prohibits a release or modification from allowing a fund to be used for a purpose other than a charitable purpose of the institution.

(b) Authorizes the court, upon application of an institution, to modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, impairs the management or investment of the fund, or, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. Provides that Chapter 123 (Attorney General Participation in Proceedings Involving Charitable Trusts) applies to a proceeding under this subsection. Requires any modification to be made in accordance with the donor's probable intention to the extent practicable.

(c) Authorizes the court, upon application of an institution, to modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument if a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional

fund becomes unlawful, impracticable, impossible to achieve, or wasteful. Provides that Chapter 123 applies to a proceeding under this subsection.

(d) Authorizes the institution, if it makes certain determinations regarding a restriction contained in a certain gift instrument, 60 days after receipt of notice by the attorney general, to release or modify the restriction, in whole or part, if certain conditions set forth in this subsection are met.

(e) Requires the notification to the attorney general under Subsection (d) to be accompanied by a copy of the gift instrument and a statement of facts sufficient to evidence compliance with Subsection (d).

Sec. 163.008. REVIEWING COMPLIANCE. Provides that compliance with this chapter is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, not by hindsight.

Sec. 163.009. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. Provides that this chapter modifies, limits, and supersedes the provisions of the Electronic Signatures in Global and National Commerce Act (15 U.S.C. Section 7001 et seq.) but does not modify, limit, or supersede Section 101 of that Act (15 U.S.C. Section 7001(a)) or authorize electronic delivery of any of the notices described in Section 103 of that Act (15 U.S.C. Section 7003(b)).

Sec. 163.010. UNIFORMITY OF APPLICATION AND CONSTRUCTION. Requires that consideration be given to the need to promote uniformity of the law with respect to the subject matter of this chapter among states that enact a law substantially similar to this chapter in applying and construing this chapter.

Sec. 163.011. APPLICABILITY OF OTHER PARTS OF CODE. Provides that Subtitle B, Title 9 (the Texas Trust Code), does not apply to any institutional fund subject to this chapter. Deletes existing text of Chapter 163.

SECTION 2. Amends Sections 43.006(a) and (k), Education Code, as follows:

(a) Authorizes the State Board of Education to delegate investment authority, rather than delegate such authority and contract, for the investment of the permanent school fund to the same extent as an institution, rather than the governing board of an institution of higher education, with respect to an institutional fund under Chapter 163, Property Code.

(k) Defines "institution." Deletes existing text defining "governing board" and "institution of higher education."

SECTION 3. Amends Section 66.08(a), Education Code, to make conforming changes.

SECTION 4. Amends Section 66.08(o)(2), Education Code, to define "institution" and "institutional fund." Deletes existing text defining "governing board" and "institution of higher education."

SECTION 5. (a) Provides that Chapter 163, Property Code, as amended by this Act, applies only to an institutional fund existing on or established after this Act's effective date.

(b) Makes application of this Act to an action taken or decision made relating to an institutional fund prospective.

SECTION 6. Effective date: September 1, 2007.

SUMMARY OF COMMITTEE CHANGES

Committee Amendment No. 1

(1) Amends SECTION 1 of H.B. 860, in added Section 163.005(d), Property Code (Engrossed Version, page 7, line 19), by adding an exception to that subsection as provided by Subsection (f) to conform it to this amendment.

(2) Amends SECTION 1 of H.B. 860, in added Section 163.005, Property Code (Engrossed Version, page 8, after line 25), by adding a new Subsection (f), to provide that the appropriation for expenditure in any year of an amount greater than nine percent of the fair market value of an endowment fund with an aggregate value of $450 million or more, 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, create a rebuttable presumption of imprudence. Requires the fair market value of an endowment fund in existence for fewer than three years to be calculated for the period the fund has been in existence. Provides that this subsection does not apply to or create a presumption of prudence for certain appropriations as set forth in the subsection. Provides that the subsection applies only to a university system, as defined by Section 61.003(10), education code [sic].

(3) Amends SECTION 1 of H.B. 860, in added Section 163.005, Property Code (Engrossed Version), to renumber the subsequent subsections of that section in accordance with the addition of the new Subsection (f), as added by this amendment.