UPMIFA Fundamentals:
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What “Is” UPMIFA?

- UPMIFA is the Uniform Prudent Management of Institutional Funds Act
- Issued by the National Conference of Commissioners on Uniform State Laws (approved July 2006)
- Replaced the Uniform Management of Institutional Funds Act (“UMIFA,” which was issued in 1972 and was adopted by 47 states)
- UPMIFA has been adopted in 49 states, the District of Columbia and the U.S. Virgin Islands (not adopted in Pennsylvania or Puerto Rico)

UPMIFA Replaced UMIFA – But What Changed?

- Most importantly (by far), UPMIFA abolished UMIFA's "historical dollar value" ("HDV")concept
  - Concerns about (1) underwater funds, (2) timing differences and (3) long-term protection of funds, where HDV becomes meaningless over time
- Under UPMIFA, investment and spending decisions must still preserve the fund's purchasing power over the long term, but more flexibility year-to-year
- UPMIFA also more fully embraces modern portfolio theory – i.e., concept of making investment decisions at portfolio level, not individual level
  - This change more of a "progression" – i.e., Prudent Investor Act

UPMIFA Embraced Particularly Following "Great Recession"

- According to data from Association of Governing Boards of Colleges and Universities:
  - About 38% of endowment funds underwater as of Dec. 31, 2008
  - About 27% were restricting distributions from underwater funds
  - Restrictions in different forms
    - Expenditures frozen
    - Some interest/dividends only
    - (All) interest/dividends only
    - Reduced principal expenditures

UPMIFA Embraced Particularly Following "Great Recession" (cont'd)

- Example: In early 2009, NY University had about $10 million of its $16 million in scholarship endowments unavailable
- UPMIFA not adopted in NY until September 2010, with notice requirements to pre-existing donors

UPMIFA Embraced Particularly Following "Great Recession" (cont'd)

"There are a lot of more recent funds that have gone underwater because of the current financial tsunami…If you're in a state that still has UMIFA, **you're screwed**."

- Harvey Dale,
NY University

UPMIFA – What It Covers (and Doesn't Cover)

- UPMIFA covers "institutions" and "institutional funds"
- "Institutions" = operated exclusively for charitable purposes
- "Institutional funds" = funds held by institutions exclusively for charitable purposes – they **do not** include:
  - Program-related assets (assets not held for investment)
  - Assets managed by individuals or third-party (non-institution) trustees (but charitable trust and similar laws may apply)
  - Funds for which non-institutions hold a beneficial interest (e.g., charitable remainder trusts, **unless non-charitable interests have terminated**)

UPMIFA – Overall Structure

- Standards of conduct for managing/investing **all** institutional funds
- Delegation of management and investment functions (**all** institutional funds)
- Release/modification of restrictions in gift instruments (**all** institutional funds)
- Expenditure/accumulation of **endowment funds** only

Standards of Conduct – Management and Investment

- Overlay: **All** decisions must be made "subject to the intent of a donor expressed in a gift instrument"
- Duties of loyalty and good faith, and "ordinarily prudent person" standard, imposed
  - Efforts to verify relevant facts
  - Must apply special skills
- Duty to manage costs
- Duty to diversify assets, unless prudent not to

Standards of Conduct – Management and Investment (cont’d)

- Investment decisions apply Modern Portfolio Theory – i.e., made in context of entire portfolio, not myopically
- Pooling multiple institutional funds OK
- Otherwise, all types of investments OK

Standards of Conduct – Management and Investment (cont'd)

- Factors that must be taken into account, if relevant:
    1. General economic conditions
    2. Possible effect of inflation/deflation
    3. Tax consequences (e.g., UBTI)
    4. Role of investment in overall portfolio
    5. Other resources of institution
    6. Needs of institution/fund to make distributions or preserve capital
    7. Asset's special purpose or value, if any

Delegation of Functions

- Prudent delegation to agent permitted, subject to “good faith” and “ordinarily prudent person” standards, as to:
  - Appointment/selection
  - Defining scope of responsibilities
  - Periodic review
- Agent submits to state law; must exercise reasonable care
- Board or other delegating party not liable for decisions or actions of agent, **if** above requirements are met

Release/Modification of Gift Restrictions

1. With **donor consent** (charitable purpose must remain)
2. **Court** may modify, if restriction is impracticable or wasteful, impairs management, or due to circumstances not anticipated by donor, modification would further purposes (State AG must be able to "weigh in")
3. **Court** may modify if restriction or purpose becomes unlawful, impracticable, impossible to achieve, or wasteful (Similar rules apply)

Release/Modification of Gift Restrictions (cont'd)

4. **Institution** may modify if unlawful, impracticable, impossible to achieve, or wasteful, following 60 days' notice to State AG, where (all of the following are true):

- Total FMV less than $25,000
- More than 20 years since fund was established
- Assets still used for charitable purpose consistent with gift instrument

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Endowment Funds

- "“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.”

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Endowment Funds (cont'd)

- "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."

- *UPMIFA Commentary*

Endowment Funds – Expenditure Restrictions

- The general rule:

"Subject to the intent of a donor expressed in the gift instrument…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."

Endowment Funds – Expenditure Restrictions (cont'd)

- Standards of "good faith" and "ordinarily prudent person" imposed, and the following factors must be applied:
    1. Duration and preservation of the endowment fund
    2. Purposes of the institution and the endowment fund
    3. General economic conditions
    4. Possible effect of inflation or deflation
    5. Expected total returns
    6. Other resources of the institution
    7. Investment policy of the institution

Endowment Funds – Restrictions Must Be Set Forth

- Endowment funds may be, but are not necessarily limited to, “perpetual” funds
- Where a gift instrument uses terms like “endowment” “income”, “interest”, “dividends”, “preserve principal,” etc.
  - The fund is to be treated as a perpetual endowment, but…
  - This language does not – in and of itself – impose further conditions on expenditures
  - Terms like “income” construed as including reasonable expenditure of capital gains (unless specifically prohibited)

Endowment Funds – Legal vs. 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**."
- *UPMIFA Commentary*

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Endowment Funds – Specific Restrictions

- Rebuttable presumption of **imprudence** if more than 7% of endowment fund's FMV spent in any year
  - FMVs calculated (at least) quarterly
  - Averaged over (at least) three-year lookback period
  - Presumption may be rebutted under numerous circumstances (constructing building or facility is a common example)
  - Spending less than 7% **does not** create a presumption of prudence
  - Some states **have not** adopted this part of UPMIFA!!

Current Controversy – Who Can Sue?

- State Attorney General? **Yes.**
- Board members/trustees? **Possibly – breach of trust-type theory.**
- Donors themselves, or their descendants? **Maybe, maybe not.**
  - Common law notion that rights in gift are relinquished (note that reversion right may affect tax deductibility of gift)
  - But, some states increasingly permitting donors to enforce intent, at least in certain circumstances

Consider Other State Laws

- UPMIFA is the primary "game in town," but there may be other legal and regulatory considerations – for example:
  - California Non-Profit Corporate Code states that Boards must "***avoid speculation****, looking instead to the permanent disposition of the funds, considering the* ***probable income****, as well as the* ***probable safety*** *of the corporation's capital…"*
  - No consensus on what it means to avoid "speculation" – i.e., risk management at portfolio level (UPMIFA) vs. individual investments?
  - Effective Jan. 1, 2016, compliance with UPMIFA will be **deemed to constitute compliance** with above passage

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Other Legal and Regulatory Considerations

- Securities laws (relief under Philanthropy Protection Act)
  - Investment Company Act of 1940 (and Securities Act of 1933)
  - Advisers Act of 1940?
- CFTC/National Futures Association
- SEC "look-through" rules for private investment funds
- Effect on tax-exempt status where entity is managing multiple funds for compensation

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Additional Best Practices

- Well-drafted minutes/records of Board or other fiduciary
- Develop template gift instruments, particularly for smaller gifts and more "typical" situations
- Donors should generally be informed of modifications to purpose, restrictions, etc. even if not required
- Written Investment Policy Statement and Expenditure Policy
  - Permissible investments, target ranges, re-balancing, watch-listing protocols, etc.
  - Striking appropriate balance as to language is key

Questions?