The California State University
OFFICE OF THE CHANCELLOR

MEMORANDUM

December 3, 2008

To: Lori Redfearn, Assistant Vice Chancellor, Advancement Services
Office of the Chancellor

From: G. Andrew Jones, University Counsel
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Re: Key Changes Resulting From UPMIFA's Replacement of UMIFA
OGC No. 06-1018

The Uniform Management of Institutional Funds Act (UMIFA) has guided the investment and expenditure activity of charitable endowment funds for over 30 years. UMIFA has now been comprehensively revised by the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA has been adopted by California and is codified in the Probate Code at Sections 18501 – 18510. (Copies of the relevant Probate Code sections are attached.) UPMIFA applies to institutional funds existing or established after January 1, 2009, and governs decisions made after that date.

Like its predecessor, UPMIFA guides the management, investment, and expenditure of endowment funds held by charitable institutions. UPMIFA's guidelines apply in the absence of explicit donor restrictions about those activities. There are three primary reasons UPMIFA was enacted:

1. UPMIFA modernizes the prudence standards for the management and investment of charitable funds and for endowment spending by adopting language similar to the Uniform Prudent Investors Act of 1994 and the Revised Model Nonprofit Corporations Act of 1987.

2. UPMIFA modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines on spending and to give institutions the ability to cope more easily with fluctuations in the value of the endowment.

3. UPMIFA updates the rules governing the release and modification of restrictions on endowments by adopting the approach taken in the Uniform Trust Code (2005) for modifying charitable trusts.

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UPMIFA contains many significant changes. The ones most applicable to the CSU and its foundations are summarized below.

1. **Rules on Allowable Investments – Section 18503**

The most significant over-arching change in the area of allowable investments is that portfolio managers are not limited in the kinds of assets that may be sought for the portfolio. This is a more flexible rule than under UMIFA. The new rules do not provide absolute discretion, but rather require that in the absence of a clear donor restriction in the gift instrument, the following factors must be considered (if relevant) when investing institutional funds:

- General economic conditions.
- The possible effects 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 needs of the institution and the fund to make distributions and to preserve capital.
- An asset's special relationship or special value, if any, to the charitable purposes of the institution.

Additionally, the new rules make it clear that investment decisions are not to be made in isolation but rather in the context of the institutional fund's entire portfolio as a whole, and as part of an overall investment strategy with risk and return objectives reasonably suited to the fund and to the institution. [18503((3)(3)] Finally, the new Act requires that investment expenses must be managed prudently in relationship to the assets, the purposes of the institution and the skills available to the institution. This requirement is not addressed in UMIFA.

When all of the rules on allowable investments under UPMIFA are read as a whole, it is clear that the standard for investing and managing charitable funds is one of prudence. Prudence is a standard that evolves over time, and UPMIFA is simply updating the statutory language to provide good direction about the role of prudence in investment and management. The prudence standard in UPMIFA requires fund managers to meet their fiduciary duty of care , the duty to minimize costs, and the duty to investigate with respect to investment decision making. In addition, UPMIFA directs managers of charitable funds to consider general economic conditions, to make decisions on a portfolio basis, to allocate risk and return across the portfolio, and to consider the needs of the charity both to make distributions and to preserve capital.

2. **Rules on Allowable Spending – Section 18504**

Perhaps the most significant change brought by UPMIFA is the abandonment of "historic dollar value" as a spending restriction. Historic dollar value was a product of UMIFA and was meant to represent the value of contributions made to an endowment fund, without increases or decreases due to investment results, inflation, or otherwise. Under UMIFA, the charity could spend whatever amount above the historic dollar value it considered prudent, but it could never spend below the historic dollar value. This was a particular hardship for funds whose value, due to stock market contractions, was below the value of the gift at the time they were given by the donor. UPMIFA no longer uses the term "historic dollar value," and no longer restricts spending to amounts above the historic dollar value of the endowment.

The Act does not, however, permit unrestricted spending from endowment funds. Rather, spending is governed by a comprehensive prudence standard that permits the institution to accumulate or spend so much of the endowment fund – including principal or income, realized or unrealized appreciation -- as the institution deems prudent after considering a number of factors. UMIFA did not address such a comprehensive spending standard.

The primary factor to consider in all cases is still donor intent. But donor intent is also subject to UPMIFA's rules of construction. In clear cases where, for example, a donor restricts spending to X% each year, then such express restrictions will govern. However, if a donor restricts the fund by stating that the institution may only use "income" or "interest" or "dividends" or "profits, or states that the institution shall "preserve the principal intact," then UPMIFA's rules of construction [18504(c)] dictate a somewhat counter-intuitive result. In these circumstances, UPMIFA will assume that the donor wants the institution to use modern investment strategies and will not limit the expenditure other than by the general "prudence standard" set forth in the Act. Under this standard, an institution may spend the amount it deems prudent after considering the donor's intent and the following economic factors:

- The duration and preservation of the endowment fund.
- The purposes of the institution and the endowment fund (not just the institution's purpose, as under UMIFA).
- General economic conditions.
- The possible effect of inflation or deflation.
- The expected total return from income and the appreciation of investments.
- Other resources of the institution.
- The investment policy of the institution.

Because the prudence standard now operates free of the historic dollar value as a floor for spending, the Act establishes a rebuttable presumption of imprudence for spending more than 7% of the value of an endowment fund in one year. That value is determined based on a three-year

rolling average. **However, this provision does not apply to the CSU or its foundations.** [18504(d)(2).] It is also important to note an institution may not interpret this provision to mean that spending below 7% is presumed to be prudent – the Act expressly states that no such assumption of prudence is created. [18504(d)(3).]

3. **<u>Rules for Releasing or Modifying Restrictions on Endowment Funds – Section 18506</u>**

UMIFA currently permits an institution to modify a donor's restriction on an endowment fund by either obtaining the donor's consent, or obtaining court approval. UPMIFA adds another avenue to release or modify a donor's restriction. [Government Code 18506(d)] The new provision would permit an institution, after giving notice to the California Attorney General and the donor, to modify a donor's restriction on its own without any court action if:

(1) the endowment has a value of less than $100,000; and
(2) more than 20 years has 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.

This new provision is intended to address the problem that under some circumstances, a donor might be deceased or otherwise unavailable to release a restriction, and yet that restriction no longer makes sense and the cost of a judicial proceeding would be too great to pursue a change in the restriction. The statute provides that these changes should only be pursued when the institution determines that the restriction is "unlawful, impracticable, impossible to achieve, or wasteful." The code also provides that the institution must wait 60 days after notifying the Attorney General and the donor. (Note that donor notification is a requirement added by the California statute and is not part of the model legislation.)

Enclosures