UPMIFA

A new roadmap for non-profit fiduciaries to manage charitable funds

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Where can non-profit boards find standards for investment decisions? Or receive guidance about spending endowments? Or learn new ways to deal with outmoded restrictions on charitable gifts? In most cases, the answer is the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Now the law in every state but Pennsylvania, UPMIFA provides a useful roadmap for non-profit directors dealing with charitable funds.

The early rules governing charitable funds were restrictive, not to mention risky, for non-profit investors. Fiduciaries were personally liable for all investment losses and were prohibited from spending any principal of an endowment—whether attributable to the original gift or to capital growth. Statutes in most states reduced or eliminated those problems, but guidelines for managing and expending charitable funds, and dealing with obsolete restrictions, remained vague. Today,[1] effectively incorporating UPMIFA standards into investment programs and spending policies can provide valuable protection for boards and investment committees. What UPMIFA doesn't provide is a checklist (or points system) that assures a decision is deemed prudent. This means much is left to the fiduciary's discretion and judgment. To illustrate how its standards are applied, we are going to describe a few of UPMIFA's key points.

Fiduciaries should become familiar with UPMIFA's general terms and the variations that some states have made, so they can take advantage of the guidance and protection this comprehensive law offers.

What standard of care applies to the investment program?

Anyone dealing with charitable funds must act in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. Therefore, the fiduciary, the board, and the investment committee should apply all relevant knowledge and skills in managing the organization's funds, document the investment decision-making process, and select investments that are consistent with the risk and return objectives of the organization and the particular fund. Absent special circumstances, fiduciaries should diversify investments and evaluate contributed property within a reasonable time horizon to determine how it fits into the overall portfolio. A charity may also combine several charitable funds for investment purposes.

In making prudent investment decisions under UPMIFA, fiduciaries need to consider the donor's expressed intent and eight specific factors:

1. Economic conditions
2. The effects of inflation or deflation
3. Tax consequences
4. The impact of the investment on the total portfolio
5. Expected total return
6. Other institutional resources
7. Any needs to make distributions and preserve capital
8. Any special relationship or special value of the asset to charitable purposes.

Busy fiduciaries may also delegate management and investment functions to committees, officers, employees, and external service providers. What this does *not* mean is shifting all responsibility for meeting the organization's spending goal. Effective fiduciaries must exercise ordinary prudence in selecting a provider, defining the scope of the delegation, and overseeing the provider's performance.

How can fiduciaries prudently tackle the new endowment spending rules?

UPMIFA also radically changes endowment expenditure rules, which had prohibited spending any of the original principal. Non-profit investors may now spend all or any part of an endowment if they determine, in good faith, that the expenditure is prudent. This authority exists even if the donor has directed the organization to preserve principal or spend-only income, unless the instrument cites the relevant UPMIFA section of state law or expressly limits spending to specific dollar amounts or percentages.

As with investment decisions, UPMIFA cites seven specific factors that fiduciaries must consider in deciding how much endowment spending is permissible:

1. The duration and preservation of the endowment
2. The purposes of the institution and the endowment
3. Economic conditions
4. Effects of inflation or deflation
5. Expected total return
6. Other institutional resources
7. The institution's investment policy

(Unlike investment decisions, the charity may not delegate endowment spending decisions to outside advisors.)

By specifically addressing the eight UPMIFA investment factors or the seven spending factors in their deliberations, and by documenting those actions in minutes, boards or committees can establish a pattern of conduct consistent with the statutory prudence standard. For the same reason, the board or committee minutes should detail the factors considered in choosing investment advisors, deciding what decisions to delegate to them, and monitoring their performance.

In light of UPMIFA's permission to spend both principal and income, a non-profit's investment policy should emphasize total return and maintaining purchasing power. The endowment policy should take the same basic approach, and both documents should expressly permit future boards to adjust those policies for all funds as changing conditions warrant.

What are the rules for modifying outmoded restrictions?

Over time, restrictions that donors have imposed on an endowment or another institutional fund may begin to impede the administration of the fund or prevent its use for current charitable needs. In many instances, fiduciaries can adjust the terms with the consent of the donor. But even when a donor cannot be identified, or is unavailable, UPMIFA provides rules for removing or modifying outmoded terms. UPMIFA authorizes state courts to grant appropriate relief; and in most states, older, smaller funds can be modified with the cooperation of the Attorney General without having to involve the courts. Limits on fund age and value vary from state to state. Given this new flexibility, fiduciaries should review their endowments and other restricted gifts to see whether any could be updated to better carry out their donors' intent.

To determine how UPMIFA applies in a particular situation, it is necessary to first identify and study the "gift instrument" that sets out relevant terms and restrictions. There is no required format for a gift instrument. It can be the following:

- The charity's own endowment resolution or fundraising materials
- The charity's gift acceptance policy
- A customized agreement with a donor
- A series of letters or emails leading up to a gift
- Contemporaneous notes of a meeting or phone call
- Any combination of similar elements

Fiduciaries should also examine their endowment and gift acceptance policies and solicitation materials to be sure that they do not inadvertently restrict certain types of gifts.

In both interpreting existing gift instruments and drafting new ones, it is important to remember that UPMIFA applies when the non-profit and the donor have *not* agreed on different rules. For example, although UPMIFA generally requires a charity to diversify investments, if the parties agree to allow the fund to retain a particular asset or asset class, that provision will override the contrary UPMIFA rule. But to the extent a gift instrument is silent or ambiguous about a particular matter, UPMIFA fills the gaps.

How should fiduciaries effectively incorporate UPMIFA into their governance structures?

Fiduciaries should become familiar with UPMIFA's general terms and the variations that some states have made, so they can take advantage of the guidance and protection this comprehensive law offers. This includes taking charge over the decisions that they are able to handle, and delegating all other decisions to the right people, whether internal or external. We recommend that fiduciaries consider partnering with an external investment service provider that has the portfolio management capabilities and legal expertise to help them effectively manage their investment programs.

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[1] UPMIFA applies to most funds held by a charitable institution for charitable purposes (which it calls "institutional funds"), regardless of when the fund was created, unless the written instrument creating the fund sets out different rules. UPMIFA does not apply to assets that a charity uses directly in its charitable activities, nor does it apply to funds held by non-charities or funds in which a non-charitable beneficiary has an interest.

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