

# Non-Profit Institutions Advisory: Massachusetts Enacts the Uniform Prudent Management of Institutional Funds Act

7/29/2009

Governor Deval Patrick signed into law the Uniform Prudent Management of Institutional Funds Act (UPMIFA) earlier this month. UPMIFA applies to both existing institutional funds, as well as those established after June 30, 2009. Our [Client Advisory dated June 4, 2009](#) discusses in detail the full import of this fundamental change to Massachusetts law affecting charitable organizations. Today's Advisory outlines certain key provisions of Massachusetts UPMIFA, while noting certain important changes between the proposed legislation we reported about in our earlier Advisory<sup>1</sup> and the law, as enacted.

## Overview

UPMIFA replaces Massachusetts' long-standing Uniform Management of Institutional Funds Act, commonly referred to as UMIFA, which was enacted in 1975. UPMIFA provides additional flexibility and much-needed clarity to charitable organizations with respect to the manner with which they deal with their endowment funds. One key change enables charities to spend from the principal of an endowment fund upon a good faith determination that such spending is prudent in light of the use, benefit, purpose and duration for which the fund was established. This is a departure from prior Massachusetts law which constrained a charity to spend only the "net appreciation" of endowment assets over historic dollar value, and prohibited an organization from spending endowment principal. It is anticipated that this change alone will have a significant impact on charities that previously were prevented from making necessary expenditures whenever their endowment funds had little or no net appreciation over historic dollar value.

UPMIFA applies to "institutional funds" held by and used for the benefit of any type of entity established for religious, educational, or charitable purposes, including certain governmental agencies, funds held by a trustee for a charitable community trust, and split-interest trusts existing after all non-charitable interests have terminated.<sup>2</sup> UPMIFA does not apply to funds established for charitable purposes held by individual trustees or commercial trustees, such as banks or trust companies, even if the sole beneficiary is a charity.

The statute provides that a donor's intent, as set forth in a gift instrument defining the terms of the gift, is controlling and takes precedence over the statute. UPMIFA includes an important rule concerning how the words in a gift instrument are to be construed. While a gift instrument that designates a gift as an "endowment," or which directs that only "income," "interest," or "dividends" be used, or which directs the charity to "preserve the principal intact" (or words of similar import) will be construed to create an endowment fund of permanent duration, such

words do not, in and of themselves, limit a charity's ability to spend the gift. The result of this UPMIFA provision is that language in a gift instrument, unless it provides explicit direction with respect to a charity's spending and accumulation policy, will not affect the governing's discretion to spend or accumulate in accordance with the standards set forth in the statute.<sup>3</sup> In other words, because a charity now has the discretion to spend from the assets of its endowment, donors will need to exercise care in detailing their intentions in the gift instrument in clear and precise terms that the charity should be restricted from spending principal.

## Rules Impacting Spending or Accumulation of Endowment Funds

UPMIFA replaces UMIFA rules applicable to the spending of endowment assets which (1) required that a charity spend only the amount of appreciation above "historic dollar value," or HDV, of the endowment fund, subject to certain limitations,<sup>4</sup> and (2) created a rebuttable presumption of imprudence where a charitable organization appropriated net **appreciation** for spending in any year in an amount which was more than 7% of the 12-quarter average fair market value of the endowment fund. UPMIFA replaces these concepts with guidelines intended to enhance a governing board's flexibility by allowing it to accumulate or spend as much of an endowment fund as it deems prudent,<sup>5</sup> provided the organization acts in good faith and with due care. The following factors are intended to guide that determination:

1. the duration and preservation of the endowment fund;
2. the purposes of the organization 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 organization; and
7. the investment policy of the organization.

There is no rebuttable presumption of what is an "acceptable" level of expenditure. Rather, a governing board will have to make a determination on a fund-specific basis, guided by the preceding statutory directives, as well as its own investment policy. A governing board should work with counsel and an investment advisor to develop such a policy.

## Rules Impacting Investment Decision-Making

UPMIFA establishes a prudence standard for members of a governing board which, if followed, is intended to protect directors and trustees from liability. UPMIFA requires each person responsible for managing and investing an institutional fund to act "in good faith and with the care an ordinarily prudent person in like position would exercise under similar circumstances."

In addition to acting prudently and in good faith, UPMIFA directs a governing board to consider the purposes of the organization **and** the purposes of the institutional fund, and to make "a reasonable effort to verify facts relevant to the management and investment of the fund." It

further directs that an organization 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.” Finally, the final version enacted in Massachusetts includes a provision requiring that the board allocate such costs “on a reasonable basis to each institutional fund prior to any appropriation.” In other words, the duty to conduct a diligence investigation, the duty to minimize and properly allocate investment expenses, and adherence to the duty of care are explicitly required by UPMIFA.

To guide the governing board of a charity in the management and investment of an institutional fund, UPMIFA provides a specified list of factors that, if relevant, “must” be considered in the exercise of prudence.<sup>6</sup> In addition to considering both the purposes of the organization and the purposes of the institutional fund, the other factors that must be considered in the prudent management and investment of a fund are:

- general economic conditions;
- the possible effect of inflation or deflation;
- expected tax consequences, if any;
- 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 organization;
- the needs of the organization and the fund to make distributions and to preserve capital; and
- an asset’s special relationship or value, if any, to the charitable purposes of the organization.

## Modernization of Investment Practices

UPMIFA requires directors, trustees, and others responsible for managing and investing a charity’s funds to use a modern portfolio theory approach to making investments and considering the risk and return objectives of an institutional fund, including diversification of an organization’s investments, unless special circumstances exist that would make diversification unreasonable. It also requires any person involved in managing and investing a charity’s institutional funds who has special skills or expertise (or who is selected in reliance upon his or her representation that he or she has special skills or expertise) to use those skills in managing and investing the charity’s funds.

## Delegation of Management/Investment Authority

UPMIFA authorizes an organization to delegate investment functions relating to institutional funds to employees, officers or committees of the organization and to external agents. An organization is required to act prudently when selecting the agent, establishing the terms of delegation, and reviewing compliance. In addition, the agent accepting the delegation is bound to exercise reasonable care in complying with the scope and terms of the delegation. This obligation is bolstered by the statutory declaration that, by accepting such delegation of authority, the agent agrees to submit itself to the jurisdiction of the courts of the Commonwealth in all proceedings arising from or related to the delegation of authority.

## Modification and Release of Donor Restrictions

UPMIFA permits a donor to modify or release a restriction imposed on the management, investment, duration, or purpose of an institutional fund contained in a gift instrument.<sup>7</sup> Alternatively, a charity may seek to modify or release a gift restriction imposed on the management, investment, or duration of an institutional fund by seeking a court order. UPMIFA provides that a court may enter such a modification order when:

- the restriction has become impracticable, wasteful, impairs the management of a fund or, if due to circumstances not anticipated by a donor, modifying the restriction will further the purposes of the fund; or
- a restriction or charitable purpose in a gift instrument becomes unlawful, impracticable, impossible to achieve, or wasteful.

UPMIFA, as enacted, provides that the Massachusetts Attorney General must be made a party to the charitable organization's application and, thereby, to the proceeding in which the charity seeks a modification or the elimination of a gift restriction.<sup>8</sup>

Finally, UPMIFA includes a provision that enables the Massachusetts Supreme Judicial Court to authorize the Attorney General to approve certain applications by charities that seek to modify a restriction contained in a gift instrument (as described above), without the need for a judicial proceeding. The Supreme Judicial Court, by rule or order, may authorize the Attorney General to approve modifications to gift restrictions when the value of the fund is not greater "than such amount as the [Supreme Judicial] Court may provide or in such other situations as the Court may provide." To our knowledge, the Supreme Judicial Court has not yet delegated this authority to the Attorney General with respect to these smaller institutional funds.<sup>9</sup>

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While donors may expect the principal amount of their gifts to charitable organizations to be held permanently, given the current and forecasted economic environment, the Massachusetts non-profit community has welcomed the enactment of UPMIFA. UPMIFA will permit Massachusetts charities to exercise greater flexibility and discretion in appropriating expenditures from endowment funds, in delegating authority to internal and external parties, and in modifying gift restrictions imposed by donors. It also provides parameters for what constitutes the exercise of prudence by governing boards of these organizations, such that their management and investment decision-making can be accomplished in a manner that shields them from liability. Working with counsel and investment advisors to develop and implement a comprehensive investment policy—covering issues such as investment goals, spending policies and procedures for delegating investment authority, and documenting adherence with the policy—are important considerations under this statute, and should be carefully considered.

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## Endnotes

<sup>1</sup> The initial draft of the UPMIFA legislation was designated as Senate Bill 1783. UPMIFA, as enacted, was designated as Senate Bill 2078, and it replaced Massachusetts General Laws Chapter 180A, which was Massachusetts' Uniform Management of Institutional Funds Act.

<sup>2</sup> "Institutional funds" are those funds that an organization may spend currently together with its endowment funds, which are the portion of its institutional funds held for investment due to restrictions imposed by donors. Therefore, "institutional funds" subject to restrictions imposed by the governing board of an organization are not "endowment funds" because the governing body has the discretion to remove such self-imposed restrictions. Further, UPMIFA does not apply to "program related assets," meaning those assets held to accomplish charitable purposes rather than for investment.

<sup>3</sup> The National Conference of Commissioners on Uniform State Laws indicated in their commentary to the model UPMIFA that, under this provision, a gift instrument that provides that the organization may "pay only the income" will not be specific enough to override the statute. However, an instruction to "pay only interest and dividend income earned by the fund and to not make other distributions of the kind authorized by UPMIFA" (relating to delegation of management and investment functions) would trump the statute.

<sup>4</sup> HDV is the value of contributions made to an endowment fund without taking into consideration any subsequent appreciation or depreciation resulting from investment results, inflation or other causes.

<sup>5</sup> Interestingly, the enacted version of UPMIFA does *not* include the 7% limitation on the ability to spend endowment assets that was included in Senate Bill 1783, as proposed. Specifically, expenditures in any year of more than 7% of the fair market value of an endowment fund, determined on a quarterly basis over a period of three years, will *not* result in a rebuttable presumption of imprudence under UPMIFA, as enacted.

<sup>6</sup> If a factor is not relevant, the minutes of the governing body of the organization, or its investment or other committee, should document why the factor is not relevant.

<sup>7</sup> Of course, a donor is not allowed to instruct an organization to use a gift for a purpose that is not one of the charitable purposes of the charity.

<sup>8</sup> In our Client Advisory dated June 4, 2009, we noted that proposed Senate Bill 1783 required any charity seeking judicial modification of a gift restriction to merely notify the Massachusetts Attorney General and afford her an opportunity to be heard. The enacted version of the law gives the Attorney General a more pronounced role in the process by requiring that she be made a party to the proceeding.

<sup>9</sup> As we noted in our previous Client Advisory, proposed Senate Bill 1783 provided that a charity could, under certain circumstances, release or modify a donor-imposed restriction on small

institutional funds (less than \$25,000) that had been in existence for more than 20 years. This language was eliminated from the enacted legislation.

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*For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.*

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