UPMIFA and Private Foundations

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For many years, the Uniform Management of Institutional Funds Act (“UMIFA”) has provided standards for managing, investing, and expending funds held by nonprofit institutions. UMIFA was first promulgated in 1972, and it was thereafter adopted, with some variations, in 47 states and the District of Columbia. In recent years, however, there has been some concern that UMIFA does not address certain current issues, and thus, the National Conference of Commissioners on Uniform State Laws undertook a project to modernize the act. The product of its efforts, the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”), was finalized in July 2006 and has now been adopted in nearly half the states.

Do Southeastern Foundations Need to Address UPMIFA?

UPMIFA is quickly becoming the law across the country, and, unlike UMIFA, which did not apply to private foundations in many states, UPMIFA does apply to most private foundations. There is an exception, however, for private foundations that are organized as charitable trusts and that have individual trustees or an institutional trustee other than a charity. Such trusts are instead governed by trust law (including the Uniform Prudent Investor Act, where adopted). However, all other private foundations, specifically including those organized as nonprofit corporations, need to be aware of the law and either react (or prepare to react) to its changes.

What States Have Adopted UPMIFA to Date?

UPMIFA has now been adopted in 24 states and the District of Columbia and soon likely will be adopted in a number of additional states. By this time next year, it is conceivable that UPMIFA will be the law in 40 or more states. In the Southeast, UPMIFA has already been adopted by Alabama (effective January 1, 2009), Georgia (effective July 1, 2008), South Carolina (effective July 1, 2008), Tennessee (effective July 1, 2007), and Virginia (effective July 1, 2008). Mississippi, bucking the trend, rejected UPMIFA this year when it allowed a bill to adopt UPMIFA to die on adjournment.

What Are UPMIFA’s Highlights?

UPMIFA provides new standards for investing the funds held by charitable organizations, imposes new duties on those responsible for managing and investing charitable funds, and modernizes the rules governing expenditures of endowment funds.

What Does UPMIFA Allow Regarding the Expenditure of Endowment Assets?

The most significant change made by UPMIFA is its elimination of the “historic dollar value” limitation on expenditures from endowment funds. Under UMIFA, while net appreciation could be spent, the “historic dollar value” of an endowment had to be preserved. Institutions are no longer limited in their ability to spend from “underwater” endowment funds (i.e., those with assets having current values less than when they were given). Under the new law, an institution may spend as much as it deems “prudent” (subject to donor intent). With the current decline in the values of securities, real estate, and other investment assets, this will be a welcome change for many institutions with endowments.

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What Should Private Foundations Do to Address the Endowment Spending Rules?

Governing boards should promptly determine whether they have any “endowment” funds (as defined in the new law), decide whether their expenditure policies comply with the new requirements, and document their conclusions. For purposes of UPMIFA, an endowment fund is defined as an institutional fund (or any part thereof) that, under the terms of a gift instrument, is “not wholly expendable by the institution on a current basis.” It does not, however, include assets that an institution designates as an endowment fund for its own use.

Are All of a Private Foundation’s Assets Potentially Subject to the Endowment Spending Rules?

Given the broad definition of “endowment” in UPMIFA (i.e., any fund or part of a fund “not wholly expendable by the institution on a current basis”), a question arises whether grant-making private foundations must generally comply with the endowment expenditure rules. Since private foundations are usually established to exist in perpetuity, it could be argued that grantors to such perpetual foundations also intend their gifts not to be “wholly expendable by the institution on a current basis” (thus making them “endowments”).

If a private foundation wishes to have the option to expend funds at a more rapid rate than might be deemed “prudent” for an endowment, it is important to avoid any implication that the foundation is an endowment. Private foundations, therefore, should consider making it clear in their organizational documents that, unless explicitly provided otherwise in writing by a testator or donor, gifts or contributions made to them will not be an “endowment,” as that term is defined in UPMIFA, and thus, that the foundation’s expenditure or accumulation of such a gift or contribution will not be subject to the endowment expenditure restrictions set forth in UPMIFA.

How Does UPMIFA Change the Rules Regarding the Investment and Management of Assets?

UPMIFA modernizes the rules governing investments of funds held for charitable purposes by adopting a more well-defined prudent-investor standard. While the prior law generally provided that “ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision” should govern investment decisions, it offered little additional guidance on what exactly that required. UPMIFA now directs that investments be made “in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances, considering the purposes, terms, distribution requirements, and other circumstances of the institutional fund,” and it lists a number of explicit factors that managers must consider “if relevant.” UPMIFA also explicitly provides that institutions may invest in any kind of property or type of investment so long as the investment is prudent.

One of the most interesting questions involved in the adoption of this prudent-investor standard has been to what extent such a standard requires institutions to diversify their holdings. The drafters of UPMIFA decided that diversification should be required unless “special circumstances” suggest the purposes of the fund would be better served without diversification, and in Alabama, South Carolina, Tennessee, and Virginia, this is the law. In Georgia, however, as UPMIFA was evaluated, few were enamored with that imprecise language. Georgia therefore adopted a unique provision. Under Georgia’s version of UPMIFA, diversifying the investments of an institutional fund or utilizing some “other appropriate mechanism” is required to manage the risks inherent in concentrated holdings of assets, unless an institution “reasonably determines that, because of special circumstances, or because of the specific purposes, terms, distribution requirements, and other circumstances of the institutional fund, the purposes of such
Do Private Foundations Need to Update Their Investment Policies?

Almost every institution covered by the new law will need to revise its formal investment policy to “track” the UPMIFA language as adopted in its state. UPMIFA includes a list of important factors that an institution must consider in making investment decisions. These include:

- Subject to donor intent, making all investment decisions in the context of the specific charitable purposes of the institution and the purposes of the fund being invested.
- Complying with the duty of loyalty imposed by state law (e.g., not using the investments to further personal interests).
- Acting in good faith, with the care an ordinarily prudent person in a like position would exercise in similar circumstances. (Note that any person who has “special skills or expertise,” or is selected in reliance upon the person’s representation that he or she has such skills, has an increased duty to use those skills or expertise in managing and investing an institution’s funds.)
- Making investment decisions with respect to an individual asset in the context of the institution’s overall portfolio and investment strategy.
- Making investment decisions in light of the following factors “if relevant”: general economic conditions; the possible effect of inflation or deflation; tax consequences; the role of each investment in relation to the overall investment portfolio; the expected total return from income and appreciation; other resources of the institution; the needs of the institution and the fund to make distributions and to preserve capital; and the relationship or value of an asset to the charitable purposes of the institution.

How Should Private Foundations Respond to the Diversification Requirement?

Governing boards should promptly consider and document their decisions regarding diversification. In Georgia, boards will need to address specifically the unique diversification requirement of Georgia law and carefully document the decisions they make on this issue.

How Does UPMIFA Address Investment Costs, and What Should Private Foundations Do in Response?

UPMIFA provides that an institution may only incur investment costs that are appropriate and reasonable in relation to the assets, the purposes of the institution and the assets, and the skills reasonably available to the institution. A private foundation’s board or investment committee, therefore, should promptly review its investment costs to ascertain that they are appropriate and reasonable. Depending on the circumstances, consideration might be given to conducting surveys or perhaps obtaining competitive bids. The conclusion reached should be documented, including a specific statement of the general investment policy found appropriate.

How Does UPMIFA Address Investment Managers, and What Should Private Foundations Do in Response?

While prior law allowed for delegation without specific standards, UPMIFA now requires that certain standards be followed when making decisions to delegate investment decisions to outside advisors or managers. These include prudence in selecting the advisor, establishing specific limitations on the scope and terms of the authority given to the investment manager, and periodic review and supervision of the investment manager. Governing boards, therefore, should review, confirm, and document any delegation.
decisions in terms of UPMIFA, establish specific time frames for subsequent periodic reviews, and
document the subsequent reviews.

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