



UPMIFA: Financial Implications

Presented by:
Leonard Cole, PretiFlaherty

Maine Association of Nonprofits
Nonprofit Finance Conference, Nov. 9, 2010

© 2009 All materials are proprietary.

PretiFlaherty

AGENDA

- UPMIFA Basics
- UPMIFA Over the Life of an Endowment Fund
- Q&A

© 2007 All materials are proprietary.

PretiFlaherty

2

What is UPMIFA?

Uniform Prudent Management of Institutional Funds Act

UPMIFA is a state statute that provides rules for

- **management and investment** of certain funds held by charitable institutions and
- **spending** of funds donated as “endowments”
- obtaining **relief from donor restrictions**

What is UPMIFA?

- Maine's UPMIFA applies to decisions made and actions taken after July 1, 2009, with respect to all institutional funds, including those established prior to July 1, 2009.
- UPMIFA has been enacted by 47 states – all except Florida, Mississippi and Pennsylvania.
- UPMIFA replaces UMIFA – Uniform Management of Institutional Funds Act

Scope of UPMIFA

UPMIFA governs the management, investment, and expenditure of *institutional funds* . . .

. . . absent explicit donor instructions.

INSTITUTIONAL FUND

Institutional fund – A fund held by an *institution* exclusively for *charitable purposes*

but not:

- program-related assets
- funds held by an individual or for-profit corporation
- split-interest trusts

INSTITUTIONAL FUND – Institution

“**Institution**” includes

- corporations,
- trusts,
- LLCs,
- unincorporated associations,
- certain governmental entities, etc.

INSTITUTIONAL FUND – Charitable Purposes

“**Charitable purpose**” means

- the relief of poverty,
- the advancement of education or religion,
- the promotion of health,
- the promotion of a governmental purpose or
- ***any other purpose the achievement of which is beneficial to the community.***

ENDOWMENT FUND

Endowment fund – An institutional fund (or part thereof) that, under the terms of a **gift instrument**, is not wholly expendable on a current basis.

- “retain principal and spend income”
- “hold the fund as an endowment”
- An endowment fund is **donor restricted**.
- Board-restricted funds (a/k/a “quasi-endowments”) are **not** endowment funds.

ENDOWMENT FUND – Gift instrument

Gift instrument – A record or records under which property is granted to, transferred to, or held by an institution as an institutional fund.

- Is evidence of donor-imposed restrictions and the institution’s acceptance of those restrictions.
- Includes any record the donor and institution were or should have been aware of at the time of the gift.

ENDOWMENT FUND – Gift instrument

Examples:

- written agreement
- note on a check
- written or email correspondence
- will
- solicitation materials or ad
- bylaws

ENDOWMENT FUND – Gift instrument

- Can contain specific instructions regarding
 - Timing of expenditure (e.g., endowment restriction)
 - Investment of fund assets
 - Purpose for which fund assets may be spent
- Can opt out of many UPMIFA default rules

THE LIFECYCLE OF AN ENDOWMENT FUND

- Creation
- Investment
- Delegation & Oversight
- Spending
- Amending
- Reporting

Endowment Fund Lifecycle: **CREATION**

- Gift Instrument: Keep on file.
- Tracking
 - Each fund must be tracked separately based on its particular donor-imposed restrictions or, for some purposes, pooled with other funds having identical restrictions.
 - Must track “historic dollar value” (More on this later.)
- Gift Acceptance Policy
 - Consider administrative burden of tracking each unique endowment fund separately.

Endowment Fund Lifecycle: INVESTMENT

- Fiduciary duties:
 - loyalty
 - good faith
 - with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- **Special skills or expertise must be used**
- Compliance with UPMIFA is determined in light of the facts and circumstances existing at the time a decision is made or action is taken and not by hindsight.

Endowment Fund Lifecycle: INVESTMENT

- Decisions about an individual asset must be made in the context of the fund's entire portfolio, under an investment strategy having risk and return objectives reasonably suited to the fund and the institution.
- May generally invest in any kind of property
- Must diversify the investments of a fund "unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification."
 - Must make and act on decisions regarding donated property within a reasonable time after it is received.

Endowment Fund Lifecycle: INVESTMENT

- Costs must be appropriate and reasonable in relation to
 - the assets
 - the purposes of the institution, and
 - the skills available to the institution.
- Can pool funds for management and investment purposes (but not all purposes)
- Must consider the charitable purposes of the institution and the fund.

Endowment Fund Lifecycle: INVESTMENT

- Factors – the following, if relevant, must be considered when making investment decisions:
 - General economic conditions
 - Inflation or deflation
 - 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 appreciation
 - 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.
- Inclusion in investment policy

Endowment Fund Lifecycle: **Delegation/Oversight**

- Can delegate to an “external agent” if prudent
- Institution is not liable for agent’s decisions or actions if its board and officers acted in good faith and with due care (prudent person) in
 - selecting the agent
 - establishing the scope and terms of the delegation
 - periodically reviewing the agent's actions to monitor performance
- Agent owes a duty to the institution to exercise reasonable care and is subject to ME jurisdiction

Endowment Fund Lifecycle: **SPENDING**

- Prior law: UMIFA prohibited appropriation from an endowment fund that would cause the fund to fall below (or further below) its “historic dollar value.”

Endowment Fund Lifecycle: **SPENDING**

- A fund's "historic dollar value" (HDV) is the aggregate of:
 - the initial donation that created the endowment fund,
 - each subsequent donation to the fund, and
 - each accumulation added to "principal" as required by the gift instrument.
- a/k/a "original corpus" or "endowment principal"

Endowment Fund Lifecycle: **SPENDING**

- UPMIFA:
 - almost eliminates the concept of HDV (the Model Act eliminates HDV entirely) and
 - provides better guidance on the prudence standard

Endowment Fund Lifecycle: **SPENDING**

- “[A]n 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 Fund Lifecycle: **SPENDING**

- To limit the authority to appropriate or accumulate, a gift instrument must specifically state the limitation.
- The following will create a permanent endowment fund but will not otherwise limit the authority to appropriate for expenditure:
 - designation as an endowment
 - a direction to use only “income,” “interest,” “dividends” or “rents, issues or profits,” or “to preserve the principal intact” or words of similar import.

Endowment Fund Lifecycle: SPENDING

- Maine quirk – Attorney General notification:
 - If total value of endowment funds is less than \$2,000,000, must notify the AG at least 60 days before appropriating an amount that would cause the value of the total endowment fund value to fall below their total historic dollar value. The AG may require the institution to obtain court approval for the proposed expenditure.
 - An institution administering endowment funds with an aggregate value of \$2,000,000 or more must notify the AG “upon its adoption of the provisions” of UPMIFA.

Endowment Fund Lifecycle: SPENDING

- Factors – the following, if relevant, must be considered in making a determination to appropriate:
 - the duration and preservation of the endowment fund,
 - the purposes of the institution and the endowment fund,
 - 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, and
 - the investment policy of the institution.
- Inclusion in spending policy

Endowment Fund Lifecycle: **SPENDING**

- Rebuttable presumption of imprudence:

Appropriation in any year of more than 7% of an endowment fund's *fair market value* creates a rebuttable presumption of imprudence.

- Fair market value is the average value, determined at least quarterly, over a period of at least 3 years immediately preceding the year of the appropriation.

Endowment Fund Lifecycle: **SPENDING**

- Compliance with all UPMIFA provisions is determined in light of the facts and circumstances existing at the time a decision is made or action is taken and not by hindsight.

Endowment Fund Lifecycle: **AMENDING**

UPMIFA provisions for release or modification of donor restrictions

- Applicable to all donor restrictions – not just endowment restriction
- 4 methods:
 - Donor consent
 - Equitable deviation
 - *Cy pres*
 - Streamlined process for small, old funds

Endowment Fund Lifecycle: **AMENDING**

- **Donor consent:** If the donor consents in writing, an institution may release or modify, in whole or in part, a restriction on the management, investment or purpose of an institutional fund.
 - Need a living individual or existing entity

Endowment Fund Lifecycle: **AMENDING**

- **Equitable deviation:** A court may modify a restriction regarding the management or investment of an institutional fund if
 - the restriction has become impracticable or wasteful,
 - if it impairs the management or investment of the fund or
 - if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund.
- AG must be notified and given an opportunity to be heard.

Endowment Fund Lifecycle: **AMENDING**

- **Cy pres:** If a restriction on the purpose or use of an institutional fund becomes unlawful, impracticable, impossible to achieve or wasteful, a court may modify the restriction.
- AG must be notified and given an opportunity to be heard.

Endowment Fund Lifecycle: **AMENDING**

- **Streamlined process for small, old funds:** If an institution determines that a restriction on the management, investment or purpose of an institutional fund is unlawful, impracticable, impossible to achieve or wasteful, it may release or modify the restriction, in whole or part, 60 days after notifying the AG if the AG does not object and if:
 - The fund has a total value of less than \$25,000 (threshold will be adjusted for inflation),
 - More than 20 years have elapsed since the fund was established, and
 - The institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument.

Endowment Fund Lifecycle: **REPORTING**

- Basic accounting and disclosure under FAS 117-1.
 - Net Asset classification
 - Permanently Restricted
 - Temporarily Restricted
 - Unrestricted
 - What is Permanently Restricted under UPMIFA?
 - “Enhanced Disclosures”
 - Board’s interpretation of UPMIFA re net asset classification
 - Description of appropriation and investment policies
 - Breakdown of investment returns, contributions, and appropriations

Questions?

Leonard Cole
lcole@preti.com
(207) 791-3223

