

Good News for Massachusetts Endowments: Enactment of UPMIFA

Help has arrived for the many Massachusetts nonprofit organizations facing sharply reduced investment portfolios and “underwater” endowment funds—funds whose current market values have declined below their original values. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) was signed into law in Massachusetts on July 2, 2009. The new law ([MA UPMIFA](#)) provides greater flexibility than its predecessor, the Uniform Management of Institutional Funds Act (UMIFA), for organizations that wish (or need) to spend from underwater endowment funds and includes several other important changes. By enacting the statute, Massachusetts joins 39 states and the District of Columbia in adopting some version of UPMIFA. MA UPMIFA is effective June 30, 2009.

Spending from Underwater Endowment Funds in Massachusetts

Under prior law (UMIFA), a charity could spend appreciation from an endowment fund that exceeded the fund’s “historic dollar value”—the aggregate value of all contributions to an endowment fund at the time they were made—to the extent the charity deemed prudent. A rebuttable presumption of imprudence, however, was created if the charity spent more than 7% of the average fair market value of the institution’s endowment funds in any year. Under UMIFA, a charity with an underwater endowment fund could distribute only current income (e.g., dividends and interest) from the fund; it could not spend below the fund’s historic dollar value. The historic dollar value limitation has proven to be administratively and economically burdensome for organizations, particularly when a new endowment fund is created shortly before or during a downturn in the economy and then falls below historic dollar value because of investment performance.

Under MA UPMIFA, Massachusetts charities are no longer restricted by historic dollar value. Instead, subject to the donor’s intent as expressed in a gift agreement or similar document, a charity can spend the amount it deems prudent—even from an underwater fund—after considering the following factors:

- 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.

MA UPMIFA also eliminates the presumption of imprudence for spending in excess of 7% of the average fair market value of an institution’s endowment funds, described above.

Bear in mind that MA UPMIFA is a default rule governing in the absence of explicit donor restrictions. A charity will not be permitted to use the MA UPMIFA endowment spending provision if an endowment fund is governed by a gift instrument that specifically limits how the charity may spend from the fund. MA UPMIFA provides, however, that terms in a gift instrument that designate a gift as an endowment, or a donor's directive to use only "income," "interest," "dividends," "rents, issues or profits," or "to preserve the principal intact," or use of similar terminology does not, standing alone, limit the charity's ability to make expenditures it deems prudent applying the factors described above. It is important to note that MA UPMIFA contains wording added to the model statute at the suggestion of the Attorney General's office, which could be interpreted to limit the ability of a charity to spend from an endowment fund when the gift instrument contains language, other than the designated terms listed above, that arguably limits expenditure.

Despite the welcome flexibility provided by MA UPMIFA, boards will still need to be careful when deciding to spend from an underwater fund since there are, as yet, few rules or even conventions as to how boards are expected to make this decision. In making such spending decisions, fiduciaries must act "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." As a general matter, we recommend that Massachusetts charities consider taking the following steps before spending from underwater endowment funds:

- Review gift agreements for any provisions that would override the MA UPMIFA rule permitting expenditures of more than current income from underwater funds. For example, a fund formed by a gift instrument that provides that the organization can spend only 4% per year from the fund or that the institution may not spend below the historic dollar value of the fund will be governed by that restriction and is not susceptible to the discretionary prudent spending analysis specified by MA UPMIFA. However, a fund formed by a gift instrument that states simply that the organization should "hold the fund as an endowment" is entitled to rely on MA UPMIFA's expenditure provisions.
- Review and revise endowment spending policies to refer to the prudent expenditure factors listed above.
- Document in minutes of the meeting of the governing board or relevant committee its consideration of the factors listed above.

Massachusetts charities should also be aware that in response to the rapid and widespread adoption of UPMIFA, the Financial Accounting Standards Board recently released guidance ([FASB Staff Position FAS No. 117-1](#)) providing financial statement reporting rules for endowments affected by UPMIFA. The new accounting rules may significantly affect the way in which expenditures from underwater funds will be disclosed for financial statement purposes and may be important to consider as organizations deliberate regarding endowment spending. Further information about UPMIFA's interaction with FASB Staff Position FAS No. 117-1 is available at [Ropes & Gray LLP: News & Publications: Underwater Endowment Funds: Legal and Accounting Considerations](#).

Release or Modification of Donor Restrictions

As under UMIFA, a Massachusetts charity may obtain release from, or modification of, restrictions on a gift by obtaining either the written consent of the donor or a court order. MA UPMIFA clarifies that the court can modify a restriction regarding management, investment or duration of a charitable fund, but, to the extent practicable, the modification must be in accordance with the donor's probable intent. The court can modify the purpose of the fund or a restriction on its use consistent with the charitable purposes expressed in the gift instrument. In either case, the Attorney General must be made a party to the application and resulting proceeding. This gives the Attorney General's office a more prominent role in the process than it had under the prior law, which required only that the Attorney General be notified and given an opportunity to be heard.

MA UPMIFA does not include a provision in the model statute permitting a charity to change or release restrictions on old, small funds after giving notice to the state attorney general. However, MA UPMIFA gives the Supreme Judicial Court authority to provide by rule or order that any release or modification that would otherwise be subject to court approval may be approved instead by the Attorney General if the fund meets certain conditions (such as valuation below a pre-determined amount). This leaves open the possibility that the Supreme Judicial Court could streamline the modification process for certain types of funds.

Investment Standards

MA UPMIFA updates investment standards for charitable funds held by charities (whether “endowments funds” or not) by incorporating elements of current trust and corporate law on the theory that the standards for management and investment of charitable funds should be the same for charitable trusts and nonprofit corporations. As noted above, fiduciaries must manage and invest the fund “in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” The statute identifies the following factors that should guide fiduciaries in making investment decisions:

- general economic conditions;
- possible effect of inflation or deflation;
- expected tax consequences of investment decisions;
- the role of each investment in the whole portfolio;
- the expected total return from income and 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 special value, if any, to the charitable purposes of the organization.

Building on UMIFA, which implemented modern concepts of portfolio management, MA UPMIFA requires that decisions about an individual asset be made not in isolation, but in the context of the charity’s portfolio of investments as a whole. Consistent with this approach, MA UPMIFA adds an explicit duty to diversify investments unless the charity reasonably determines, because of special circumstances, that the purposes of the fund are better served without diversification. Compliance with MA UPMIFA is determined in light of the facts and circumstances existing at the time a decision is made or an action is taken and not “by hindsight.”

A standard of prudence also applies to any delegation of management and investment responsibilities for charitable funds, and includes a duty to periodically review the agent’s performance and compliance with the terms of the delegation.

While UMIFA did not address endowment management costs, MA UPMIFA requires that in managing and investing a charitable fund an organization “may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution.” MA UPMIFA also adds a requirement not found in the model statute that, except as otherwise provided by the donor, endowment management costs must be allocated on a reasonable basis to each fund before any appropriation is made from it.

Application of MA UPMIFA

Both MA UPMIFA and the statute it replaces define the term “endowment fund” as a fund that under the terms of the gift instrument is “not wholly expendable by the institution on a current basis.” The new law clarifies that the term “endowment”

does not include assets that an institution itself designates as an endowment fund for its own use (i.e., board-restricted, or “quasi,” endowment funds).

MA UPMIFA applies to incorporated and unincorporated organizations organized and operated exclusively for charitable purposes, including trusts with charitable trustees, and governmental organizations to the extent they hold funds exclusively for charitable purposes. It does not apply to funds established for charitable purposes but held by other types of organizations. The new law extends its reach to charitable community trusts. In addition, charitable remainder trusts are covered by MA UPMIFA after non-charitable interests have terminated. Many private foundations, however, will not be subject to MA UPMIFA.

Effective Date

MA UPMIFA applies to all endowment funds and other funds held by organizations for charitable purposes that were in existence on or established after June 30, 2009. As applied to funds existing on June 30, 2009, MA UPMIFA governs only decisions made or actions taken on or after that date.

If you have any questions about underwater endowments or MA UPMIFA, please contact your usual Ropes & Gray attorney.

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