

# HOUSE BILL REPORT

## SHB 1119

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### As Amended by the Senate

**Title:** An act relating to the management of funds held by nonprofit institutions.

**Brief Description:** Concerning the management of funds held by nonprofit institutions.

**Sponsors:** House Committee on Judiciary (originally sponsored by Representatives Pedersen, Rodne, Goodman and Kelley; by request of Uniform Legislation Commission).

#### **Brief History:**

##### **Committee Activity:**

Judiciary: 1/21/09, 1/22/09 [DPS].

##### **Floor Activity**

Passed House: 2/23/09, 96-0.

Senate Amended.

Passed Senate: 4/8/09, 45-0.

Senate Amended.

Passed Senate: 4/22/09, 49-0.

#### **Brief Summary of Substitute Bill**

- Adopts the Uniform Prudent Management of Institutional Funds Act, which updates and expands the standards that govern the management, investment, and expenditure of funds held by charitable institutions.

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### HOUSE COMMITTEE ON JUDICIARY

**Staff:** Edie Adams (786-7180)

#### **Background:**

The Legislature adopted the Uniform Management of Institutional Funds Act (UMIFA) in 1973. The UMIFA provides guidelines for the management, investment, and expenditure of funds held by charitable institutions. The UMIFA applies to institutions that are organized and operated exclusively for educational, religious or charitable purposes, including governmental organizations if they hold funds exclusively for any of these purposes.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

The UMIFA establishes the standard of conduct that applies to an institution's decisions in managing institutional funds, making investment decisions, and authorizing expenditures from the fund. The institution must exercise ordinary business care and prudence, considering the long- and short-term needs of the institution, its present and anticipated financial requirements, expected total return on investments, price level trends, and general economic conditions.

The UMIFA provides specific investment authority for an institution, unless limited in a gift instrument, to invest in any type of property, retain property contributed by a donor, and invest institutional funds in a pooled or common fund. An institution may delegate the authority to make investment decisions to its committees or agents or to independent investment advisors.

The UMIFA allows an institution to spend as much of the net appreciation of an endowment fund over the historic dollar value of the fund as the institution deems prudent. Historic dollar value means the total of all contributions to the fund, with each contribution valued at the time it was made.

The UMIFA also contains procedures for removing restrictions in a gift instrument on the use or investment of the gift. A restriction in the gift instrument may be released either with the written consent of the donor, or through court order if the court finds that the restriction is obsolete, inappropriate, or impracticable, and the donor's consent cannot be obtained due to death, disability, or unavailability.

In 2006 the National Conference of Commissioners on Uniform State Laws approved a revised version of the UMIFA – the Uniform Prudent Management of Institutional Funds Act – to update the standards and guidelines that apply to managing, investing, and spending funds of charitable institutions.

### **Summary of Substitute Bill:**

The UMIFA is repealed and replaced with the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The UPMIFA establishes updated and more specific standards and guidelines for the management and investment of charitable funds and the expenditure of a charitable institution's endowment funds.

#### Standard of Conduct.

Decisions regarding management and investment of institutional funds and expenditures or accumulations of endowment funds must be made in good faith and with the care an ordinarily prudent person would use in similar circumstances.

#### Managing and Investing Institutional Funds.

An institution, in managing and investing an institutional fund, must consider the charitable purposes of the institution and the purposes of the institutional fund.

Additional rules are provided for the management and investment of institutional funds. The factors that must be considered in making investment decisions are expanded to include: tax consequences of investment decisions; the role each investment or course of action plays in the overall investment portfolio; other resources of the institution; and any special relationship or value of an asset to the charitable purposes of the institution. Decisions concerning an individual asset must be made not in isolation, but in the context of the overall investment strategy. The institution must diversify investments unless the purposes of the fund are better served without diversification.

A person with special skills or expertise has a duty to use the skills or expertise in managing and investing institutional funds.

#### Delegation of Management and Investment of Institutional Funds.

Standards for the delegation of management and investment decisions to an agent are provided. An institution must act in good faith with the care of a reasonably prudent person in selecting an agent, establishing the scope and objectives of the delegation, and periodically reviewing and supervising the agent. An agent has the duty to use reasonable care in managing and investing institutional funds. An institution that makes a delegation in conformance with the prudence standard is not liable for acts of the agent.

#### Expenditures or Accumulations of Endowment Funds.

The standard that applies to an institution's decisions about making expenditures from or allowing accumulations to an endowment fund is revised. An institution may make expenditures from or accumulate as much of the endowment fund as the institution determines is prudent for the uses, purposes, and duration for which the endowment fund is established. Seven factors are established in evaluating expenditure decisions.

#### Restrictions on Use or Investment of Institutional Funds.

The circumstances under which a court may modify a restriction in a gift instrument that is impracticable, wasteful, or impossible to achieve are expanded. Any modification must be consistent with the donor's probable intent and the charitable purposes expressed in the gift instrument.

An institution may release a restriction in a gift instrument without court approval if the fund subject to the restriction is more than 20 years old and has a value of less than \$75,000, as long as the institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument. The \$75,000 limitation is increased annually by \$2,500, beginning July 1, 2011.

The Attorney General must be provided notice of any proposed modification of a purpose or restriction in a gift instrument.

#### **EFFECT OF SENATE AMENDMENT(S):**

The Senate amendment includes an emergency clause and immediate effective date, but provides that the provisions of the act do not apply to existing institutional funds until July 1, 2009, unless an institution's governing body elects to apply the chapter to existing institutional funds before July 1, 2009.

**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) This bill is a uniform law proposed by the Washington Uniform Law Commission to replace the current act that is more than 35 years old. This bill could not be more timely. The nonprofit sector is suffering just as much as the government and private sectors from the traumatic declines in equity markets. Many institutions that depend on endowments are hampered in their ability to make the best use of their funds in these difficult times.

The bill has clearer and more modern standards regarding investment management and investment spending and will result in more accountability. Charitable institutions will have more flexibility in spending from charitable endowments. The bill requires more focus on donor intent, allows more diversity in asset allocation, and allows charities to think in terms of total returns when they set how much they spend. The prudent investor standard is used broadly in the trust arena and has been the standard for charities under current law. However, this bill provides charities with more guidance in applying the prudent investor standard. It also provides an important process for dealing with old and small funds that cannot be managed cost-effectively.

(In support with concerns) There are a couple of concerns with the bill. The 7 percent bright line rule of imprudence is problematic and should be removed. Current market conditions are a great example of a time when it might be prudent to spend more than 7 percent of the endowment. The \$25,000 limit on funds that can be modified without court approval is too low. Most institutions have minimum endowment levels that are well above that amount. It would be helpful to raise that number and have it increase over time.

(Opposed) None.

**Persons Testifying:** (In support) Representative Pedersen, prime sponsor; and Marlin Appelwick, Washington Uniform Legislation Commission.

(With concerns) Violet Boyer, Independent Colleges of Washington; and Judy Peterson, University of Washington.

**Persons Signed In To Testify But Not Testifying:** None.