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BILL



ANALYSIS

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Senate Bills 411 and 412 (as introduced 3-31-09)
Sponsor: Senator Michael Switalski (S.B. 411)
Senator Wayne Kuipers (S.B. 412)
Committee: Judiciary

Date Completed: 3-31-09

CONTENT

Senate Bill 411 would enact the "Uniform Prudent Management of Institutional Funds Act" to do all of the following:

- Require an institution managing and investing an institutional fund to consider the institution's charitable purposes and the purposes of the fund.
- Establish a good faith and prudent person standard for each person responsible for managing and investing an institutional fund.
- Specify factors that would have to be considered, and rules that would apply, in the management and investment of an institutional fund.
- Allow an institution to appropriate for expenditure or accumulate amounts of an endowment fund that were prudent for its uses, benefits, purposes, and duration.
- Require an institution to consider specific factors in determining to appropriate or accumulate amounts in an endowment fund.
- Specify circumstances under which an institution could delegate the management and investment of an institution fund to an external agent.
- Specify conditions under which an institution could release or modify a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund.
- Require the Attorney General to be notified and given an opportunity to

be heard on the matter of releasing or modifying a restriction in a gift instrument.

- Outline provisions regarding compliance with, and the scope of, the Act.

The bill also would repeal the Uniform Management of Institutional Funds Act.

Senate Bill 412 would amend the Nonprofit Corporation Act to refer to the proposed Uniform Prudent Management of Institutions Funds Act rather than the current Uniform Management of Institutional Funds Act.

Senate Bill 412 is tie-barred to Senate Bill 411.

A detailed description of Senate Bill 411 follows.

"Institution", "Institutional Fund", & "Charitable Purpose"

Under the proposed Act, "institution" would mean any of the following:

- A person, other than an individual, organized and operated exclusively for charitable purposes.
- A government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose.
- A trust that had both charitable and noncharitable interest, after all noncharitable interest have terminated.

"Institutional fund" would mean a fund held by an institution exclusively for charitable purposes. It would not include any of the following:

- Program-related assets (those held by an institution primarily to accomplish a charitable purpose and not primarily for investment).
- A fund held for an institution by a trustee that is not an institution, unless the fund is held by the trustee as a component trust or fund of a community trust or foundation.
- A fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise on violation or failure of the purposes of the fund.

"Charitable purpose" would mean the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose whose achievement is beneficial to the community.

Managing & Investing Institutional Funds

Subject to the donor's intent expressed in a gift instrument, an institution managing and investing an institutional fund would have to consider the institution's charitable purposes and the purposes of the institutional fund. ("Gift instrument" would mean a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund.)

In addition to complying with the duty of loyalty imposed by law other than the proposed Act, each person responsible for managing and investing an institutional fund would have to manage and invest it in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. In managing and investing an institutional fund, both of the following would apply:

- An institution could incur only costs that were appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to it.
- An institution would have to make a reasonable effort to verify facts relevant to the management and investment of the fund.

An institution could pool two or more institutional funds for purposes of management and investment.

Except as otherwise provided by a gift instrument, in the management and investment of an institutional fund, the following factors, if relevant, would have to be considered:

- General economic conditions.
- The possible effect of inflation or deflation.
- The expected tax consequences, if any, of investment decisions or strategies.
- The role that each investment or course of action would play within the overall investment portfolio of the fund.
- The expected total return from income and the appreciation of investments.
- The institution's other resources.
- 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.

In addition, except as otherwise provided by a gift instrument, all of the rules described below would apply.

Management and investment decisions about an individual asset could be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution.

Except as otherwise provided by law other than the proposed Act, an institution could invest in any kind of property or type of investment consistent with Section 3 of the proposed Act (which specifies these management and investment requirements).

An institution would have to diversify the investments of its institutional fund unless the institution reasonably determined that, because of special circumstances, the purposes of the fund were better served without diversification.

Within a reasonable time after receiving property, an institution would have to make and carry out decisions concerning the retention or disposition of the property or to

rebalance a portfolio, in order to bring the institutional fund into compliance with the purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of the proposed Act.

A person who had special skills or expertise, or was selected in reliance upon his or her representation that he or she had special skills or expertise, would have the duty to use those skills or that expertise in managing and investing institutional funds.

Appropriation or Accumulation of Endowment Fund

Subject to the intent of a donor expressed in the gift instrument, an institution could appropriate for expenditure or accumulate so much of an endowment fund as the institution determined was prudent for the uses, benefits, purposes, and duration for which the endowment fund was established. ("Endowment fund" would mean an institutional fund or part of an institutional fund that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. It would not include assets that an institution designated as an endowment fund for its own use.)

Unless stated otherwise in the gift instrument, the assets in an endowment fund would be donor-restricted assets until appropriated for expenditure by the institution. In making a determination to appropriate or accumulate, the institution would have to act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and would have to consider, if relevant, all of 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.
- The institution's other resources.
- The institution's investment policy.

To limit the authority to appropriate for expenditure or accumulate, a gift instrument

would have to state the limitation specifically.

Terms in a gift instrument designating a gift as an endowment, or a direction or authorization in the gift instrument to use only "income", "interest", "dividends", "rests, issues, or profits", or "to preserve the principal intact", or words of similar import, would create an endowment fund of permanent duration unless other language in the gift instrument limited the duration or purpose of the fund, and would not otherwise limit the authority to appropriate for expenditure or accumulate.

Delegation of Management & Investment

Subject to any specific limitation set forth in a gift instrument or in a law other than the proposed Act, an institution could delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances. An institution would have to act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in doing any of the following:

- Selecting an agent.
- Establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund.
- Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

An institution that complied with those requirements would not be liable for the decisions or actions of an agent to which the function was delegated.

In performing a delegated function, an agent would owe a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.

By accepting a delegation of a management or investment function from an institution that was subject to Michigan law, an agent would submit to the jurisdiction of the courts of this State in all proceedings arising from or related to the delegation or the performance of the delegated function.

An institution also could delegate management and investment functions to its committees, officers, or employees as authorized by Michigan law other than the proposed Act.

Release or Modification of Donor Restriction

If the donor consented in a record, an institution could release or modify all or part of a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. A donor could give prior consent to an institution for release or modification of a restriction or charitable purpose in a gift instrument that also included a restriction or stated charitable purpose. A release or modification, however, could not allow a fund to be used for a purpose other than a charitable purpose of the institution.

On application of an institution, a court could modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction had become impracticable or wasteful; if it impaired the management or investment of the fund; or if, because of circumstances not anticipated by the donor, a modification of a restriction would further the purposes of the fund. The institution would have to notify the Attorney General of the application, and the Attorney General would have to be given an opportunity to be heard. To the extent practicable, any modification would have to be made in accordance with the donor's probable intention.

If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund became unlawful, impracticable, impossible to achieve, or wasteful, a court, upon application of an institution, could modify the purpose of the fund or the restriction on its use in a manner consistent with the charitable purposes expressed in the gift instrument. The institution would have to notify the Attorney General, who would have to be given an opportunity to be heard.

If an institution determined that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund was unlawful, impracticable, impossible to achieve, or wasteful, the institution could release or

modify all or part of the restriction 60 days after notifying the Attorney General, if all of the following applied:

- The institutional fund subject to the restriction had a total value of less than \$25,000.
- More than 20 years had elapsed since the fund was established.
- The institution used the property in a manner consistent with the charitable purposes expressed in the gift instrument.

This section of the proposed Act would not affect the right of an institution's governing body to exercise the power to modify restrictions contained in a gift instrument as conferred by the institution's governing instruments or by a gift instrument.

Compliance with & Scope of the Act

Compliance with the proposed Act would have to be determined in light of the facts and circumstances existing at the time a decision was made or action was taken and not by hindsight.

The Act would apply to institutional funds existing on or established after its effective date. As applied to institutional funds existing on that date, the proposed Act would govern only decisions made or actions taken on or after that date.

In applying and construing the proposed uniform Act, consideration would have to be given to the need to promote uniformity of the law with respect to its subject matter among states that enacted it.

The proposed Act specifies that it would apply only to matters included within the meaning of the terms "institution", "institutional fund", and "person", as defined in the Act. It would not apply to or affect the validity, construction, interpretation, effect, administration, or management of any other trust, estate, or applicable governing instrument.

The proposed Act specifies that it would modify, limit, and supersede the Electronic Signatures in the Global and National Commerce Act (15 USC 7001 to 7031), but would not modify, limit, or supersede 15 USC 7001(a) or authorize electronic delivery

of any of the notices described in 15 USC 7003(b).

(Section 7001(a) of that Federal statute provides that, with respect to any transaction in or affecting interstate or foreign commerce, both of the following apply:

- A signature, contract or other record relating to the transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form.
- A contract relating to the transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.

Section 7003(b) provides that Section 7001 of the Federal statute does not apply to court orders or notices or official court documents required to be executed in connection with court proceedings; any document required to accompany any transportation or handling of hazardous materials, pesticides, or other toxic or dangerous materials; or particular notices pertaining to utility service; actions under a credit agreement secured by, or a rental agreement for, a primary residence; health or life insurance or benefits; or product recall or failure.)

Repealer

The proposed Act would repeal the Uniform Management of Institutional Funds Act, which establishes guidelines for the management and use of investments held by eleemosynary institutions and funds.

MCL 450.2124 et al. (S.B. 412)

BACKGROUND

The National Conference of Commissioners on Uniform State Laws (NCCUSL), at its annual meeting in July 2006, approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and recommended it for enactment by the legislatures of the various states. According to the NCCUSL website, UPMIFA is designed to replace the existing Uniform Management of Institutional Funds Act (UMIFA), which was approved by NCCUSL in 1972. That uniform Act was enacted in 47 states,

including Michigan, which enacted UMIFA in 1976. As of March 27, 2009, 30 states plus the District of Columbia had adopted UPMIFA, and it had been introduced in 15 other states including Michigan.

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FISCAL IMPACT

The bills would have no fiscal impact on State or local government.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.