New Law Gives Illinois Charitable and Educational Institutions Flexibility in Managing Endowments

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) recently was signed into law in Illinois and is effective as of June 30, 2009.

UPMIFA, a model act already adopted by a majority of states, give colleges, universities, hospitals, foundations, and other nonprofit institutions more flexibility in managing their endowments and other institutional funds. The new law updates the 35-year-old Uniform Management of Institutional Funds Act (UMIFA) (codified at 760 ILCS 50).

UPMIFA establishes a new, more modern standard of prudence for the management of invested charitable funds. This new standard applies to all funds held by an institution exclusively for charitable purposes, regardless of whether the fund is a donor restricted endowment fund. Like UMIFA, UPMIFA applies to those institutions or organizations organized and operated exclusively for charitable purposes, including nonprofit corporations and government subdivisions or agencies, as well as certain kinds of charitable trusts.

Prior Illinois law permitted a charitable institution to spend that portion of an endowment fund’s appreciation its directors deemed prudent, so long as the value of such fund did not dip below its “historic dollar value.” Historic dollar value was defined as the fair value in dollars at the creation of the fund plus the value of any later gifts or accumulation reinvested as endowment principal. When UMIFA was enacted in the early 1970s, it revolutionized the way colleges, universities, and other nonprofit institutions managed their endowment funds, enabling those institutions to use a total return method of accounting to invest more aggressively for long-term growth. UMIFA’s focus on historic dollar value, however, has proven to be cumbersome, particularly during periods of market volatility. Under UMIFA, if the value of a donor-restricted fund dropped below its historic dollar value (known as going “underwater”), no portion of that fund could be spent. This result has hamstrung nonprofit institutions at times when their needs are the greatest and has frustrated donors’ intent to provide funds to be used for charitable purposes.

UPMIFA eliminates historic restrictions on endowment spending in favor of a less restrictive prudence standard. Under UPMIFA, a charity is not limited to spending only amounts above the historic dollar value of donor-restricted endowment funds.

Drawing on standards of care and prudence applicable to fiduciaries, UPMIFA permits charities to spend that portion of their endowment funds they deem prudent, subject to donor intent. Charities are instructed to consider various factors in deciding what portion of a fund is prudent to spend, taking into account general economic conditions, the other resources of the institution, and the donor’s intent to see the fund continue in perpetuity. These standards of care and prudence are default rules. Under UPMIFA, a donor has the ability to impose restrictions on the expenditure and use of endowment funds.
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UPMIFA also makes it easier to modify burdensome or outdated donor restrictions on certain older and smaller endowment funds. An institution, without court involvement, may release or modify restrictions on the administration or purposes of charitable funds which are below $50,000 and which have been in existence 20 years or more. In order to take advantage of this process, an institution must provide the Illinois attorney general with notice and adequate time to object.

UPMIFA provides a clearer standard of conduct for investing than is found under UMIFA, particularly as applied to diversification and pooling of assets, and the delegation of investment management authority to outside service providers. These standards of conduct also are default provisions, which may be modified by donor intent as expressed in the terms of the gift instrument.

UPMIFA’s emphasis on acting in good faith should provide comfort to nonprofit boards and investment managers navigating a difficult investment climate, while the elimination of the historic dollar value concept gives institutions flexibility to respond to fluctuations in fund levels. Charitable and educational institutions in Illinois will want to review and revise their investment and spending policies and related agreements as necessary to take advantage of changes in the law.

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