

STATE OF CALIFORNIA
California Law Revision Commission

TENTATIVE RECOMMENDATION

relating to

REVISION OF
THE UNIFORM MANAGEMENT OF
INSTITUTIONAL FUNDS ACT

February 1989

This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature in 1990. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN MARCH 30, 1989.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

CALIFORNIA LAW REVISION COMMISSION
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02/16/89

LETTER OF TRANSMITTAL

This tentative recommendation proposes to expand the scope of the California version of the Uniform Management of Institutional Funds Act to be consistent with the official uniform act. The existing statute applies only to private educational institutions accredited by the Association of Western Colleges and Universities. (See Educ. Code §§ 94600-94610.) Under this proposal, the act would apply to any incorporated or unincorporated educational, religious, charitable, or other eleemosynary institution and to any governmental organization holding funds for such purposes. The proposal would also make other minor and technical changes.

A comment follows each section of the proposed legislation. The comment gives the source of the section and indicates the nature of the changes the section would make in existing law.

TENTATIVE RECOMMENDATION

relating to

REVISION OF THE UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

California enacted the Uniform Management of Institutional Funds Act in 1973 as a pilot study, subject to a five-year sunset clause and restricted to certain accredited private colleges and universities.¹ The official text of the Uniform Management of Institutional Funds Act has a much broader scope, applying to private educational, religious, charitable, and eleemosynary institutions and to governmental organizations holding funds for such purposes.² Apparently, the pilot study was successful, since the sunset provision was repealed in 1978.³ However, the restricted scope of the act was retained and the authority to use unrealized, as opposed to realized, appreciation was deleted from the statute.⁴

The Commission recommends that the California version of the Uniform Management of Institutional Funds Act be applied to the same organizations covered by the original uniform act. No persuasive reasons have been given for continuing the restrictions that applied under the original pilot study. None of the other 29 jurisdictions that have enacted the uniform act has so drastically restricted its scope.⁵ The problems faced by charitable organizations that are

1. See 1973 Cal. Stat. ch. 950, § 1 (enacting Civil Code §§ 2290.1-2290.12). The California version of the act applies only to private incorporated or unincorporated educational institutions accredited by the Association of Western Colleges and Universities. The sunset clause was enacted by 1973 Cal. Stat. ch. 950, § 3. The act was moved to Education Code Sections 94600-94610 when the Civil Code trust provisions were generally repealed in connection with enactment of the new Trust Law. See 1986 Cal. Stat. ch. 820, §§ 7, 24.

2. See Unif. Management Inst. Funds Act § 1(1) (1972).

3. 1973 Cal. Stat. ch. 806, § 1.

4. 1978 Cal. Stat. ch. 806, § 2.

5. See annotations at 7A U.L.A. 714-27 (1985) & Supp. at 143-44 (1988).

treated by the uniform act are not unique to private colleges and universities.⁶ The effect of this recommendation would be to extend the benefits of the uniform act to all educational, religious, charitable, or eleemosynary institutions. Specifically, these institutions would be able (1) to use appreciation of endowment funds subject to a fiduciary standard, (2) to delegate day-to-day investment management to committees and employees and hire investment advisory or management services, and (3) to release illegal, impossible, or impracticable restrictions on use of endowment funds with the donor's consent or on petition to a court and notice to the Attorney General.⁷ Extending the act's application would also provide guidance as to a board's power to invest and manage property and the standard of care governing the exercise of a board's powers⁸ where the board is not governed by some other statute.⁹

6. In addition, the Commission recommends that the act be moved to the Probate Code. The Education Code is not an ideal location if the act's coverage is expanded beyond private colleges and universities. It is appropriate to place the expanded act with the Trust Law, since the Trust Law also applies to charitable trusts. See Prob. Code § 15004.

7. For the existing provisions that would apply under a broadened statute, see Educ. Code §§ 94602 (use of appreciation), 94605 (delegation of authority), 94607 (release of restrictions). See generally Prefatory Note, Unif. Management Inst. Funds Act (1972), 7A U.L.A. 706-09 (1985).

8. For the existing provisions that would apply under a broadened statute, see Educ. Code §§ 94604 (investment authority), 94606 (standard of care).

9. The proposed law would provide that UMIFA does not alter the duties and liabilities of governing boards under other laws. See, e.g., Corp. Code §§ 5231-5231.5 (directors of nonprofit public benefit corporations), 7231-7231.5 (directors of nonprofit mutual benefit corporations), 9240-9241 (directors of nonprofit religious corporations). Similarly, the proposed law would not displace any limitations on the expenditure of public funds by governmental organizations.

The Commission's recommendation would be effectuated by enactment of the following measure:

An act to amend Section 5240 of the Corporations Code, to add Part 7 (commencing with Section 18500) to Division 9 of the Probate Code, and to repeal Chapter 6 (commencing with Section 94600) of Part 59 of Division 10 of Title 3 of the Education Code, relating to the Uniform Management of Institutional Funds Act.

The people of the State of California do enact as follows:

Corporations Code § 5240 (amended). Investments under Nonprofit Public Benefit Corporations Law

SECTION 1. Section 5240 of the Corporations Code is amended to read:

5240. (a) This section applies to all assets held by the corporation for investment. Assets which are directly related to the corporation's public or charitable programs are not subject to this section.

(b) Except as provided in subdivision (c), in investing, reinvesting, purchasing, acquiring, exchanging, selling and managing the corporation's investment, the board shall do the following:

(1) Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital.

(2) Comply with additional standards, if any, imposed by the articles, bylaws or express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation.

(c) No investment violates this section where it conforms to provisions authorizing such investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation. No investment violates this section or Section 5231 where it conforms to provisions requiring such investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation.

(d) In carrying out duties under this section, each director shall

act as required by subdivision (a) of Section 5231, may rely upon others as permitted by subdivision (b) of Section 5231, and shall have the benefit of subdivision (c) of Section 5231, and the board may delegate its investment powers as permitted by Section 5210.

(e) Nothing in this section shall be construed to preclude the application of the Uniform Management of Institutional Funds Act, ~~Chapter 3 Part 7~~ (commencing with Section ~~2290, 1~~ 18500) of ~~Title 8 of Part 4 of~~ Division 3 9 of the Civil Probate Code, if that act would otherwise be applicable, but nothing in the Uniform Management of Institutional Funds Act alters the status of governing boards, or the duties and liabilities of directors, under this part.

Comment. Subdivision (e) of Section 5240 is revised to correct a cross-reference and to add language consistent with Probate Code Section 18508.

Education Code §§ 18500-18508 (repealed). Uniform Management of Institutional Funds Act

SEC 2. Chapter 6 (commencing with Section 94600) of Part 59 of Division 10 of Title 3 of the Education Code is repealed.

Note. *Comments to repealed sections are set out at the end of this recommendation.*

Probate Code §§ 18500-18509 (added). Uniform Management of Institutional Funds Act

SEC. 3. Part 7 (commencing with Section 18500) is added to Division 9 of the Probate Code, to read:

PART 7. UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

§ 18500. Short title

18500. This part may be cited as the Uniform Management of Institutional Funds Act.

Comment. Section 18500 continues Education Code Section 94600 without change. The Uniform Management of Institutional Funds Act has been relocated from the Education Code, where it applied only to certain private institutions of higher education. See Section 18501(e) and the Comment thereto. See also Sections 2(b) (interpretation of uniform acts), 11 (severability).

§ 18501. Definitions

18501. As used in this part:

(a) "Endowment fund" means an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument.

(b) "Gift instrument" means a will, deed, grant, conveyance, agreement, memorandum, writing, or other governing document (including the terms of any institutional solicitations from which an institutional fund resulted) under which property is transferred to or held by an institution as an institutional fund.

(c) "Governing board" means the body responsible for the management of an institution or of an institutional fund.

(d) "Historic dollar value" means the aggregate fair value in dollars of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the endowment fund at the time it is made, and (3) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the endowment fund.

(e) "Institution" means an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of these purposes.

(f) "Institutional fund" means a fund held by an institution for its exclusive use, benefit, or purposes, but does not include (1) a fund held for an institution by a trustee that is not an institution or (2) a fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purposes of the fund.

Comment. Section 18501 restates former Education Code Section 94601 without substantive change, except that the definition of "institution" has been substantially expanded. As revised, the definition of "institution" is the same as that provided in Section 1(1) of the Uniform Management of Institutional Funds Act (1972). Former Education Code Section 94601(a) defined "institution" as a "private incorporated or unincorporated organization organized and operated exclusively for educational purposes and accredited by the Association of Western Colleges and Universities to the extent that it holds funds exclusively for any of such purposes."

Section 18501 lists the definitions in alphabetical order, unlike former Education Code Section 94601. The definition of "historic

dollar value" in subdivision (d) has been revised by adding "endowment" preceding "fund" in the second and third clauses.

§ 18502. Expenditure of asset net appreciation for current use

18502. The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the realized net appreciation in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by Section 18506. This section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution.

Comment. The first sentence of Section 18502 restates the first sentence of former Education Code Section 94602 without substantive change. The phrase "net appreciation, realized in the fair value" has been revised for clarity to read "realized net appreciation in the fair value." See the Comment to Section 18500.

The second sentence of Section 18502 continues the third sentence of former Education Code Section 94602 without change. The second sentence of former Education Code Section 94602, providing a rolling five-year averaging rule, has been omitted as obsolete since the elimination of authority to appropriate unrealized net appreciation by amendment in 1978. See 1978 Cal. Stat. ch. 806, § 2, amending former Civil Code § 2290.2, the predecessor to former Educ. Code § 94602.

§ 18503. Construction of gift instrument

18503. (a) Section 18502 does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended.

(b) If the gift instrument includes a designation of the gift as an endowment or a direction or authorization to use only "income," "interest," "dividends," or "rents, issues, or profits," or "to preserve the principal intact," or a direction or authorization that contains other words of similar meaning:

(1) A restriction on the expenditure of net appreciation need not be implied solely from the designation, direction, or authorization, if the gift instrument became effective before the Uniform Management of Institutional Funds Act became applicable to the institution.

(2) A restriction on the expenditure of net appreciation may not be implied solely from the designation, direction, or authorization, if

the gift instrument becomes effective after the Uniform Management of Institutional Funds Act became applicable to the institution.

(c) The effective dates of the Uniform Management of Institutional Funds Act are the following:

(1) January 1, 1974, with respect to a private incorporated or unincorporated organization organized and operated exclusively for educational purposes and accredited by the Association of Western Colleges and Universities.

(2) January 1, 1990, with respect to an institution not described in paragraph (1).

Comment. Subdivisions (a) of Section 18503 continues former Education Code Section 94603(a) without change. Subdivisions (b) and (c)(1) restate former Education Code Section 94603(b) without substantive change. Subdivision (c)(2) applies a consistent rule of construction to institutions (as defined in Section 18501(e)) that were not covered by the former law. See the Comment to Section 18501.

§ 18504. Investment authority

18504. In addition to an investment otherwise authorized by law or by the applicable gift instrument, the governing board, subject to any specific limitations set forth in the applicable gift instrument, may do any or all of the following:

(a) Invest and reinvest an institutional fund in any real or personal property deemed advisable by the governing board, whether or not it produces a current return, including mortgages, stocks, bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations or partnerships, and obligations of any government or subdivision or instrumentality thereof.

(b) Retain property contributed by a donor to an institutional fund for as long as the governing board deems advisable.

(c) Include all or any part of an institutional fund in any pooled or common fund maintained by the institution.

(d) Invest all or any part of an institutional fund in any other pooled or common fund available for investment, including shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the governing board.

Comment. Section 18504 continues former Education Code Section 94604 without change, except that an unnecessary comma following the word "associations" in subdivision (a) has been omitted. See the Comment to Section 18500.

§ 18505. Delegation of authority

18505. Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may do the following:

(a) Delegate to its committees, officers, or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds.

(b) Contract with independent investment advisers, investment counsel or managers, banks, or trust companies, so to act.

(c) Authorize the payment of compensation for investment advisory or management services.

Comment. Section 18505 continues former Education Code Section 94605 without change.

§ 18506. Standard of care

18506. (a) When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing property, appropriating appreciation, and delegating investment management for the benefit of an institution, the members of the governing board shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the institution. In the course of administering the fund pursuant to this standard, individual investments shall be considered as part of an overall investment strategy.

(b) In exercising judgment under this section, the members of the governing board shall consider the long and short term needs of the institution in carrying out its educational, religious, charitable or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, general economic conditions, the appropriateness of a reasonable proportion of

higher risk investment with respect to institutional funds as a whole, income, growth, and long-term net appreciation, as well as the probable safety of funds.

Comment. Section 18506 restates former Education Code Section 94606 without substantive change. See the Comment to Section 18500. The standard of care in subdivision (a) is consistent with the general standard of care provided by Section 16040.

§ 18507. Release of restriction in gift instruments

18507. (a) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund.

(b) If written consent of the donor cannot be obtained by reason of the donor's death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the superior court of the county in which the principal activities of the institution are conducted, or other court of competent jurisdiction, for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. No court has jurisdiction to release a restriction on an institutional fund under this part unless the Attorney General is a party to the proceedings. If the court finds that the restriction is illegal, impossible to fulfill, or impracticable, it may by order release the restriction in whole or in part. A release under this subdivision may not change an endowment fund to a fund that is not an endowment fund.

(c) A release under this section may not allow a fund to be used for purposes other than the educational, religious, charitable, or other eleemosynary purposes of the institution affected.

(d) This section does not limit the application of the doctrine of *cy pres*.

Comment. Section 18507 restates former Education Code Section 94607 without substantive change, except that the standard for releasing restrictions under subdivision (b) has been revised to refer to "illegal, impossible to fulfill, or impracticable" rather than "obsolete or impracticable." This revision is intended to conform this provision with the *cy pres* doctrine. See, e.g., *Estate of Loring*, 29 Cal. 2d 423, 436, 175 P.2d 524 (1946); *Estate of Mabury*, 54 Cal. App.

3d 969, 984-85, 127 Cal. Rptr. 233 (1976); Society of California Pioneers v. McElroy, 63 Cal. App. 2d 332, 337-38, 146 P.2d 962 (1944); Restatement (Second) of Trusts § 399 (1957).

In the second sentence of subdivision (b), the phrase "release a restriction on" has been substituted for the phrase "modify any use of" in former Education Code Section 94607(b).

§ 18508. Status of governing boards

18508. Nothing in this part alters the status of governing boards, or the duties and liabilities of directors, under other laws of this state.

Comment. Section 18508 continues former Education Code Section 94610 without change, except for the language relating to duties and liabilities of directors which is new. The purpose of this new provision is to make clear that the duties and liabilities of directors of incorporated institutions are governed by the relevant statute and not by this part. See, e.g., Corp. Code §§ 5231-5231.5 (directors of nonprofit public benefit corporations), 7231-7231.5 (directors of nonprofit mutual benefit corporations), 9240-9241 (directors of nonprofit religious corporations).

§ 18509. Laws relating to expenditure of public funds

18509. Nothing in this part limits the application of any law relating to the expenditure of public funds.

Comment. Section 18509 is a new provision that makes clear the relation of the Uniform Management of Institutional Funds Act to any other law concerning expenditure of public funds. See, e.g., Gov't Code § 53601. Thus, under Section 18509, if other law provides greater limitations on the expenditure of public funds, that law prevails over any provision of this part that might otherwise have been applicable.

COMMENTS TO REPEALED SECTIONS

Education Code § 94600 (repealed). Short title

Comment. Former Section 94600 is continued in Probate Code Section 18500 without change. The Uniform Management of Institutional Funds Act has been moved from the Education Code since it has been expanded to apply to religious, charitable, and other eleemosynary institutions.

Education Code § 94601 (repealed). Definitions

Comment. Former Section 94601 is restated in Probate Code Section 18501 without substantive change, except that the definition of "institution" in subdivision (a) has been substantially expanded in the new provision. Additional technical changes have been made. See Prob. Code § 18501 and the Comment thereto.

Education Code § 94602 (repealed). Expenditure of asset net appreciation for current use

Comment. The first sentences of former Section 94602 is restated in Probate Code Section 18502 without substantive change. The second sentence is omitted as obsolete. See the Comment to Prob. Code § 18502. The third sentence is continued in the second sentence of Probate Code Section 18502 without change.

Education Code § 94603 (repealed). Construction of gift instrument

Comment. Former Section 94603 is restated in Probate Code Section 18503 without substantive change. See the Comment to Prob. Code § 18503.

Education Code § 94604 (repealed). Authority of board to invest and reinvest

Comment. Former Section 94604 is continued in Probate Code Section 18504 without change, except that the comma following the word "associations" in subdivision (a) is omitted.

Education Code § 94605 (repealed). Delegation of authority

Comment. Former Section 94605 is continued in Probate Code Section 18505 without change.

Education Code § 94606 (repealed). Standard of care

Comment. Former Section 94606 is restated in Probate Code Section 18506 without substantive change, except as noted in the Comment to Probate Code Section 18506.

Education Code § 94607 (repealed). Release of restriction in gift instruments

Comment. Former Section 94607 is restated in Probate Code Section 18507 without substantive change. See the Comment to Prob. Code § 18507.

Education Code § 94608 (repealed). Severability

Comment. Former Section 94608 is omitted because it is unnecessary. See Prob. Code § 11 (severability).

Education Code § 94609 (repealed). Application and construction

Comment. Former Section 94609 is omitted because it is unnecessary. See Prob. Code § 2(b) (interpretation of uniform acts).

Education Code § 94610 (repealed). Status of governing boards

Comment. Former Section 94610 is restated in Probate Code Section 18508 without substantive change. See the Comment to Prob. Code § 18507.