

Date of Hearing: May 4, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
AB 792 (Chiu) – As Introduced February 25, 2015

SUBJECT: Board of directors: investment standards

SUMMARY: Provides that the investment standards under the Nonprofit Public Benefit Corporation Law and the Nonprofit Religious Corporation Law shall include, where applicable, the Uniform Prudent Management of Investment Funds Act (UPMIFA).

EXISTING LAW:

- 1) Provides under UPMIFA, Probate Code 18500 *et seq.*, the following:
 - a) Defines various terms, including "institutional fund," "gift instrument," and "endowment fund." An "endowment fund" means an institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. The term would not include assets designated by the institution as an endowment fund for its own use;
 - b) Imposes on an institution managing an institutional fund the duty to consider the charitable purposes of the institution and the purposes of the institutional fund when managing the fund, subject to the donor's intent, as well as the duty to manage and invest the fund in good faith and in compliance with the prudent investor standard;
 - c) Authorizes an institution, subject to a donor's intent expressed in the gift instrument, to appropriate for expenditure or accumulate so much of an endowment as the institution deems prudent for the uses or purposes and duration of the endowment;
 - d) Provides that unless stated otherwise in a gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution;
 - e) Specifies the factors for the institution to consider when making a determination to appropriate or accumulate so much of an endowment fund;
 - f) Allows the institution to delegate to an external agent the management and investment of an institutional fund to the extent the institution could prudently delegate under the circumstances, and would delineate the areas over which the institution must exercise prudence;
 - g) Provides that a charitable institution that complies with this measure is not liable for the decisions or actions of an agent to which the function of management and investment of an institutional fund was delegated except to the extent a trustee would be liable for those actions or decisions under Probate Code sections 16052 and 16401;
 - h) Provides that the appropriation for expenditure in any year of an amount greater than 7 percent of the fair market value of an endowment fund creates a rebuttable presumption

of imprudence;

- i) Authorizes, if the donor consents in writing, the institution to release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. Prohibits a release or modification to allow the fund to be used for purposes other than a charitable purpose of the institution;
 - j) Allows, using the doctrine of *cy pres*, a court, upon application of an institution, to modify a restriction contained in a gift instrument regarding the management or investment of a fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund;
 - k) Authorizes, if an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impossible to achieve, or wasteful, the institution, after 60 days' notice to the Attorney General, to release or modify the restriction in whole or in part, if the following apply: 1) the fund subject to the restriction has a total value of less than \$100,000; 2) 20 or more years have elapsed since the fund was established; and 3) the institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument;
 - l) Authorizes a court, upon petition by the Attorney General, to order the winding up and dissolution of a nonprofit public benefit corporation without meeting the requirements of existing law, based on the ground that it is impossible or impracticable to meet some or all of those requirements; and,
 - m) Provides that nothing in this section alters the duties and liabilities of a director of a nonprofit public benefit corporation as specified in Corporations Code section 5240 which, among other things, requires the director to act in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.
- 2) Specifies, under Corporations Code Section 5240 that a nonprofit public benefit corporation when investing, reinvesting, purchasing, acquiring, exchanging, selling and managing the corporation's investments, the board shall do the following:
- a) 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.
 - b) 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; and,
 - c) Provides that nothing in this section shall be construed to preclude the application of the UPMIFA.

- 3) Requires, under Corporations Code Section 9250 that a nonprofit religious corporation when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing the corporation's investment shall meet the following standards set forth in Section 9241.

FISCAL EFFECT: None

COMMENTS:

This measure is sponsored by the Business Law Section of the State Bar of California and they provide the following background information:

California regulatory requirements as they relate to the investments of nonprofit public benefit and religious corporations have been confusing and unclear. California Corporations Code Sections 5240 and 9250 subject those corporations to certain investment standards applicable to all assets held by the corporation. Section 5240 includes the requirement to “avoid speculation” for each individual investment. Notwithstanding a body of case law, there appears to be no precise legal definition of “speculation.”

Effective January 1, 2009 California adopted Probate Code Section 18500 et seq., the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”). UPMIFA is different from the standard in Section 5240 in at least the following two ways: (1) UPMIFA clearly articulates a focus on the overall fund rather than a particular investment, and (2) rather than “avoid speculation” UPMIFA specifies a variety of factors including a consideration of the risk and the appropriateness thereof with respect to the institution. UPMIFA has been adopted by 49 states and the District of Columbia.

While Corporations Code Sections 5240 and 9250 do not preclude the application of UPMIFA, they specifically subject it to the Corporations Code requirements. Because of the confusing and uncoordinated interplay between the Corporations Code sections and UPMIFA, in most cases, practitioners advise clients to attempt to comply with both – resulting in an overly conservative investment approach.

Assembly Bill 792 would solve the problem by amending Sections 5240 and 9250 to allow compliance with UPMIFA to satisfy the requirements of the Corporations Code.

The result would be to authorize these nonprofits to utilize appropriate investments in accordance with the nationally recognized standards of UPMIFA. Under those standards, the nonprofits would be in a better position to avoid an overly conservative investment approach and improve returns. For example, reliance on the UPMIFA standards would allow investment in widely used index funds across different asset classes.

What is UPMIFA?

At its annual meeting in July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the UPMIFA and recommended it for enactment by the legislatures of the various states. UPMIFA is designed to replace the existing Uniform Management of Institutional Funds Act (UMIFA), which was approved by NCCUSL in 1972 and has since been enacted in 47 states. UMIFA was a pioneering statute, providing uniform and fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as “endowments” to those institutions. Those rules supported two general principles: 1) that

assets would be invested prudently in diversified investments that sought growth as well as income, and 2) that appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable institution.

UPMIFA provides guidance and authority to charitable organizations concerning the management, investment and expenditure of funds held by those organizations and imposes additional duties on those who manage and invest charitable funds as well as on the boards of non-profit organizations who authorize spending decisions. These duties provide additional protections for charities and also protect the interests of donors who want to see their contributions used wisely. UPMIFA modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines on spending from endowment funds and to give institutions the ability to cope more easily with fluctuations in the value of the endowment by authorizing the substitution of prudent spending rules for the previously inflexible requirements for maintaining historical dollar value. Finally, UPMIFA updates the provisions governing the release and modification of restrictions on charitable funds to permit more efficient management of these funds. These provisions derive from the approach taken in the Uniform Trust Code (UTC) for modifying charitable trusts. Like the UTC provisions, UPMIFA's modification rules preserve the historic position of the attorneys general in most states as the overseers of charities.

REGISTERED SUPPORT / OPPOSITION:

Support

California State Bar (Sponsor)

Opposition

None on file.

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