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2009 BUSINESS REFORM STUDY GROUPS
MEETING OF THE TRUST LAWS STUDY GROUP

First Meeting

Wednesday, July 22, 2009
11:00 A.M.

Secretary of State's Office
700 North Street
Jackson, Mississippi

AGENDA

1. Welcome – Cheryn Baker
2. Introduction of Members and Attendees
3. Remarks by Co-Chairs Jamie Houston and Jimmy Young
4. Outline of Proposed Topics – Doug Jennings
    a. Asset-protection trusts
    b. Dynasty trusts
    c. Virtual representation
    d. Updates to Uniform Trustees Powers Act
    e. Uniform Principal and Income Act (UPAIA)
    f. Uniform Prudent Management of Institutional Funds Act (UPMIFA)
5. Suggestions for Additional Topics
6. Next Steps for Upcoming Meetings / Creation of Subgroups
7. Reminder of Upcoming Meetings
8. Other Business
9. Adjourn 1:00 P.M (or earlier)

Upcoming Meeting Dates: August 4, August 25, and September 15

Handouts

1. Group roster
2. Introductory PowerPoint presentation
3. Asset-protection and dynasty trusts
    a. Memo – *An Introduction to Asset-Protection Trusts*
    b. Relevant statutes and commentary re: spendthrift trusts in Mississippi
    c. Recommended reading (not included in packet): Robert H. Sitkoff and Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: an Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005).
    d. Recommended reading (not included in packet): Garrett Morris, *Dynasty Trusts and the Rule Against Perpetuities*, 116 HARV. L. REV. 2588 (2003).
4. Virtual representation
    a. Recommended reading (not included in packet): Martin D. Begleiter, *Serve the Cheerleader - Serve the World: An Analysis of Representation in Estate and Trust Proceedings and Under the Uniform Trust Code and Other Modern Trust Codes*, 43 REAL PROP. TR. & EST. L.J. 311 (2008).
5. Uniform Prudent Management of Institutional Funds Act (UPMIFA)
    a. Explanatory materials
    b. Full text of act
6. Uniform Principal and Income Act (UPAIA)
    a. Explanatory materials
    b. Full text of Act available at http://www.nccusl.org

Mississippi Secretary of State Trust Laws Study Group

Mississippi Secretary of State
Division of Policy and Research
July 2009

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Topics for Consideration:

- Asset-protection trusts
- Dynasty trusts
- Virtual representation
- Uniform Principal and Income Act (UPAIA)
- Uniform Prudent Management of Institutional Funds Act (UPMIFA)

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Asset-Protection Trusts (APTs)

- More formally known as self-settled spendthrift trusts
- Allow the creator of a trust (the "settlor" or "trustor") to benefit from trust assets while protecting those assets from potential creditors
- A departure from the traditional rule recognized in Mississippi and most other U.S. jurisdictions that spendthrift restrictions are invalid if the settlor and beneficiary are one and the same
- Recognized in eleven states, first by Alaska in 1997 and then soon thereafter by Delaware
- Prior to 1997, APT protection was available only offshore.

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Benefits of APTs

- Tax savings
- General asset protection
- Protect gifts and inheritances
- Premarital planning
- Protect estate-planning vehicles
  - Several common estate-planning vehicles, e.g., CRTs, GRATs, QPRTs, and grantor-retained income trusts are self-settled trusts and therefore are vulnerable to creditor claims

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States Recognizing Domestic APTs

- Alaska (1997)
- Delaware (1997)
- Nevada (1999)
- New Hampshire (2009)
- Rhode Island (1999)
- Utah (2003)
- Missouri (2004)
- Oklahoma (2004)
- South Dakota (2005)
- Tennessee (2007)
- Wyoming (2007)

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Asset Protection, with Limits

- General rule in APT jurisdictions disallows creditors from reaching trust assets to satisfy a debt or judgment until those assets are actually distributed to the trustor.
- However, most states have created exceptions to protect certain creditors and to guard against dishonest behavior by the trustor.

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Exceptions Allowing Creditor Access to Trust Assets

- All states recognizing APTs allow creditors to access trust assets if those assets were fraudulently placed in trust by the settlor.
- Many states allow trust assets to be invaded to collect child support, alimony, or for breach of an agreement or order regarding equitable distribution.
- In addition, Delaware law protects personal injury and property damage claimants by allowing them to proceed against the trust assets (only if the claim pre-dates the creation of the trust).

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Dynasty Trusts

- Most states recognizing APTs have repealed the Rule Against Perpetuities in whole or in part to allow trusts to have a significantly greater duration.
- Rule Against Perpetuities: The common-law rule prohibiting a grant of an estate unless the interest must vest, if at all, no later than 21 years after the death of some person alive when the interest was created.
- Dynasty trusts are intended to benefit successive generations, a far more difficult objective in jurisdictions bound by the Rule.

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Maximum Length of Trusts in States Recognizing APTs

- Alaska, Utah, Wyoming = 1,000 years
- Delaware = Indefinitely for personal property; 110 years for real property
- Nevada = Up to 365 years
- Tennessee = Up to 360 years

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Virtual Representation

Under the Uniform Probate Code (UPC), Uniform Trust Code (UTC) & Other State Provisions

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What Is Virtual Representation?

- In the field of trust law, the doctrine of virtual representation allows representation of unborn, unascertained, or incapacitated individuals by a party with substantially identical interests.
- Generally, the rule in equity is that all persons interested in a matter (i.e., those whose rights are directly affected) shall be made party to a suit. Virtual representation is a widely acknowledged exception to this rule.

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Virtual Representation Under §1-403 of the Uniform Probate Code

- Provides for representation in the following circumstances:
  - A holder or co-holder of power of appointment or revocation may represent persons subject to that power
  - Fiduciary and parental representation
  - Representation of minor, incapacitated, unborn or unascertained person by person with substantially identical interest
- Expressly requires adequate representation in the case of a minor, incapacitated, unborn or unascertained persons
- Allows appointment of guardian ad litem at any point if representation of a minor, incapacitated, unborn or unascertained person is deemed inadequate
- Applies to all formal proceedings involving trusts or estates of decedents, minors, protected persons, or incapacitated persons and judicially supervised settlements

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Virtual Representation Under § 304 of the Uniform Trust Code

- Derived from § 1-403(2)(iii) of the Uniform Probate Code
- Does not expressly require adequate representation
- Provisions for fiduciary and parental representation are not included in § 304, but are included in § 303 of the UTC
- Provision for extending representation to non-judicial proceedings is not included in § 304, but is included in § 301 of the UTC
- "Unless otherwise represented, a minor, incapacitated, or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable, may be represented by and bound by another having a substantially identical interest with respect to the particular question or dispute, but only to the extent there is no conflict of interest between the representative and the person represented."

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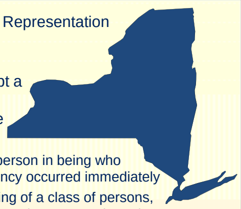

New York – SPCA § 315. Joinder and Representation of Persons Interested in Estates

- NY was one of the earliest states to adopt a virtual representation statute (1967)
- Statute provides for representation in the following circumstances:

1. In any contingency, representation by a person in being who would constitute the class if the contingency occurred immediately
2. Representation by a party to the proceeding of a class of persons, described in terms of their relationship to such party, to whom the same interest has been limited upon the happening of a future event
3. Representation of unborn or unascertained persons by person with substantially similar interests
4. Representation of contingent interests
5. Representation of disabled persons, if the instrument so provides

- Extends to any estate proceeding requiring service of process
- NY Trust Law incorporates this section by reference

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Delaware – Title 12 § 3547. Representation of persons with substantially identical interest

- Adopted UTC virtual representation provision
- 2007 and 2009 Amendments added three subsections:

1. Codifying rule in Official Comment to UTC § 304 that presumptive remaindermen may represent contingent successor interests
2. Codifying parental/guardian representation of minors and unborn and unascertained persons with substantially identical interests
3. Codifying extension of representation principle to non-judicial proceedings, including consents, releases and ratifications

- Does not expressly require adequate representation
- Disallows representation where a conflict of interest exists

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Uniform Principal and Income Act of 1997 (UPAIA)

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Background

- Previous Promulgations
  - 1931 Principal and Income Act
  - 1962 Revised Principal and Income Act
    - Adopted in Mississippi in 1967 without any substantive changes
- Prudent Person Rule
- Parallels revisions to the Uniform Prudent Investor Act (adopted by MS in 2006).
- 2008 Amendments

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State Adoptions

- UPAIA has been adopted by 41 states and the District of Columbia.

Alabama	Indiana	New Hampshire	South Carolina
Alaska	Iowa	New Jersey	South Dakota
Arizona	Kansas	New Mexico	Tennessee
Arkansas	Kentucky	New York	Texas
California	Maine	North Carolina	Utah
Colorado	Maryland	North Dakota	Virginia
Connecticut	Massachusetts	Ohio	Washington
District of Columbia	Michigan	Oklahoma	West Virginia
	Missouri	Oregon	Wisconsin
Florida	Montana	Pennsylvania	Wyoming
Hawaii	Nebraska		
Idaho	Nevada		

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Substantive Changes

- Trustee's Power to Adjust (UPAIA § 104)
  - Enables a trustee to engage in "total return" investing after consideration of several factors
- Addition of new accounting rules for the allocation of trust receipts to principal or income
- Modernization or clarification of existing rules.

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Trustee's Power to Adjust

Trustee must consider nine factors (§ 104(b))

1. Nature of the trust
2. Settlor's intent
3. Identity and circumstances of the beneficiary
4. Need for liquidity and preservation of capital
5. Assets held in the trust
6. Net amount allocated to income
7. Extent to which the terms of the trust permit the trustee to invade principal
8. Actual and anticipated effect of economic conditions on trust assets
9. Anticipated tax consequences.

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Uniform Prudent Management of Institutional Funds Act (UPMIFA)

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Background

- Uniform Management of Institutional Funds Act (UMIFA)
  - Approved by NCCUSL in 1972
  - Adopted in 47 states and D.C.
  - Permitted charitable organizations to invest for total return
  - Established concept of "historic dollar value" (HDV)

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Background

- Recent developments under UMIFA
  - NCCUSL promulgated the Uniform Prudent Investor Act in 1994 which provides further guidance on "total return" investing
  - Dot-com crisis of late 1990's created a number of "under water" endowments (funds whose value dropped below HDV thus preventing charities from using them)
- Mississippi adopted UMIFA in 1998 without making substantive amendments (Miss. Code Ann. 79-11-611 *et seq.)*
- UPMIFA was introduced in 2009 but died in committee

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What is UPMIFA?

- Approved by NCCUSL in 2006
- Incorporates 30 years of experience under UMIFA, including developments in prudent investor law
- Applies to all funds held by institutions and organizations organized and operated for charitable purposes except charitable trust unless the charity is acting as the trustee (same as UMIFA)

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Substantive Changes

- Provides a list of eight factors institutions should consider when making investment decisions (§3)
- Abolishes HDV and expressly authorizes total return expenditure (§4)
- Establishes express standards for the delegation of fund management (§5)

Substantive Changes

- Provides new procedures for the release of restrictions on small funds ($25,000) which are over twenty years old (§6)
- **Optional provision:** creates a rebuttable presumption of imprudence for expending more than 7% of the fund's total value in one year (§4(d))

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Standard of Care

Trustee must consider the following factors before investing (§3)

1. General economic conditions
2. Possible effect of inflation or deflation
3. Expected tax consequences
4. Roll each investment plays in the overall portfolio
5. Expected total return
6. Institution's other resources
7. Needs of the institution and fund to make distributions and preserve capital
8. An asset's special relationship or value to the purpose of the institution

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Expenditure or Accumulation of Funds

Except as provided in a gift instrument, a fund may appropriate for so much as it considers prudent, but must consider the following factors (§4)

1. The duration and preservation of the fund
2. The purposes of the institution and the fund
3. General economic conditions
4. The possible effect of inflation or deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the institution
7. The investment policy of the institution

State Adoptions

UPMIFA has been adopted by 37 states.

Alabama	Kansas	South Carolina	Introduced 2009
Arizona	Minnesota	South Dakota	Alaska
Arkansas	Missouri	Tennessee	Kentucky
California	Montana	Texas	Maine
Connecticut	Nebraska	Utah	Maryland
Colorado	Nevada	Vermont	Massachusetts
Delaware	New Hampshire	Virginia	Michigan
District of Columbia	New Mexico	Washington	**Mississippi**
Georgia	North Dakota	West Virginia	New Jersey
Hawaii	North Carolina	Wyoming	New York
Idaho	Oklahoma		Wisconsin
Illinois	Ohio		
Indiana	Oregon		
Iowa	Rhode Island		

Mississippi Secretary of State Trust Laws Study Group

- Conclusion
- Questions
- Other potential topics
- Subcommittee assignments

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An Introduction to Asset-Protection Trusts

Since 1997, eleven U.S. states[1] have amended their trust laws to recognize so-called "asset-protection trusts" (or APTs, known more formally as self-settled spendthrift trusts) which allow a settlor to enjoy the benefits of assets in trust while at the same time shielding (to varying degrees) those assets from creditors. The reasons a settlor might want to create an APT are varied and many: to protect assets from future court judgments and from creditors, to obtain federal and state tax benefits, and to aid in premarital and estate planning, just to name a few.

States choosing to recognize asset-protection trusts have broken away from the long-standing U.S. legal tradition of prohibiting self-settled spendthrift trusts, generally to stimulate their own financial-services sectors. In fact, prior to 1997, the sort of asset protection provided by these state laws was available only offshore. Most states (including Mississippi[2]) have adopted the position reflected in the Restatement (Second) of Trusts, that where a person creates a trust for his or her own benefit, creditors may access the trust assets up to the maximum amount the settlor could potentially enjoy under the terms of the trust. In addition, the Uniform Trust Code – drafted by the National Conference of Commissioners on Uniform State Laws and adopted by 21 states (not including Mississippi) – rejects the approach taken by states recognizing self-settled spendthrift trusts.

Unsurprisingly, laws giving effect to self-settled spendthrift trusts have been subject to a great deal of controversy. Critics of these laws cite the long legal tradition against such trusts and claim that such trusts are largely created to thwart courts and creditors, particularly involuntary creditors such as tort victims. On the other hand, proponents claim that self-settled spendthrift trusts protect the assets of professionals (such as doctors and lawyers) from meritless legal claims, provide stimulus to the financial-services sectors of states adopting these laws, and increase the efficiency of the marketplace for credit.[3]

While one study shows that certain changes to the law (namely, repealing the rule against perpetuities and repealing taxes on trust funds attracted from outside the state) have had a major

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[1] These states are Alaska (1997), Delaware (1997), Nevada (1999), New Hampshire (2009), Rhode Island (1999), Utah (2003), Missouri (2004), Oklahoma (2004), South Dakota (2005), Tennessee (2007), and Wyoming (2007).
[2] *See* Miss. Code Ann. § 91-9-509(a).
[3] For further explanation of the arguments for and against recognition of self-settled spendthrift trusts, see Darsi Newman Sirknen, *Domestic Asset Protection Trusts: What's the Big Deal?*, 8 TRANSACTIONS: TENN. J. BUS. L. 133, 142-148 (2006).

impact on the trust business in many states, there is not yet enough evidence to confirm that merely recognizing self-settled spendthrift trusts will result in an influx of trust funds to a state choosing to recognize these trusts.[4] However, it seems plausible that by making other changes to the trust laws in addition to recognizing self-settled spendthrift trusts, the trust business in Mississippi could similarly be given a boost.

Spendthrift trusts under Mississippi law

A spendthrift clause in a trust instrument prohibits the beneficiary from transferring, assigning, or otherwise alienating his or her right to future payments of income or principal.[5] Thus, in a typical scenario where a beneficiary is unable to pay a debt, the creditor will be prohibited from accessing any of the trust assets to satisfy the debt (or even to collect upon a judgment) until those assets are paid to the beneficiary.[6] Further, if payment of trust assets to the beneficiary is subject to the trustee's discretion, the creditor cannot compel the trustee to make a payment to the beneficiary.[7]

The above rules contemplate that the beneficiary and settlor of the trust are separate persons, however. If the trust is self-settled (that is, if the settlor is a beneficiary of his or her own self-created trust), Mississippi law provides that creditors may in fact invade the trust to satisfy a debt or judgment, notwithstanding the presence of a spendthrift clause.[8] Similarly, in the case of a self-settled support or discretionary trust, creditors of the settlor may reach the maximum amount of the trust that could be paid to or for the benefit of the settlor, not to exceed the amount of the settlor's proportionate contribution to the trust.[9] While a small number of states deem self-settled trusts entirely void, Mississippi law provides that a self-settled trust is valid even though creditors may reach the trust assets.[10]

Fraudulent transfers and other exceptions allowing creditor access to trust assets

While Mississippi law provides that creditors may invade a self-settled trust for any reason (see above), states recognizing self-settled spendthrift trusts allow creditors to access trust assets only in the narrowest of circumstances. A discussion of the more common exceptions follows.

a. Fraudulent transfers

One exception common to all of the states recognizing self-settled trusts allows creditors access to those trust assets which are fraudulently transferred into a trust. Most states (43 plus the District of Columbia) have adopted the Uniform Fraudulent Transfer Act (UFTA), which

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[4] *See* Robert H. Sitkoff and Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: an Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005).
[5] 76 AM. JUR. 2D TRUSTS § 94.
[6] Miss. Code Ann. § 91-9-503.
[7] Miss. Code Ann. § 91-9-507(1).
[8] Miss. Code Ann. § 91-9-509(1).
[9] Miss. Code Ann. § 91-9-509(2).
[10] Miss. Code Ann. § 91-9-509(1).

provides that such a transfer will be deemed fraudulent if it is made with actual intent to hinder, delay, or defraud; if the transfer was made with constructive fraudulent intent; or if the transfer was made while the settlor was insolvent.[11] Constructive fraudulent intent may be inferred from the circumstances surrounding the transfer (for example, whether the transfer occurred shortly before or after a substantial debt was incurred or whether the debtor absconded after making the transfer).[12] Of the states surveyed in Appendix B, Nevada, Tennessee, Utah, and Wyoming have adopted the UFTA position without change, applying it to both existing and future creditors. Delaware[13] generally follows the UFTA approach, but its laws provide that future creditors may set aside such a transfer only if made with actual intent to defraud. Though Alaska has not adopted UFTA, its statutes set aside transfers made with intent to defraud.

b. Spouses and children

Most states recognizing APTs provide some type of exception allowing a current or former spouse to invade trust assets to recover child support payments, alimony, or other family support. The states surveyed in Appendix B vary in their application of these exceptions. Delaware, Tennessee, and Utah allow a person whose claim arises from an agreement or court order providing for alimony, child support, or property division to reach the assets of an APT. Alaska and Wyoming provide an exception for child support only. Notably, Nevada law does not provide any sort of exception for the claims of spouses or children.

c. Tort claims

Of the states recognizing APTs, only Delaware and Utah provide an exception regarding tort claims. Under Delaware law, creditors whose claims arise as a result of death, personal injury, or property damage occurring before or on the date of transfer, for which the settlor was liable either directly or vicariously, may proceed against the trust assets. Utah law allows a creditor to invade trust assets where the claim is based upon a judgment, penalty, or other determination of liability against the settlor constituting fraud, intentional infliction or harm, or a crime.

d. Miscellaneous exceptions

Utah law provides a number of additional exceptions which allow creditor access to APT assets under the following circumstances:

a) If the claim is based on a decision or ruling resulting from judicial, arbitration, mediation, or administrative proceeding commenced prior to or within three years after the trust was created;
b) If the claim is for recovery of public assistance received by the settlor under Utah law;
c) If the claim is for taxes owed by the settlor to a governmental entity; or

[11] *See* UFTA § 5.
[12] *See* UFTA § 4.
[13] Note that several states have essentially adopted the Delaware scheme verbatim, and that "Delaware" refers to those states as well.

d) If the settlor transferred assets into the trust in violation of written representations or agreements.

In addition, Wyoming's APT statute creates an exception if trust property is listed on an application or financial statement used to obtain credit.

A closer look at the asset-protection statutes of selected states (see accompanying Appendix B)[14]

a. Delaware

How to Create a Delaware APT:

- To create an APT under the Delaware Act, a person must create an irrevocable trust that (1) contains a spendthrift clause; (2) provides that Delaware law governs the trust's validity, construction, and administration; and (3) appoints at least one Delaware trustee.[15]
- A Delaware trustee is either an individual who resides in Delaware or a corporation that is authorized to conduct trust business in Delaware and is regulated by the Delaware Bank Commissioner or a federal agency.[16]
- The Delaware trustee or trustees must maintain or arrange for custody in Delaware of some trust property, maintain records for the trust, prepare or arrange for the preparation of fiduciary income-tax returns, or otherwise materially participate in the administration of the trust.[17]
- If only one Delaware trustee is acting, it will be deemed to have resigned if it ceases to meet these requirements.[18] Similarly, a trustee of a Delaware APT automatically ceases to serve if a court declines to apply Delaware law in determining the validity, construction, or administration of such trust, or the effect of its spendthrift clause, in a proceeding involving such trustee.[19] If a trustee ceases to act for one of these reasons, any successor trustee designated in the trust will take its place and the Delaware Court of Chancery may fill any vacancy.

The Delaware Act specifically permits the trustor of a Delaware APT to have the power to:

- Consent to or direct investment changes;
- Veto distributions; and/or
- Replace trustees or advisers.[20]

The Delaware Act also expressly authorizes the trustor to have:

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[14] Taken from Richard W. Nenno, *Planning and Defending Domestic Asset-Protection Trusts*, American Law Institute - American Bar Association Continuing Legal Education (2009).
[15] 12 Del. C. § 3570(11)(a)-(c).
[16] Id. § 3570(8)(a).
[17] Id. § 3570(8)(b).
[18] Id. § 3570(8)(e).
[19] Id. § 3572(g).
[20] Id. §§ 3570(8)(d), 3570(11)(b).

- The ability to receive income or principal pursuant to broad discretion or a standard as determined by Delaware trustees, non-Delaware trustees, and/or advisers;
- The right to receive current income distributions;
- An interest in charitable-remainder trust (CRT), an interest in a qualified personal-residence trust (QPRT), or a qualified annuity interest created if a residence in a QPRT ceases to be used as a personal residence;
- Up to a 5% interest in a grantor-retained annuity trust (GRAT), a grantor-retained unitrust (GRUT), or a total-return unitrust;
- A non-general testamentary power of appointment; and/or
- The ability to provide for the payment of debts, expenses, and taxes following death.[21]

Who May Defeat a Delaware APT:

- The Delaware Act bars original actions and actions to enforce judgments, including judgments entered elsewhere, and it requires any action involving a Delaware APT to be brought in the Delaware Court of Chancery.[22] Any action to set aside such a trust must be based on § 1304 or § 1305 of the Delaware UFTA.

a. Pre-Transfer Claims

- If a creditor's claim arose before the trust was created, the creditor must bring suit within four years after the trust's creation or, if later, within one year after the creditor discovered (or should have discovered) the trust[23] and must prove, by clear and convincing evidence, that creation of the trust was a fraudulent transfer.

b. Post-Transfer Claims

- If a creditor's claim arose after the trust was created, the creditor must bring suit within four years after the trust's creation and must prove, by clear and convincing evidence, that creation of the trust was made with actual intent to defraud – not to hinder or delay – that creditor.[24] Hence, this exception is not available for a creditor who does not exist or is not foreseeable when a Delaware APT is created.

c. Family Claims

- A person whose claim results from an agreement or court order providing for alimony, child support, or property division may reach the assets of a Delaware APT,[25] but only a spouse who was married to the trustor of the trust before it was created may avail himself or herself of this exception.[26]

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[21] 12 Del. C. § 3570(11)(b).
[22] Id. § 3572(a).
[23] Id. § 3572(b)(1).
[24] Id. § 3572(b)(2).
[25] Id. § 3573(1).
[26] Id. § 3570(9).

- The surviving spouse of a Delaware decedent never has been able to reach trust assets by electing against the will,[27] and Delaware law does not defer to the law of a decedent's domicile to determine a surviving spouse's elective-share rights.[28]

d. Tort Claims

A person who suffers death, personal injury, or property damage before a Delaware APT is established for which the trustor is liable may reach the trust assets.[29]

Consequences if a Delaware APT Is Defeated:

- If one of the above exceptions applies, the Delaware APT is defeated only to the extent necessary to pay that creditor's claim and related costs, including attorneys' fees.[30] Thus, if a trustor is confronted by multiple creditors with the type of claim that is permitted to be pursued, each creditor must bring a separate action for avoidance.
- Unless a creditor proves by clear and convincing evidence that a trustee acted in bad faith in accepting and administering the trust, that trustee may use trust assets to pay its costs of litigating the claim before satisfying the claim.[31] A trustee's mere acceptance of the trust is presumed not to be in bad faith.
- A beneficiary who receives a distribution before a creditor brings a successful suit to defeat a Delaware APT may keep the distribution unless the creditor proves by clear and convincing evidence (by a preponderance of the evidence if the beneficiary is the trustor) that he or she acted in bad faith.[32]
- The creation of a Delaware APT will not be treated as fraudulent or otherwise contrary to law for purposes of any action against any trustee, adviser, or protector acting under a trust instrument or against any attorney or other professional adviser involved in establishing the trust.[33]

Moving Trusts to Delaware:

- A trustee may create a Delaware APT either by establishing a Delaware APT or by effectuating the transfer of a trust that meets the requirements of the Delaware Act to Delaware[34] except that the trust does not have to provide that Delaware law governs.[35]
- If a trustee of an irrevocable spendthrift trust creates a Delaware APT, the time that the trust exists before it is moved to Delaware counts toward the four-year period for pursuing post-transfer claims against the trust.[36] Thus, it might be possible for the trustee

[27] 12 Del. C. §§ 901(a), 908(b).
[28] Id. § 901(b).
[29] Id. § 3573(2).
[30] Id. § 3574(a).
[31] Id. § 3574(b)(1), (c).
[32] Id. § 3574(b)(2), (c).
[33] 12 Del. C. § 3572(d)-(e).
[34] Id. § 3570(10).
[35] Id. 3570(11)(d).
[36] Id. §§ 3572(c), 3575.

of an existing onshore or offshore trust to create a Delaware APT that cannot be defeated under the Delaware Act.

- Under the Delaware Act, a trustor may have a testamentary power to appoint to anyone except the trustor, the trustor's estate, the trustor's creditors, or creditors of the trustor's estate.[37] An existing trust will not qualify under the Delaware Act if it gives the trustor an inter vivos or testamentary general or an inter vivos limited power of appointment. The existing trustee may, with the written consent of the trustor, bring such a trust into conformity with the Delaware Act by deleting the excessive power.[38]

Additional Protection for Trust Distributions

Creditors of non-Delaware residents as well as Delaware residents may not reach assets of accounts in Delaware banks. The current statute provides that "Banks, trust companies, savings institutions and loan associations … shall not be subject to the operations of the attachment laws of this State."[39] Over the years, Delaware courts have read this protection broadly.[40]

However, the Delaware Supreme Court has held that "the seizure by sequestration of spendthrift trust income in the hands of a bank as Trustee at the suit of a wife seeking maintenance from a husband is not an attachment within the meaning of § 3502."[41]

Accordingly, mandatory or discretionary distributions from a Delaware APT into a checking account, savings account, revocable trust, or other account at a Delaware institution will insulate the funds from creditor claims. Although the statute prohibits attachment of assets in a non-bankruptcy context, it will not apply upon the filing of a petition under the Bankruptcy Code unless the account fits within one of the limited exemptions or exclusions provided by the Bankruptcy Code.

b. Alaska

How to Create an Alaska APT:

- To create an APT under the Alaska Act, a settlor must create an Alaska spendthrift trust. To do so, some or all of the trust assets must be deposited in Alaska and administered by an Alaska trustee,[42] i.e., a bank with trust powers (state-chartered or nationally chartered)

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[37] Id. § 3570(11)(b)(2).
[38] Id. § 3572(c).
[39] 12 Del. C. § 3502(b).
[40] *See Sterling v. Tantum*, 94 A. 176 (Del. Super. Ct. 1915) (funds in trust department of corporation having banking powers are exempt from attachment even though trust department is distinct from banking business); *Provident Trust Co. v. Banks*, 9 A.2d 260 (Del. Ch. 1939) (filing of creditor bill in equity court does not enable creditors to reach assets of self-settled trust at Delaware trust company); *Bank of Delaware v. Wilmington Housing Authority*, 352 A.2d 420 (Del. Super. Ct. 1976) (**w**ages of employee of Delaware bank are not subject to garnishment); *Delaware Trust Co. v. Partial*, 517 A.2d 259 (Del. Ch. 1986) (request for temporary restraining order to enjoin withdrawal of funds from bank denied).
[41] *Garretson v. Garretson*, 306 A.2d 737, 742 (Del. 1973).
[42] Alaska Stat. § 13.36.035(c)(1)-(2).

or a state-chartered trust company which has its principal place of business in Alaska or an individual who resides in Alaska.[43]

- The Alaska trustee must maintain records for the trust on an exclusive or nonexclusive basis and prepare or arrange for the preparation of fiduciary income tax returns for the trust.[44] Part or all of the administration of the trust must take place in Alaska.[45]
- If at least one Alaska trustee serves, an individual or institution that is not an Alaska trustee also may serve.[46] The settlor may be a cotrustee or advisor if he or she does not have a trustee power over discretionary distributions,[47] and the trust may authorize the settlor to appoint trust protectors and trustee advisors.[48]
- The terms of the trust instrument set the rights of the settlor in trust property, and implied or express understandings are void.[49]
- Before a settlor transfers assets to an Alaska APT, he or she must sign a solvency affidavit.[50]

<u>Who May Defeat an Alaska APT</u>:

- An action, including an action to enforce a judgment entered by a court or other body having adjudicative authority, may not be brought for an attachment or other provisional remedy against property in an Alaska APT, unless the action is to set aside a fraudulent transfer and is brought within the limitations periods described below.[51] The courts of Alaska have exclusive jurisdiction over controversies involving Alaska APTs.[52]

The Alaska Act does not protect the settlor from a creditor's claim if:

- The transfer to the trust was intended to defraud that creditor (a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud);
- The settlor may revoke or terminate all or a part of the trust without the consent of a person who has a significant adverse beneficial interest;[53]
- The trust instrument requires that all or a part of the trust income or principal or both be distributed to the settlor; or

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[43] Id. § 13.36.390(2).
[44] Id. § 13.36.035(c)(3).
[45] Id. § 13.36.035(c)(4).
[46] Id. § 13.36.320(a).
[47] Id. § 34.40.110(f).
[48] Alaska Stat. § 34.40.110(h).
[49] Id. § 34.40.110(i).
[50] Id. § 34.40.110(j).
[51] Id. § 34.40.110(k).
[52] Id.
[53] A settlor's power to revoke or terminate does not include: (a) A power to veto trust distributions; (b) a testamentary non-general power of appointment; (c) The right to receive: (1) a distribution from the trust in the discretion of a person, including the trustee, other than the settlor; (2) distributions from a CRT; (3) distributions from a total-return unitrust; (4) an interest in a QPRT; or (5) distributions from a GRAT or GRUT. See id. § 34.40.110(b)(2)-(3).

- At the time of the transfer, the settlor is in default by 30 or more days of making a payment under a child support judgment or order.[54]

a. <u>Pre-transfer Claims</u>

- If the creditor's claim arose before the transfer was made, the claim will be extinguished unless the creditor brings an action within four years after the transfer is made or, if later, within one year after the creditor discovers (or reasonably could have discovered) the transfer.[55] To take advantage of this provision, a creditor must prove, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer or, within four years of the transfer, file another action against the settlor that asserts a claim based on an act or omission of the settlor that occurred before the transfer.[56]

b. <u>Post-transfer Claims</u>

- If the creditor's claim arose after the transfer was made, the claim will be extinguished unless the creditor brings an action within four years after the transfer is made.[57]

c. <u>Family Claims</u>

- A settlor's interest in an Alaska APT created prior to marriage is not considered property subject to division or part of a property division in an Alaskan divorce proceeding.[58]
- Unlike the Delaware Act, the Alaska Act does not contain a separate exception for claims by existing or former spouses and minor children, but this does not necessarily mean that such claimants will not be able to reach the assets of Alaska APTs.
    - First, if a spouse elects against the will of the settlor of an Alaska APT, the augmented estate includes the trust.[59] This exception is not limited to Alaska residents because, under Alaska law, the right of a surviving spouse of a settlor who dies outside Alaska to take an elective share in property in Alaska is governed by the law of the settlor's domicile at death.[60]
    - Second, a federal statute requires each state to enforce child support orders made by courts of other states,[61] and, in actions to enforce arrearages in child support orders, the statute requires courts to apply the statute of limitations of the forum state or the state of the court that issued the order, whichever is longer.[62]

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[54] Alaska Stat. § 34.40.110(b).
[55] Id. § 34.40.110(d)(1).
[56] Id.
[57] Id. § 34.40.110(d)(2).
[58] Id. § 34.40.110(1).
[59] Id. § 13.12.205(2)(A).
[60] Alaska Stat. § 13.12.202(d).
[61] *See* 28 USC § 1738B(a).
[62] Id. § 1738B(h).

- Third, claims by destitute spouses, former spouses, and minor children are likely to be viewed sympathetically by courts and they therefore might find ways to reach trust assets.

d. Tort Claims

- Unlike the Delaware Act, the Alaska Act also does not contain an exception for tort claims that existed when an APT was created.

Consequences if an Alaska APT Is Defeated:

- If one of the above exceptions applies, a creditor may reach trust assets only to the extent necessary to pay that creditor's claim and related costs, including attorney's fees.[63]
- If the trustee has not acted in bad faith in accepting and administering the trust, the trustee may use trust assets to pay its costs of litigating the claim before satisfying the claim and a beneficiary (including the settlor) who received a proper distribution before a creditor brings a successful suit to defeat a transfer may retain the distribution.[64]
- The Alaska Act offers protection to trustees and advisors who participate in the preparation and funding of an APT.[65]

Moving Trusts to Alaska:

- A non-Alaska trust may become an Alaska APT if it satisfies the above requirements.[66] A trust that has its situs transferred to Alaska and has provisions that permit payments to the settlor, allow the trust to be perpetual, or are not expressly prohibited by the laws of Alaska is effective and enforceable.[67]

c. Nevada

How to Create a Nevada APT:

- To create an APT under the Nevada Act, a settlor must create in writing an irrevocable Nevada spendthrift trust.[68]
- The trust must also appoint at least one Nevada trustee, i.e., a natural person who resides and is domiciled in Nevada, a trust company that maintains an office in Nevada, or a bank with trust powers that maintains an office in Nevada.[69]
- The Nevada trustee must maintain records and prepare income tax returns for the trust, and part or all of the administration of the trust must take place in Nevada.[70]

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[63] Alaska Stat. §§ 13.36.310(b), 34.40.110(c).
[64] Id. § 13.36.310(c).
[65] Id. § 34.40.110(e).
[66] Id. § 13.36.043.
[67] Id.
[68] Nev. Rev. Stat. § 166.040(1)(b)-(c).
[69] Id. § 166.015(2).

The Nevada Act specifically permits the trustor of a Nevada APT to have the power to:

- The settlor may keep a power to prevent trust distributions, a testamentary special power of appointment, and the ability to receive a distribution from the trust in the discretion of another person.[71]

Who May Defeat a Nevada APT:

The Nevada Act does not protect the settlor from creditors' claims if:
- The trust is revocable;
- The trust instrument requires that all or a part of the trust income or principal be distributed to the settlor; or
- The transfer was intended to hinder, delay, or defraud known creditors.[72]

a. Pre-Transfer Claims

- If the creditor's claim arose before the trust was created, the creditor must bring an action within two years after the trust's creation or, if later, within six months after the creditor discovers (or reasonably should have discovered) the trust.[73] The Nevada Act specifies that a creditor is deemed to have discovered a transfer when a public record is made of it.[74]

b. Post-Transfer Claims

- If the creditor's claim arose after the trust was created, the creditor must bring an action within two years after its creation.[75]

c. Family Claims

- The Nevada Act does not address this subject. However, recall that:
    - A federal statute requires each state to enforce child support orders made by courts of other states,[76] and, in actions to enforce arrearages in child support orders, the statute requires courts to apply the statute of limitations of the forum state or the state of the court that issued the order, whichever is longer.[77]
    - Claims by destitute spouses, former spouses, and minor children are likely to be viewed sympathetically by courts and they therefore might find ways to reach trust assets.

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[70] Id. § 166.015(1)(d).
[71] Id. § 166.040(2).
[72] Id. § 166.040(1)(b).
[73] Id. § 166.170(1)(a).
[74] Nev. Rev. Stat. § 166.170(2).
[75] Id. § 166.170(1)(b).
[76] *See* 28 USC § 1738B(a).
[77] Id. § 1738B(h).

d. Tort Claims

- The Nevada Act does not provide an exception for tort claims.

Consequences if a Nevada APT Is Defeated:

- The Nevada Act does not address this subject.

Moving Trusts to Nevada

- The Nevada Act does not address this subject.

APPENDIX A[1]

STATE SELF-SETTLED TRUST STATUTES

State	Citation	Effective Date
PROHIBITS TRUSTOR'S CREDITORS FROM REACHING TRUSTOR'S INTEREST IN OR ASSETS OF SELF-SETTLED TRUST IN CERTAIN CIRCUMSTANCES		
Alaska	Alaska Stat. § 34.40.110	1997
Delaware	12 Del. C. §§ 3536(c), 3570-3576	1997
Missouri	R.S. Mo. § 456.5-505	2005
Nevada	Nev. Rev. Stat. §§ 166.010-166.170	1999
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:5-505(c), 564-D:1-564-D:18	2009
Oklahoma	Okla. Stat. tit. 31, §§ 10-18	2005
Rhode Island	R.I. Gen. Laws §§ 18-9.2-1-18-9.2-7	1999
South Dakota	S.D. Codified Laws §§ 55-1-36, 55-16-1-55-16-17, 55-3-47	2005
Tennessee	Tenn. Code Ann. §§ 35-16-101-35-16-112	2007
Utah	Utah Code Ann. § 25-6-14	2003
Wyoming	Wyo. Stat. Ann. §§ 4-10-103, 4-10-506(b), 4-10-510-4-10-523	2007

PERMITS TRUSTOR'S CREDITORS TO REACH TRUSTOR'S INTEREST IN SELF-SETTLED TRUST	
Alabama	Ala. Code § 19-3B-505(a)(2)
Arizona	Ariz. Rev. Stat. § 14-10505(a)(2)
Arkansas	Ark. Code Ann. § 28-73-505(a)(2)
California	Cal. Prob. Code § 15304
Delaware	12 Del. C. § 3536(c)
District of Columbia	D.C. Code § 19-1305.05(a)(2)
Florida	Fla. Stat. § 736.0505(1)(b)
Georgia	Ga. Code. Ann. § 53-12-28(c)
Idaho	Idaho Code § 15-7-502(4)
Illinois	735 Ill. Comp. Stat. 5/2-1403
Indiana	Ind. Code § 30-4-3-2(b)
Iowa	Iowa Code §§ 633A.2303-633A.2304
Kansas	Kan. Stat. Ann. § 58a-505(a)(2)
Kentucky	Ky. Rev. Stat. Ann. § 381.180(7)(a)
Louisiana	La. Rev. Stat. Ann § 9:2004
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 505(1)(B)
Mississippi	Miss. Code Ann. § 91-9-509(1)
Montana	Mont. Code Ann. § 72-33-305(1)
Nebraska	Neb. Rev. Stat. § 30-3850(a)(2)
New Hampshire	N.H. Rev. Stat. Ann. § 564-B:5-505(a)(2)

[1] Taken from Richard W. Nenno, *Planning and Defending Domestic Asset-Protection Trusts*, American Law Institute - American Bar Association Continuing Legal Education (2009).

New Jersey	NJSA § 3B:11-1
New Mexico	N.M. Stat. Ann. § 46A-5-505(A)(2)
New York	N.Y. Est. Powers & Trusts Law § 7-3.1(a)
North Carolina	N.C. Gen. Stat. § 36C-5-505(a)(2)
North Dakota	N.D. Cent. Code § 59-13-05(1)
Ohio	Ohio Rev. Code Ann. § 5805.06(A)(2)
Oklahoma	Okla. Stat. tit. 60, § 175.25(H)
Oregon	Or. Rev. Stat. § 130.315(1)(b)
Pennsylvania	20 Pa. C.S. § 7745(2)
South Carolina	S.C. Code Ann. § 62-7-505(a)(2)
South Dakota	S.D. Codified Laws § 55-1-36
Tennessee	Tenn. Code Ann. § 35-15-505(a)(2)
Texas	Tex. Prop. Code Ann. § 112.035(d)
Utah	Utah Code Ann. § 75-7-505(1)(b)
Virginia	Va. Code Ann. § 55-545.05(A)(2)
Washington	Wash. Rev. Code § 19.36.020
West Virginia	W. Va. Code § 36-1-18(a)
Wisconsin	Wis. Stat. § 701.06(6)(a)

PROVIDES THAT SELF-SETTLED TRUST IS VALID EVEN THOUGH TRUSTOR'S CREDITORS MAY REACH TRUSTOR'S INTEREST

California	Cal. Prob. Code § 15304(a)
Mississippi	Miss. Code Ann. § 91-9-509(1)
Montana	Mont. Code Ann. § 72-33-305(1)

PROVIDES THAT SELF-SETTLED TRUST IS VOID

Idaho	Idaho Code § 55-905
Illinois	735 Ill. Comp. Stat. 5/2-1403
New Jersey	NJSA § 25:2-1(a)
New York	N.Y. Est. Powers & Trusts Law § 7-3.1(a)
Washington	Wash. Rev. Code § 19.36.020

HAS NO RELEVANT STATUTE

Connecticut
Hawaii
Maryland
Massachusetts
Michigan
Minnesota
Vermont

Appendix B – Comparison of asset-protection trust (APT) statutes from selected states[1]

Prepared by the Mississippi Secretary of State, Division of Policy and Research
July 2009

I. What requirements must a trust meet to come within protection of the statute?

Alaska	**Delaware**	**Nevada**
The trust instrument must: (1) be irrevocable; (2) expressly state that Alaska law governs the validity, construction, and administration of the trust; and (3) contain a spendthrift clause. In addition, before transferring assets to the trust, the settlor must sign a solvency affidavit.	The trust instrument must: (1) be irrevocable; (2) expressly state that Delaware law governs the validity, construction, and administration of the trust (unless trust is being transferred to a Delaware trustee from a non-Delaware trustee); and (3) contain a spendthrift clause.	The trust instrument must: (1) be irrevocable; (2) provide that if the settlor is not a Nevada resident, at least some of the trust assets must be located in Nevada and a Nevada trustee be appointed; and (3) state that distributions to the settlor must be approved by someone other than the settlor.
Tennessee	**Utah**	**Wyoming**
The trust instrument must: (1) be irrevocable; (2) expressly state that Tennessee law governs the validity, construction, and administration of the trust (unless the trust is being transferred to Tennessee from a non-Tennessee trustee); and (3) contain a spendthrift clause.	The trust instrument must be irrevocable and contain a spendthrift clause.	The trust instrument must: (1) state that the trust is a qualified spendthrift trust; (2) be irrevocable; (3) expressly state that Wyoming law governs the validity, construction, and administration of the trust; and (4) contain a spendthrift clause. In addition, before transferring assets to the trust, the settlor must sign a solvency affidavit that includes a recitation that the settlor has and will maintain personal liability coverage equal to the lesser of $1 million or the value of the trust assets.

[1] Information taken from Richard W. Nenno and John E. Sullivan III, *Planning and Defending Asset-Protection Trusts*, American Law Institute - American Bar Association Continuing Legal Education Course of Study, April 20 - 24, 2009, and David G. Shaftel, *Comparison of the Twelve Domestic Asset Protection Statutes*, 34 ACTEC J. 293 (2009).

II. What contacts with the state are suggested or required by law?

Alaska	Delaware	Nevada
<u>Suggested</u> (but not required) that: (1) some or all of the trust assets be deposited in Alaska; (2) an Alaska trustee be appointed; and (3) part or all of the administration of the trust must take place in Alaska.	Delaware <u>requires</u> that (1) some or all of the trust assets be deposited in Delaware, and (2) that a Delaware trustee be appointed or participate materially in the administration of the trust.	Nevada law <u>requires</u> that: (1) some or all of the trust assets be deposited in Nevada, and (2) that a Nevada trustee be appointed and all or part of the trust's administration takes place in the state.
Tennessee	**Utah**	**Wyoming**
Tennessee law <u>requires</u> that: (1) some or all of the trust assets be deposited in the state, and (2) a Tennessee trustee be appointed or participate materially in the administration of the trust.	Utah law <u>requires</u> that: (1) a Utah trust company be appointed as trustee, and (2) some or all of the trust assets be held in certain types of accounts in the state.	Wyoming law <u>requires</u> that a Wyoming trustee be appointed who either maintains custody of some or all of the trust assets within the state or who otherwise materially participates in the administration of the trust.

III. Who must serve as trustee to come within protection of statute?

Alaska	Delaware	Nevada
An Alaska trustee is not required, but it is suggested that the trustee be a resident individual, or a trust company or bank that possesses trust powers and has its principal place of business in Alaska.	The trustee must be a resident individual (other than the settlor) or corporation whose activities are subject to supervision by the Delaware Bank Commissioner, FDIC, Comptroller of Currency, or Office of Thrift Supervision. A Delaware trustee automatically ceases to serve if it fails to meet these requirements.	The trustee must be a resident individual or trust company or bank that maintains an office in Nevada.
Tennessee	**Utah**	**Wyoming**
The trustee must be a resident individual (other than the settlor) or corporation whose activities are subject to supervision by the Tennessee Department of Financial Institutions, FDIC, Comptroller of Currency, or Office of Thrift Supervision. A Tennessee trustee automatically ceases to serve if it fails to meet these requirements.	The trustee must be an institution authorized to engage in trust business in Utah, including Utah depository institutions, non-Utah depository institutions authorized to do business in Utah, and certain other institutions.	The trustee must be a resident individual, person authorized to conduct trust business in Wyoming, or a regulated financial institution. A Wyoming trustee automatically ceases to serve if it fails to meet these requirements.

IV. Does the statute provide exceptions for spouses or children of the settlor?

Alaska	Delaware	Nevada
Yes. A creditor due child support may proceed against the trust if, at the time of transfer, the settlor was 30 days or more in default of making a payment under a child support judgment or order. In addition, federal law might enable minor children to access the trust assets for support. An Alaska APT created before marriage is not subject to division in an Alaska divorce proceeding.	Yes. Creditors whose claims result from the settlor's breach of an agreement or court order as to child support, alimony, or equitable distribution may proceed against the trust, but, in the case of alimony or equitable distribution, only if the ex-spouse was married to the settlor before or on the date of transfer.	No. However, federal law might enable minor children to access the trust assets for support.
Tennessee	**Utah**	**Wyoming**
Yes. Creditors whose claims result from the settlor's breach of an agreement or court order as to child support, alimony, or equitable distribution may proceed against the trust, but, in the case of alimony or equitable distribution, only if the ex-spouse was married to the settlor before or on the date of transfer.	Yes. Creditors whose claims result from the settlor's breach of an agreement or court order as to child support, alimony, or equitable distribution may proceed against the trust. The creditor must prove by clear and convincing evidence that the exception applies.	Yes. Creditors whose claims result from the settlor's breach of an agreement or court order as to child support may proceed against the trust. They may not proceed if the claim involves alimony.

V. May tort creditors proceed against the trust?

Alaska	Delaware	Nevada
No. Presumably, however, a tort creditor as of the date of transfer would be able to proceed against the trust, subject to the statute of limitations set forth below.	Yes. Creditors whose claims arise as result of death, personal injury, or property damage occurring before or on the date of transfer, for which the settlor was liable either directly or through vicarious liability, may proceed against the trust.	No. Presumably, however, a tort creditor as of the date of transfer would be able to proceed against the trust, subject to the statute of limitations set forth below.
Tennessee	**Utah**	**Wyoming**
No. Presumably, however, a tort creditor as of the date of transfer would be able to proceed against the trust, subject to the statute of limitations set forth below.	Utah law contains no specific exception for tort creditors. But see the discussion of other exceptions below at VIII.	No. Presumably, however, a tort creditor as of the date of transfer would be able to proceed against the trust, subject to the statute of limitations set forth below.

VI. Are fraudulent transfers excepted from coverage?

Alaska	**Delaware**	**Nevada**
Yes. Alaska has not adopted the Uniform Fraudulent Transfer Act (UFTA). The Alaska statute sets aside transfers made with intent to defraud.	Yes. UFTA applies and sets aside transfers with actual intent to hinder, delay, or defraud, and transfers made with constructive fraudulent intent. However, future creditors may set aside a transfer only if it was made with actual intent to defraud.	Yes. UFTA applies and sets aside transfers with actual intent to hinder, delay, or defraud, and transfers made with constructive fraudulent intent.
Tennessee	**Utah**	**Wyoming**
Yes. UFTA applies and sets aside transfers with actual intent to hinder, delay, or defraud, and transfers made with constructive fraudulent intent.	Yes. UFTA applies and sets aside transfers with actual intent to hinder, delay, or defraud, and transfers made with constructive fraudulent intent.	Yes. UFTA applies and sets aside transfers with actual intent to hinder, delay, or defraud, and transfers made with constructive fraudulent intent.

VII. For a fraudulent transfer action, what is the statute of limitations?

Alaska	**Delaware**	**Nevada**
Existing creditors: Four years after the transfer, or one year after the transfer was or reasonably could have been discovered. Future creditors: Four years after the transfer.	Existing creditors: Four years after the transfer, or one year after the transfer was or reasonably could have been discovered if claim is based upon intent to hinder, delay, or defraud. Four years after the transfer for claims based upon constructive fraud. Future creditors: Four years after the transfer.	Existing creditors: Two years after the transfer, or, if longer, six months after the transfer was or could reasonably have been discovered if the claim is based upon actual intent to defraud. A transfer is deemed discovered when reflected in a public record. Future creditors: Two years after the transfer.
Tennessee	**Utah**	**Wyoming**
Existing creditors: Four years after the transfer, or one year after the transfer was or reasonably could have been discovered if claim is based upon intent to hinder, delay, or defraud. Four years after the transfer for claims based upon constructive fraud. Future creditors: Four years after the transfer.	Existing and future creditors: Four years after the transfer, or one year after the transfer was or reasonably could have been discovered if claim is based upon intent to hinder, delay, or defraud. Four years after the transfer for claims based upon constructive fraud.	Existing and future creditors: Four years after the transfer, or one year after the transfer was or reasonably could have been discovered if claim is based upon intent to hinder, delay, or defraud. Four years after the transfer for claims based upon constructive fraud.

VIII. Are there any other circumstances under which creditor may proceed against the trust?

Alaska	**Delaware**	**Nevada**
No.	No.	No.
Tennessee	**Utah**	**Wyoming**
No.	Yes. A creditor may proceed against the trust if: (1) the claim is based on a decision or ruling resulting from judicial, arbitration, mediation, or administrative proceeding commenced prior to or within three years after the trust was created; (2) if the settlor's transfer into the trust was made with actual intent to hinder, delay, or defraud that creditor; (3) a transfer was made when the settlor was insolvent or rendered the settlor insolvent; (4) the claim is for recovery of public assistance received by the settlor under Utah law; (5) the claim is for taxes owed by the settlor to a governmental entity; (6) the settlor transferred assets into the trust in violation of certain written representations or agreements; or (7) the claim is a judgment, award, order, sentence, fine, penalty, or other determination of liability of settlor constituting fraud, intentional infliction of harm, or a crime. The creditor must prove by clear and convincing evidence that the exception applies.	Yes – if trust property is listed on an application or financial statement used to obtain credit or if the property was transferred to the trust from the settlor and the settlor received it fraudulently.

IX. Are there provisions for moving the trust to the state and making it subject to the statute?

Alaska	Delaware	Nevada
Yes. The trust must meet all statutory requirements (listed above), and an Alaska trustee must serve.	Yes. A trust may become subject to the statute if moved to Delaware, provided that trust meets the statutory requirements listed above, except the trust instrument does not have to state that Delaware law applies. For purposes of the statute of limitations, if a trust is moved from another jurisdiction, the transfer is deemed made on the date the property was originally transferred in trust, whether before or after the effective date of the Delaware statute.	No.
Tennessee	**Utah**	**Wyoming**
Yes. A trust may become subject to the statute if moved to Tennessee, provided that trust meets the statutory requirements listed above, except the trust instrument does not have to state that Tennessee law applies. For purposes of the statute of limitations, if a trust is moved from another jurisdiction, the transfer is deemed made on the date the property was originally transferred in trust, whether before or after the effective date of the Tennessee statute.	Yes. The trust must have a Utah trust company as the trustee and must be administered in Utah.	Yes. A trust may become subject to the statute if moved to Wyoming, provided that trust meets the statutory requirements listed above, except the trust instrument does not have to state that Wyoming law applies. For purposes of the statute of limitations, if a trust is moved from another jurisdiction, the transfer is deemed made on the date the property was originally transferred in trust, whether before or after the effective date of the Wyoming statute.

X. What powers may the settlor retain?

Alaska	**Delaware**	**Nevada**
The settlor may retain: (1) the power to veto distributions; (2) a non-general testamentary power of appointment; and (3) the right to appoint a trust protector or trustee advisor.	The settlor may retain: (1) the power to veto distributions; (2) a non-general testamentary power of appointment; and (3) the power to replace a trustee adviser.	The settlor may retain: (1) the power to veto distributions; and (2) a testamentary special power of appointment.
Tennessee	**Utah**	**Wyoming**
The settlor may retain: (1) the power to veto distributions; (2) a non-general testamentary power of appointment; (3) the power to replace a trustee advisor with an unrelated non-subordinate party; and (4) the power to serve as an investment advisor.	The settlor may retain: (1) the power to veto distributions; (2) a testamentary special power of appointment; and (3) the power to appoint non-subordinate advisors or protectors.	The settlor may retain: (1) the power to veto distributions; (2) an inter vivos or testamentary general or limited power of appointment; (3) the power to add, remove, or replace a trustee, trust protector, or trust advisor; and (4) the power to serve as an investment advisor.

XI. May the trust utilize a distribution advisor, investment advisor, or trust protector?

Alaska	**Delaware**	**Nevada**
Yes. A trust may have a trust protector (who must be a disinterested third party) and a trustee advisor. The settlor may be an advisor if he/she does not have trustee power over discretionary distributions.	Yes. A trust may have one or more advisors (other than the settlor) who may remove and appoint qualified trustees or trust advisors or who have authority to direct, consent to, or disapprove distributions from the trust. The trust may also have an investment advisor, which may be the settlor.	N/A
Tennessee	**Utah**	**Wyoming**
Yes. A trust may have one or more advisors (other than the settlor) who may remove and appoint qualified trustees or trust advisors or who have authority to direct, consent to, or disapprove distributions from the trust. The trust may also have an investment advisor, which may be the settlor.	Yes. A trust may utilize non-subordinate advisors or protectors who may remove or appoint trustees, who may direct, consent to, or disapprove distributions, and who may serve as investment directors. The settlor may also serve as an investment director.	Yes. A trust may have one or more advisors (other than the settlor) who may remove and appoint qualified trustees or trust advisors or who have authority to direct, consent to, or disapprove distributions from the trust. The trust may also have an investment advisor, which may be the settlor.

XII. Does the state assert an income tax against APTs formed by non-resident settlors?

Alaska	**Delaware**	**Nevada**
No.	No. However, it does impose its income tax upon trusts that accumulate revenue for Delaware residents.	No. Nevada has no state income tax.
Tennessee	**Utah**	**Wyoming**
No, if the beneficiaries are nonresidents. If the beneficiaries are residents, a tax is levied on dividends and interest.	No, except for Utah source income such as rental income from Utah real property.	No.

XIII. Does the statute provide that a spendthrift clause constitutes a transfer restriction described in § 541(c)(2) of the Bankruptcy Code?

Alaska	**Delaware**	**Nevada**
Yes.	Yes.	No.
Tennessee	**Utah**	**Wyoming**
Yes.	Yes.	Yes.

XIV. Does the statute provide that express or implied understandings regarding distributions to the settlor are invalid?

Alaska	**Delaware**	**Nevada**
Yes.	Yes.	No.
Tennessee	**Utah**	**Wyoming**
Yes.	No.	No.

XV. Does the statute provide protection for attorneys, trustees, and others involved in the creation and administration of the trust?

Alaska	**Delaware**	**Nevada**
Yes.	Yes.	No.
Tennessee	**Utah**	**Wyoming**
Yes.	Yes.	Yes.

XVI. Has the state legislature consistently supported APTs and related estate planning by continued amendments?

Alaska	**Delaware**	**Nevada**
Yes; amendments enacted in 1998, 2000, 2001, 2003, 2004, and 2006.	Yes; amendments enacted in 1998, 2000, 2001, 2002, 2003, 2005, 2006, 2007, and 2008.	Yes. The 2007 legislature approved minor amendments.
Tennessee	**Utah**	**Wyoming**
Yes; amended in 2008.	No amendments.	No amendments since enacted in 2007.

XVII. What is the allowable duration of trusts?

Alaska	**Delaware**	**Nevada**
Up to 1,000 years.	Indefinitely for personal property (Delaware has abolished the rule against perpetuities for personal property); up to 110 years for real property.	Up to 365 years.
Tennessee	**Utah**	**Wyoming**
Up to 360 years.	Up to 1,000 years.	Up to 1,000 years, except for real property.

Encyclopedia of Mississippi Law

Database updated September 2008

Jeffrey Jackson and Mary Miller

Chapter
73. Trusts

Robert E. Williford[*]

IV. Enforcement of Rights to Trust Property

Summary

§ 73:18. Liability of beneficiary's interest; spendthrift provisions

Where the income of the trust is held for the support of the beneficiary, who has no present right of enjoyment or power of alienation, the beneficiary's interest in the property cannot be reached by creditors.[1]

A beneficiary does not have such an interest as can be subjected to the payment of his or debts because legal title, as distinguished from the equitable title, is in the trustee for the beneficiary's use.[2] Thus, a trust interest may be made subject to a spendthrift provision, which places either restrictions or prohibitions on a beneficiary's right to dispose of his or her interest or the right of creditors to reach a beneficiary's interest.[3] Since a creditor is charged with a knowledge of the law and the provisions of a trust, a creditor has no right to look to the property in a spendthrift trust for the satisfaction of his or her demands.[4] Even under spendthrift trusts, however, excess accumulations beyond the beneficiary's needs may be subject to the beneficiary's debts if the direction to the trustee to pay that excess is absolute and unconditional.[5] Although a subsequent decision allowed an innocent tort judgment creditor to reach the assets of a spendthrift trust, especially where the fault rose to the level of gross negligence or intentional conduct,[6] this result was mitigated by the Family Trust Preservation Act.[7] Under the Act, if the agreement provides that a beneficiary's interest in the trust is not subject to voluntary or involuntary transfer, the interest may not be transferred and is not subject to the enforcement of a money judgment until that property is paid to the beneficiary.[8] Moreover, if payment of the trust property is discretionary with the trustee, a creditor of the beneficiary may not compel the trustee to pay any amount from the trust that may be paid only in the exercise of the trustee's discretion.[9] If the trust is self-settled, that is, the grantor is a beneficiary of his or her own self-created trust, the restraint is invalid against creditors and the assets may be exposed to the claims of creditors.[10]

A trust providing that a beneficiary has both a right to receive income during her lifetime and a right to receive the principal upon attaining a specified age does not give a creditor a right to look to the trust property for the satisfaction of the creditor's demands.[11] On the other hand, failure of a trust agreement to include language, whether by express provision or implication, protecting the interest of the beneficiaries from claims opens the door for creditors to reach the trust assets.[12]

[FN*] The author is a partner in the law firm of Williford, McAllister & Jacobus, LLP, Jackson, Mississippi.

The author wishes to thank Reeve G. Jacobus, Jr., Robert R. Stephenson, Samuel H. Williford and Sara Grice for their contribution to this chapter.

[FN1] Mitchell v. Choctaw Bank, 107 Miss. 314, 65 So. 278 (1914).

West's Key Number Digest

West's Key Number Digest, Trusts 150 to 152.

[FN2] Jordon v. Thomas, 34 Miss. 72 (1857). As to the nature of the trustee's title, see § 73:10.

[FN3] West Tennessee Co. v. Townes, 52 F. 2d 764 (N.D. Miss. 1931); Sligh v. First Nat. Bank of Holmes County, 704 So. 2d 1020 (Miss 1997) (spendthrift trust doctrine is a judicially created doctrine).

[FN4] Calhoun v. Markow, 168 Miss. 556, 151 So. 547 (1933).

West's Key Number Digest

West's Key Number Digest, Trusts 12, 141, 152.

[FN5] Leigh v. Harrison, 69 Miss. 923, 11 So. 604 (1892). In commenting on *Leigh v. Harrison*, the court in Sligh v. First Nat. Bank of Holmes County, 704 So. 2d 1020 (Miss 1997) noted: "Although the trust contained no spendthrift language, the Court held that under the circumstances, it could only have been [the testatrix's] intent that the trust should be protected from her son's creditors."

[FN6] Sligh v. First Nat. Bank of Holmes County, 704 So. 2d 1020 (Miss 1997).

[FN7] Miss. Code Ann. §§ 91-9-501 to 91-9-511.

[FN8] Miss. Code Ann. § 91-9-503.

[FN9] Miss. Code Ann. § 91-9-507(1).

[FN10] Miss. Code Ann. § 91-9-509(1). *See also*Johnson v. First Nat. Bank of Jackson, 386 So. 2d 1112 (Miss. 1980), holding that creator may not create an irrevocable spendthrift trust for herself. *Also see*Deposit Guaranty Nat. Bank v. Walter E. Heller & Co., 204 So. 2d 856 (Miss. 1967), finding spendthrift provision of self-settled trust invalid as against the claims of creator's creditors, notwithstanding existence of remaindermen.

[FN11] Calhoun v. Markow, 168 Miss. 556, 151 So. 2d 547 (1933).

[FN12] Clegg v. Federal Reserve Bank of St. Louis, 169 Miss. 578, 153 So. 812 (1934) (will did not provide that beneficiary's interest shall not become subject to her debts; no spendthrift or similar provision).

MSPRAC-ENC § 73:18

C

West's Annotated Mississippi Code Currentness
Title 91. Trusts and Estates
Chapter 9. Trusts and Trustees
Article 11. Family Trust Preservation Act of 1998
§ 91-9-501. Definitions

The following words and phrases shall have the meanings ascribed herein unless the context clearly indicates otherwise:

(a) "Trust" means the following:

(i) An express trust, private or charitable, with additions thereto, wherever and however created; or

(ii) A trust created or determined by a judgment or decree under which the trust is to be administered in the manner of an express trust.

(b) "Trust" excludes the following:

(i) Constructive trusts, other than those described in paragraph (a)(ii) of this section, and resulting trusts;

(ii) Guardianships and conservatorships;

(iii) Executors and administrators of decedent's estates;

(iv) Totten trust accounts;

(v) Custodial arrangements pursuant to the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act of any state;

(vi) Business trusts that are taxed as partnerships or corporations;

(vii) Investment trusts subject to regulation under the laws of this state or any other jurisdiction;

(viii) Common trust funds;

(ix) Voting trusts;

(x) Security arrangements;

(xi) Transfers in trust for purpose of suit or enforcement of a claim of right;

(xii) Liquidation trusts; or

(xiii) Any arrangement under which a person is nominee or escrowee for another.

(c) “Trustee” means an original, additional, or successor trustee, whether or not appointed or confirmed by a court.

(d) “Trust instrument” means a written instrument which creates, defines or determines a trust, including, but not limited to, a last will and testament of a decedent.

CREDIT(S)

Laws 1998, Ch. 460, § 1, eff. from and after passage (approved March 23, 1998).

RESEARCH REFERENCES

Encyclopedias

Encyclopedia of Mississippi Law § 73:18, Liability of Beneficiary's Interest; Spendthrift Provisions.

Miss. Code Ann. § 91-9-501, MS ST § 91-9-501
Current through all 2008 Sessions and HB Nos. 197, 699, 636 and 1027 of the 2009 Regular Session

END OF DOCUMENT

C

West's Annotated Mississippi Code Currentness
Title 91. Trusts and Estates
Chapter 9. Trusts and Trustees
Article 11. Family Trust Preservation Act of 1998
§ 91-9-503. Interests of beneficiary not subject to transfer

Except as provided in Section 91-9-509, if the trust instrument provides that a beneficiary's interest in income or principal or both of a trust is not subject to voluntary or involuntary transfer, the beneficiary's interest in income or principal or both under the trust may not be transferred and is not subject to the enforcement of a money judgment until paid to the beneficiary.

CREDIT(S)

Laws 1998, Ch. 460, § 2, eff. from and after passage (approved March 23, 1998).

LIBRARY REFERENCES

Trusts 152.
WESTLAW Topic No. 390.
C.J.S. Trusts §§ 198 to 199.

RESEARCH REFERENCES

Encyclopedias

Encyclopedia of Mississippi Law § 73:18, Liability of Beneficiary's Interest; Spendthrift Provisions.

Treatises and Practice Aids

Bogert - the Law of Trusts and Trustees § 222, Spendthrift Trusts in the United States.

Bogert - the Law of Trusts and Trustees § 224, Exceptions to the Validity of Spendthrift Trusts--Public Policy.

Restatement (3d) of Trusts § 58, Spendthrift Trusts: Validity and General Effect.

Restatement (3d) of Trusts § 59, Spendthrift Trusts: Exceptions for Particular Types of Claims.

C

West's Annotated Mississippi Code Currentness
Title 91. Trusts and Estates
Chapter 9. Trusts and Trustees
Article 11. Family Trust Preservation Act of 1998
§ 91-9-505. Education-designated trust monies

Except as provided in Section 91-9-509, if the trust instrument provides that the trustee shall pay income or principal or both of a trust for the education or support of a beneficiary, the beneficiary's interest in income or principal or both under the trust, to the extent the income or principal or both is necessary for the education or support of the beneficiary, may not be transferred and is not subject to the enforcement of a money judgment until paid to the beneficiary. This section shall not be applied or construed to limit or otherwise diminish a restraint on transfer that is valid under Section 91-9-503.

CREDIT(S)

Laws 1998, Ch. 460, § 3, eff. from and after passage (approved March 23, 1998).

LIBRARY REFERENCES

Trusts 152.
WESTLAW Topic No. 390.
C.J.S. Trusts §§ 198 to 199.

RESEARCH REFERENCES

Treatises and Practice Aids

Restatement (3d) of Trusts § 60, Transfer or Attachment of Discretionary Interests.

Miss. Code Ann. § 91-9-505, MS ST § 91-9-505
Current through all 2008 Sessions and HB Nos. 197, 699, 636 and 1027 of the 2009 Regular Session

END OF DOCUMENT

C

West's Annotated Mississippi Code Currentness
Title 91. Trusts and Estates
Chapter 9. Trusts and Trustees
Article 11. Family Trust Preservation Act of 1998
§ 91-9-507. Monies designated for payment at discretion of trustee

(1) Except as provided in Section 91-9-509, if the trust instrument provides that the trustee shall pay to or for the benefit of a beneficiary so much of the income or principal or both of a trust as the trustee in the trustee's discretion sees fit to pay, a transferee or creditor of the beneficiary may not compel the trustee to pay any amount from the trust that may be paid only in the exercise of the trustee's discretion. This subsection shall not be applied or construed to limit or otherwise diminish a restraint on transfer that is valid under Section 91-9-503.

(2) If the trustee has knowledge of a transfer of a beneficiary's interest in a trust or has been served with process in a proceeding for garnishment or attachment or the like by a judgment creditor seeking to reach a beneficiary's interest in a trust, and the trustee pays to or for the benefit of the beneficiary any part of the income or principal of the trust that may be paid only in the exercise of the trustee's discretion, the trustee is liable to the transferee or creditor to the extent that the payment to or for the benefit of the beneficiary impairs the right of the transferee or creditor. This subsection does not apply if the beneficiary's interest in the trust is subject to a restraint on transfer that is valid under Section 91-9-503.

(3) This section applies regardless of whether the trust instrument provides a standard for the exercise of the trustee's discretion.

(4) Nothing in this section limits any right the beneficiary may have to compel the trustee to pay to or for the benefit of the beneficiary all or part of the income or principal of a trust.

CREDIT(S)

Laws 1998, Ch. 460, § 4, eff. from and after passage (approved March 23, 1998).

LIBRARY REFERENCES

Trusts 152.
WESTLAW Topic No. 390.
C.J.S. Trusts §§ 198 to 199.

C

West's Annotated Mississippi Code Currentness
Title 91. Trusts and Estates
Chapter 9. Trusts and Trustees
Article 11. Family Trust Preservation Act of 1998
§ 91-9-509. Settlor as beneficiary of settlor-created trust

(1) If the settlor is a beneficiary of a trust created by the settlor and the settlor's interest in the trust is subject to a provision restraining the voluntary or involuntary transfer of the settlor's interest, the restraint is invalid against transferees or creditors of the settlor. The invalidity of the restraint on transfer does not affect the validity of the trust.

(2) If the settlor is the beneficiary of a trust created by the settlor and the trust instrument provides that the trustee shall pay income or principal or both of the trust for the education or support of the beneficiary or gives the trustee discretion to determine the amount of income or principal or both of the trust to be paid to or for the benefit of the settlor, a transferee or creditor of the settlor may reach the maximum amount of the trust that the trustee could pay to or for the benefit of the settlor under the trust instrument, not exceeding the amount of the settlor's proportionate contribution to the trust.

CREDIT(S)

Laws 1998, Ch. 460, § 5, eff. from and after passage (approved March 23, 1998).

LIBRARY REFERENCES

Trusts 12.
WESTLAW Topic No. 390.
C.J.S. Trusts §§ 22, 26.

RESEARCH REFERENCES

Encyclopedias

Encyclopedia of Mississippi Law § 73:18, Liability of Beneficiary's Interest; Spendthrift Provisions.

Treatises and Practice Aids

Restatement (3d) of Trusts § 60, Transfer or Attachment of Discretionary Interests.

C

West's Annotated Mississippi Code Currentness
Title 91. Trusts and Estates
Chapter 9. Trusts and Trustees
Article 11. Family Trust Preservation Act of 1998
§ 91-9-511. Application of provisions

Sections 91-9-501 through 91-9-511 shall apply to trusts created, defined or determined in trust instruments executed at any time whether before, on or after March 23, 1998.

CREDIT(S)

Laws 1998, Ch. 460, § 6, eff. from and after passage (approved March 23, 1998).

LIBRARY REFERENCES

Trusts 4, 130.
WESTLAW Topic No. 390.
C.J.S. Trusts §§ 25, 30, 176, 199.

RESEARCH REFERENCES

Encyclopedias

Encyclopedia of Mississippi Law § 73:18, Liability of Beneficiary's Interest; Spendthrift Provisions.

Miss. Code Ann. § 91-9-511, MS ST § 91-9-511
Current through all 2008 Sessions and HB Nos. 197, 699, 636 and 1027 of the 2009 Regular Session

END OF DOCUMENT

A SUMMARY

At its annual meeting in July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the Uniform Prudent Management of Institutional Funds Act (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. These two principles have been the twin lodestars of asset management for endowments since UMIFA became the law of the land in nearly all U.S. jurisdictions.

UPMIFA continues these fundamental principles as a needed upgrade of UMIFA. Both investment in assets and expenditure for charitable purposes have grown exponentially in the 35 years since UMIFA was drafted; asset management theory and practice have also advanced. UPMIFA, as an up-date and successor to UMIFA, establishes an even sounder and more unified basis for charitable fund management than UMIFA has done.

INVESTMENT

In 1972, UMIFA represented a revolutionary advance over prevailing practices which imposed upon endowments the limited investment opportunities available for managing trust assets – even endowments not organized as trusts. By stating the first prudent investor rule in statutory law, UMIFA allowed endowments to invest in any kind of assets, to pool endowment funds for investment purposes, and to delegate investment management to other persons (*e.g.*, professional investment advisors), as long as the governing board of the charitable institution exercised ordinary business care and prudence in making these decisions. A range of factors guided the exercise of prudence.

UPMIFA incorporates the experience gained in the last 35 years under UMIFA by providing even stronger guidance for investment management and enumerating a more exact set of rules for investing in a prudent manner. It requires investment "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." It requires prudence in incurring investment costs, authorizing "only costs that are appropriate and reasonable." Factors to be considered in investing are expanded to include, for example, the effects of inflation. UPMIFA emphasizes that investment decisions must be made in relation to the overall resources of the institution and its charitable purposes. No investment decision may be made in isolation, but must be made in light of the fund's entire portfolio, and as a part of an investment strategy "having risk and return objectives reasonably suited to the fund and to the institution." A charitable institution must diversify assets as an affirmative obligation unless "special circumstances" dictate otherwise. Assets must be reviewed within a reasonable time after they come into the possession of the institution in order to conform them to the investment strategy and objectives of the fund. Investment experts, whether in-house or hired for the purpose, are held to a standard of care consistent with that expertise.

UMIFA initiated the era of modern portfolio management for charitable institutions. UPMIFA provides the standards and guidelines that subsequent experience tells us are the most appropriate for the purpose. Charitable institutions will have more precise standards to guide them. Courts will have more precise standards with which to measure prudence in the event of a challenge. The result should be more money for programs supported by charitable funds, including endowments.

EXPENDITURE

UMIFA initiated the concept of total return expenditure of endowment assets for charitable program purposes, expressly permitting prudent expenditure of both appreciation and income and replacing the old trust law concept that only income (*e.g.*, interest and dividends) could be spent. Thus, asset growth and income could be appropriated for program purposes, subject to the rule that a fund could not be spent below "historic dollar value."

UPMIFA builds upon UMIFA's rule on appreciation, but it eliminates the concept of "historic dollar value." UPMIFA, instead, provides better guidance on prudence and makes the need for a floor on spending unnecessary. UPMIFA states that the institution "may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes and duration for which the endowment fund is established." Seven criteria guide the institution in its yearly expenditure decisions: "1) duration and preservation of the endowment fund; 2) the purposes of the institution and the endowment fund; 3) general economic conditions; 4) effect of inflation or deflation; 5) the expected total return from income and the appreciation of investments; 6) other resources of the institution; and, 7) the investment policy of the institution." These standards mirror the standards that apply to investment decision-making, thus unifying both investment and expenditure decisions more concretely.

UPMIFA includes an optional provision that allows states to enact another kind of safeguard against excessive expenditure. If a state does not want to rely solely upon the rule of prudence provided in UPMIFA, the state may adopt a provision that creates a rebuttable presumption of imprudence if an institution expends an amount greater than seven percent of fair market value of a fund, calculated in an averaging formula over three years. While the seven percent rule is likely not to be necessary, it is available for those states that may be uncomfortable with the general standards.

RELEASE OR MODIFICATION OF RESTRICTIONS

UPMIFA recognizes and protects donor intent more broadly than UMIFA did, in part by providing a more comprehensive treatment of the modification of restrictions on charitable funds. Sometimes a restriction imposed by a donor becomes impracticable or wasteful or may impair the management of a fund. The donor may consent to release the restriction, if the donor is still alive and able to do so, but if the donor is not available the charity can ask for court approval of a modification of the restriction. The trust law doctrines of cy pres (modifying a purpose restriction) and deviation (modifying a management restriction) probably already apply to charitable funds held by nonprofit corporations. UPMIFA makes this clear. Under UMIFA, the only option with respect to a restriction was release of the restriction. UPMIFA instead authorizes a modification that a court determines to be in accordance with the donor's probable intention. If the charity asks for court approval of a modification, the charity must notify the state's chief charitable regulator and the regulator may participate in the proceeding.

UPMIFA adds a new provision that allows a charity to modify a restriction on a small (less than $25,000) and old (over 20 years old) fund without going to court. If a restriction has become impracticable or wasteful, the charity may notify the state charitable regulator, wait 60 days, and then, unless the regulator objects, modify the restriction in a manner consistent with the charitable purposes expressed in any documents that were part of the original gift.

CONCLUSION

UPMIFA reflects and incorporates the 35 years of experience that has accumulated under the original UMIFA. Rather than changing institutional investment or expenditure practices, it brings them up to date and unifies them across a broad range of charitable funds. The better charitable institutions manage investments and prudently control expenditures, the more money they should have for program purposes.

QUICK COMPARISON

UPMIFA	UMIFA
Scope: • Charitable organizations except for trusts unless a charity is the trustee	**Scope:** • Charitable organizations except for trusts unless a charity is the trustee
Investment Conduct: • Express cost management obligation • Whole portfolio management standard of performance • Express diversification requirement • Portfolio balancing required • Special skills standard of performance	**Investment Conduct:** • General obligation to invest prudently using ordinary business care
Expenditure of Funds: • Express prudent total return standard, 7 factors: o Fund duration o Fund/institution purposes o General economic conditions o Effects, inflation/deflation o Expected total return o Other resources o Institutional investment policy • Optional, over 7% of total return presumed imprudent	**Expenditure of Funds:** • Net appreciation may be spent for purposes of endowment • Historic dollar value limitation
Delegation of Management/Investment: • Prudent delegation in good faith, care standard of prudent person: o To select agent o Establish scope and terms of delegation o Requires periodic review and supervision of agent • Agent has duty of reasonable care • Agent subject to court jurisdiction • Delegation to committees, officers or employees as authorized by other law	**Delegation of Management/Investment:** • Delegation allowed without express standards

<table>
<tr><th>UPMIFA</th><th>UMIFA</th></tr>
<tr><td>
Release or Modification of Restrictions:
<u>Restriction</u>

Court may release or modify if restriction is:

Impracticable or wasteful
Impairs management or investment
Meets unanticipated circumstances that allow release or modification furthering purposes of the fund

Notice to Attorney General required

<u>Purpose</u>

Court may release or modify if purpose is:

Unlawful to retain
Impracticable
Impossible to achieve
Wasteful

Must be consistent with donor’s intent
Notice to Attorney General Required

<u>Small Old Fund</u>

Institution may institute release or modification without court approval
Notice to Attorney General required

</td><td>
Release or Modification of Restrictions:

Court release if restriction obsolete, inappropriate or impracticable
Notice to Attorney General required
Cy pres (modification of purpose) not limited or addressed

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</table>

WHY STATES SHOULD ADOPT THE ACT

This 2006 Uniform Prudent Management of Institutional Funds Act replaces and updates the 1972 Uniform Management of Institutional Funds Act. Its rules govern investment of the funds of charitable organizations and total return expenditure of those funds. It establishes a prudent management investment regime derived from the Uniform Prudent Investor Act (which applies only to trusts) and a prudent total return expenditure based upon performance of the portfolio held by a charitable institution. It also provides for delegation of authority for investment to outside agents and reformation of donor restrictions (cy pres) on funds when these are so outdated that the original objective can no longer be honored.

States should adopt the Uniform Prudent Management of Institutional Funds Act:

1. To make sure that the best investment practices govern the actual investment of institutional funds.

2. To withdraw obsolete rules governing prudent total return expenditure and provide a modern rule of prudence consistent with the rules that govern investment.

3. To eliminate differences in investment and expenditure rules that apply to different types of nonprofit organizations. The same rules govern all under UPMIFA.

4. To encourage growth of institutional funds while eliminating investment risks that threaten principal.

5. To assure that there are adequate assets in any institutional fund to meet program needs.

6. To make the law governing institutional funds uniform in every state.

Comparison of UPMIFA (2006) with existing Mississippi Law

(Prepared 04/09/07 by Joshua Poje, ULC Law Clerk)

Legislative History of Mississippi law:

- Mississippi enacted the Uniform Management of Institutional Funds Act in 1998. It is codified at MCA §79-11-611 et seq.

UPMIFA (2006)	Mississippi Law
SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Prudent Management of Institutional Funds Act.	**§ 79-11-617. Short title** Sections 79-11-601 through 79-11-617 may be cited as the "Uniform Management of Institutional Funds Act."
SECTION 2. DEFINITIONS. In this [act]: (1) "Charitable purpose" means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community. (2) "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 does not include assets that an institution designates as an endowment fund for its own use. (3) "Gift instrument" means 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. (4) "Institution" means: (A) a person, other than an individual, organized and operated exclusively for charitable purposes; (B) a government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; and (C) a trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated. (5) "Institutional fund" means a fund held by an institution exclusively for charitable purposes. The term does not include: (A) program-related assets; (B) a fund held for an institution by a trustee that is not an institution;	**§ 79-11-601. Definitions** For the purposes of Sections 79-11-601 through 79-11-617: (a) "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. (b) "Institutional fund" means a fund held by an institution for its exclusive use, benefit or purposes, but does not include (i) a fund held for an institution by a trustee that is not an institution, or (ii) 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. (c) "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. (d) "Governing board" means the body responsible for the management of an institution or of an institutional fund. (e) "Historic dollar value" means the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. The determination of historic dollar value made in good faith by the institution is conclusive.

<table>
<tr>
<td>or
(C) a fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund.
(6) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.
(7) “Program-related asset” means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.
(8) “Record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.</td>
<td>(f) "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.</td>
</tr>
<tr>
<td>SECTION 3. STANDARD OF CONDUCT IN MANAGING AND INVESTING INSTITUTIONAL FUND.
(a) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.
(b) In addition to complying with the duty of loyalty imposed by law other than this [act], each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
(c) In managing and investing an institutional fund, an institution:
(1) may incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution; and
(2) shall make a reasonable effort to verify facts relevant to the management and investment of the fund.
(d) An institution may pool two or more institutional funds for purposes of management and investment.</td>
<td><u>§ 79-11-607. Role of board concerning investments</u>

In addition to an investment otherwise authorized by law or by the applicable gift instrument, and without restriction to investments a fiduciary may make, the governing board, subject to any specific limitations set forth in the applicable gift instrument or in the applicable law other than law relating to investments by a fiduciary, may:

(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, partnerships or individuals, 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; and

(d) Invest all or any part of an institutional fund in any other pooled or common fund available for</td>
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(e) Except as otherwise provided by a gift instrument, the following rules apply:

(1) In managing and investing an institutional fund, the following factors, if relevant, must be considered:

(A) general economic conditions;

(B) the possible effect of inflation or deflation;

(C) the expected tax consequences, if any, of investment decisions or strategies;

(D) the role that each investment or course of action plays within the overall investment portfolio of the fund;

(E) the expected total return from income and the appreciation of investments;

(F) other resources of the institution;

(G) the needs of the institution and the fund to make distributions and to preserve capital; and

(H) an asset's special relationship or special value, if any, to the charitable purposes of the institution.

(2) Management and investment decisions about an individual asset must 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.

(3) Except as otherwise provided by law other than this [act], an institution may invest in any kind of property or type of investment consistent with this section.

(4) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification.

(5) Within a reasonable time after receiving property, an institution shall 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

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.

§ 79-11-611. Standard of care of board

In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. In so doing they shall consider 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, price level trends and general economic conditions.

purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of this [act]. (6) A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.	
SECTION 4. APPROPRIATION FOR EXPENDITURE OR ACCUMULATION OF ENDOWMENT FUND; RULES OF CONSTRUCTION. (a) Subject to the intent of a donor expressed in the gift instrument [and to subsection (d)], an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. In making a determination to appropriate or accumulate, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors: (1) the duration and preservation of the endowment fund; (2) the purposes of the institution and the endowment fund; (3) general economic conditions; (4) the possible effect of inflation or deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the institution; and (7) the investment policy of the institution. (b) To limit the authority to appropriate for expenditure or accumulate under subsection (a), a gift instrument must specifically state the limitation.	**§ 79-11-603. Funding** Except as otherwise provided in Section 79-11-605, the governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, 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 79-11-611. 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. **§ 79-11-605. Gift instruments** Section 79-11-603 does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended. A restriction upon the expenditure of net appreciation may not be implied from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only "income," "interest," "dividends" or "rents, issues or profits," or "to preserve the principal intact," or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after July 1, 1998.

(c) 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”, or “rents, issues, or profits”, or “to preserve the principal intact”, or words of similar import: (1) create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund; and (2) do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (a). [(d) The appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of not less than three years immediately preceding the year in which the appropriation for expenditure was made, creates a rebuttable presumption of imprudence. For an endowment fund in existence for fewer than three years, the fair market value of the endowment fund must be calculated for the period the endowment fund has been in existence. This subsection does not: (1) apply to an appropriation for expenditure permitted under law other than this [act] or by the gift instrument; or (2) create a presumption of prudence for an appropriation for expenditure of an amount less than or equal to seven percent of the fair market value of the endowment fund.]	
[SECTION 5. DELEGATION OF MANAGEMENT AND INVESTMENT FUNCTIONS. (a) Subject to any specific limitation set forth in a gift instrument or in law other than this [act], an institution may 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 shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in: (1) selecting an agent;	**§ 79-11-609. Role of board concerning delegation and contracting** Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may (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 advisors, investment counsel or managers, banks or trust companies, so to act, and (c) authorize the payment of compensation for investment advisory or management services.

(2) establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation. (b) In performing a delegated function, an agent owes a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation. (c) An institution that complies with subsection (a) is not liable for the decisions or actions of an agent to which the function was delegated. (d) By accepting delegation of a management or investment function from an institution that is subject to the laws of this state, an agent submits 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. (e) An institution may delegate management and investment functions to its committees, officers, or employees as authorized by law of this state other than this [act].]	
SECTION 6. RELEASE OR MODIFICATION OF RESTRICTIONS ON MANAGEMENT, INVESTMENT, OR PURPOSE. (a) If the donor consents in a record, an institution may 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. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution. (b) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional 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. The institution shall	**§ 79-11-613. Release of gift instrument restrictions** (1) 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. (2) If written consent of the donor cannot be obtained by reason of his death, disability, unavailability or impossibility of identification, the governing board may apply in the name of the institution to the chancery court of the county in which the institution is located for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The Attorney General shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund.

notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard. To the extent practicable, any modification must be made in accordance with the donor's probable intention. (c) If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument. The institution shall notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard. (d) If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, [60 days] after notification to the [Attorney General], may release or modify the restriction, in whole or part, if: (1) the institutional fund subject to the restriction has a total value of less than [$25,000]; (2) more than [20] 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.	(3) 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. (4) This section does not limit the application of the doctrine of cy pres.
SECTION 7. REVIEWING COMPLIANCE. Compliance with this [act] is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, and not by hindsight.	
SECTION 8. APPLICATION TO EXISTING INSTITUTIONAL FUNDS. This [act] applies to institutional funds existing on or established after [the effective date of this act]. As applied to institutional funds existing on [the effective date of this act] this [act] governs only decisions made or actions taken on or after that date.	

SECTION 9. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101 of that act, 15 U.S.C. Section 7001(a), or authorize electronic delivery of any of the notices described in Section 103 of that act, 15 U.S.C. Section 7003(b).	
SECTION 10. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.	**§ 79-11-615. Purpose** Sections 79-11-601 through 79-11-617 shall be so applied and construed as to effectuate its general purpose to make uniform the law with respect to the subject of these sections among those states which enact them.
SECTION 11. EFFECTIVE DATE. This [act] takes effect	
SECTION 12. REPEAL. The following acts and parts of acts are repealed: (a) [The Uniform Management of Institutional Funds Act]	

UMIFA Becomes UPMIFA [1]

By Susan Gary [2]

The Uniform Management of Institutional Funds Act (UMIFA) guides charities on the management and investment of funds, provides rules on spending from endowment funds, and permits the release of restrictions on the use and management of charitable funds. The Act has been adopted in 47 states and the District of Columbia. It has been successful, but portions of it are out-of-date, and the National Conference of Commissioners on Uniform State Laws (the Uniform Law Commission) at its annual meeting on July 13, 2006, approved a revised version: the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

In 1972, when the Uniform Law Commission promulgated UMIFA, a great deal of uncertainty existed about the standards that governed directors of charities operating as nonprofit corporations. Trust law provided guidance, but trust law at that time restricted investment decision making in a number of ways. Trustees analyzed risk on an asset-by-asset basis, rather than across the portfolio. Trust law did not permit delegation of investment authority, so involving investment advisors caused concern. Trust accounting rules defined income and principal in a way that affected both spending and investing. If a charity could spend only "income" under trust law rules, the trust law definition of income limited investment options. UMIFA created a new set of rules that made total-return investing possible for charities organized as nonprofit corporations.

In the period since 1972, trust law has caught up with UMIFA in many respects. The Uniform Prudent Investor Act (UPIA), a trust law statute now adopted in 44 states, provides modern guidance for the prudence standard fiduciaries should follow in making investment decisions. Although the comments to UPIA suggest that the standards articulated in that statute also apply to charities organized as nonprofit corporations, making the standard explicitly applicable to all charities makes sense. With this and other changes in mind, the Uniform Law Commission decided to update UMIFA.

Four years in the making, UPMIFA updates the prudence standard that applies to the management and investment of charitable funds. UPMIFA also modernizes the rules governing expenditures from endowment funds, both to provide better guidance on spending from

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endowment funds and to give institutions the ability to cope more easily with fluctuations in the value of the endowment. Finally, UPMIFA adopts provisions governing the release and modification of restrictions on charitable funds to permit more efficient management of these funds. UPMIFA applies, as did UMIFA, to charities organized as nonprofit corporations and to charities organized as trusts, but only to those trusts that have a charity as a trustee.

Prudent Investing

The standard for investing and managing charitable funds is one of prudence. Although the law applicable to private trusts and to business corporations may hold trustees and directors to different standards of care, the standard of care for those managing a charity should be the same for all charities, regardless of the organizational form.

UPMIFA's articulation of the prudence standard reflects the merging of the trust and corporate standards when applied to managers of charitable funds. The statute takes language from both the Revised Model Nonprofit Corporation Act (RMNCA) and UPIA. The RMNCA states that a manager must act "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." This language derives from the business standard, but "similar circumstances" refers to the fact that the funds are managed for charitable purposes and not business purposes. UPMIFA uses language from the RMNCA and then follows this general direction with specific factors that a manager should consider. These factors derive from UPIA and are consistent with good practice under current law.

The prudence standard in UPMIFA requires managers to meet their fiduciary duty of care, the duty to minimize costs, and the duty to investigate with respect to investment decision making. In addition, UPMIFA directs managers of charities to consider general economic conditions, to make decisions on a portfolio basis, to allocate risk and return across the portfolio, and to consider the needs of the charity both to make distributions and to preserve capital. A charity can pool funds for purposes of management and investment, and in some situations doing so can yield better investment results. Managers are reminded that donor intent controls, so a charity must follow any specific donor directions for investment and management of assets. Of course, this emphasis on donor intent does not mean that a donor should control the management of a charity.

Prudence is a standard that evolves over time, and UPMIFA is simply updating the statutory language to provide good direction about the role of prudence in investment and management. The guidance should be helpful to charities and comports with current best practices.

Endowment Spending

The big change UPMIFA brings comes in the rules on spending from endowment funds, defined as funds that cannot be wholly expended on a current basis. These rules apply to donor-restricted funds and not to board-restricted funds. Money set aside by a board of directors as an "endowment" is a board-restricted fund; money contributed by a donor with the intent that the money be held as an endowment is a donor-restricted fund. If a charity raises money for its endowment, and donors contribute with the understanding that the charity will hold their contributions in the endowment, then these rules apply to that fund. Donor intent in this regard will depend on the applicable "gift instrument," the documents that define the terms of the gift. The gift instrument may be a letter from the donor accompanying the gift, a solicitation from the charity to which the donor responds, or a gift agreement entered into by the donor and the charity.

UMIFA's spending rule has been critically important to the successful functioning of the investment guidance the statute provides. Endowments are typically described as funds that maintain principal and distribute income. The difficulty lies in determining what constitutes principal and income. Before UMIFA arrived on the scene, charities organized as nonprofit corporations assumed that trust accounting rules applied to them. Those rules defined income to exclude capital gains. Thus, a direction to "spend only income" meant that a charity might skew its investment decisions to produce more trust accounting income, to the detriment of the long-term health of a fund.

Rather than trying to define income and principal, the drafters of UMIFA devised a spending rule that seemed a better fit for charities. UMIFA uses the term historic dollar value (HDV) to mean the value of contributions made to an endowment fund, without increases or decreases because of investment results, inflation, or anything else. Under UMIFA, a charity can spend from an endowment fund the amount of appreciation above HDV the charity deems prudent, after considering the charity's purposes, but can never spend below HDV. The prudence standard in UMIFA limits spending above HDV because a charity can spend only the amounts the directors determine to be prudent. The statute provides minimal guidance, however, and focuses on the needs of the charity rather than on the purpose of the particular fund. Fortunately, despite the limited statutory guidance, most charities have developed spending rules that comply with UMIFA and also limit spending in ways that preserve the purchasing power of the endowment funds they manage.

UPMIFA no longer uses the term "historic dollar value" and no longer restricts spending to amounts above HDV. Under UPMIFA, a charity can spend the amount the charity deems prudent after considering the donor's intent that the endowment fund continue permanently, the purposes of the fund (and not just of the charity as under UMIFA), and relevant economic factors. The intention of the change is not to permit unrestricted spending from an endowment fund. UPMIFA applies a more carefully articulated prudence standard than that used in UMIFA to guide the process of making decisions about spending. UPMIFA emphasizes the perpetuation of the purchasing power of the fund, not just of the original dollars contributed to the fund. Although the Act does not require that a specified amount be set aside as principal, the Act assumes that a charity will preserve "principal" by maintaining the purchasing power of amounts contributed and will spend "income" by making a distribution each year using a reasonable spending rate. UPMIFA encourages charities to establish a spending policy that will be responsive to short-term fluctuations in the value of the fund.

Any donor restrictions agreed to by a charity will control the management of an endowment fund. If a donor wants to create an endowment fund that can spend only 4% each year, and if the charity agrees to the restriction, the restriction will govern spending from the fund. If, however, the donor restricts the fund by indicating that the charity should "pay only income" or "hold the fund as an endowment," then a rule of construction in UPMIFA will treat the fund as an endowment fund subject to the UPMIFA rules on spending. The Act assumes that a donor who gives to an endowment fund wants the charity to use modem investment strategies to generate enough funds to distribute while maintaining the long-term viability of the fund. UPMIFA gives effect to the presumed intent of the donor.

UPMIFA will apply to charitable funds created both before and after enactment. Some people have expressed concern that the change in the endowment spending rules will affect donor intent. The rule of construction in UPMIFA gives meaning to a donor's direction to "pay only the income" from an endowment. A constructional rule resolves an ambiguity, in this case because the words used by a donor do not convey a specific meaning. Changing a statutory constructional rule does not change the underlying intent and, instead, changes the way an ambiguity is resolved. The change should better effectuate the intent of the donors. The committee that drafted UPMIFA concluded that the new rules provide better protection for donors and for charities. The committee also noted that unless UPMIFA applies retroactively, charities will face unwieldy and costly administrative burdens. Without retroactive application, a charity would have to maintain two sets of records for every endowment fund created before enactment that receives contributions after enactment.

Because of concerns expressed by some constituencies about the removal of HDV as a floor for spending, the committee agreed to draft two optional provisions for legislatures to consider. The Act should function well without these optional provisions, but some states may prefer to include one or both of them. The first optional provision appears in brackets in the text of the Act. The provision, section 4(d), creates a rebuttable presumption of imprudence for spending more than 7% of the value of an endowment fund in one year. The value of the fund is determined based on a three-year rolling average. Seven percent is a high number and is not intended as a safe harbor. The number was made high enough to allow some fluctuation in a year when a charity needs to spend more and to allow for some changes in economic conditions.

Those in favor of the presumption argue that the presumption provides a useful guideline for charities and for those who supervise charities. The presumption may also curb a charity's temptation to spend its endowment funds too quickly. Those opposed to including the presumption express concern that a charity may interpret the provision to mean that spending below 7% is presumed to be prudent, even though the statute provides otherwise. Other arguments against the presumption focus on the difficulty of identifying a percentage that can be appropriate for the range of charities and purposes covered by UPMIFA.

The second optional provision appears in the comments following section 4. This provision targets charities with limited initial investment and spending experience that could benefit from additional scrutiny by the attorney general. This optional provision states that if a charity with endowment funds valued, in the aggregate, at less than $2 million, plans to authorize spending that will take the total value of all endowment funds held by the charity below total HDV for those funds, then the charity must notify the attorney general in that state before proceeding. The optional provision gives the attorney general 60 days to take action before the charity spends below HDV but does not require approval from the attorney general. If the attorney general's office gets notice of proposed spending, someone in the office can review the decision, talk with the charity, and provide advice on prudent spending before the charity spends the money.

Release or Modification of Restrictions

A charity can continue indefinitely. Over time, changing circumstances may necessitate changes in the way the charity carries out its purposes or changes in the purposes themselves. UPMIFA provides rules for modification that clarify the ways in which nonprofit corporations can change restrictions.

UPMIFA, like UMIFA, permits a donor to release a restriction the donor imposed on a charitable gift. The donor cannot direct the use of the property after the release, but a charity would likely work with the donor to decide on the appropriate changes.

Under UMIFA, if the charity could not obtain the donor's consent, perhaps because the donor was dead, the charity could ask a court to release a restriction. The problem with this approach is that the statute gives the court authority to release the restriction but appears to give the charity control over the use of the assets after the release, without the application of cy pres principles. Section 7(d) of UMIFA then cryptically notes that the release provision "does not limit the application of the doctrine of cy pres."

Rather than permitting release by a court, with no restrictions on future use, UPMIFA adopts the doctrines of cy pres and deviation from trust law, taking language from the Uniform Trust Code. Deviation, in UPMIFA 5 6(b), allows a charity to ask the court to release or modify a restriction that has become impracticable or wasteful or one that impairs the management or investment of the fund. The same section permits a request to modify a restriction if, because of circumstances not anticipated by the donor, the modification will further the purposes of the fund. Any change must be consistent with the donor's probable intention. Cy pres allows a charity to ask a court to approve a change because a restriction has become unlawful, impracticable, impossible to achieve, or wasteful. Under the application of cy pres, a change must be consistent with the charitable purposes expressed in the document that created the gift.

UPMIFA adds a new provision that should be of help to charities. Section 6(d) provides that if a fund is both old (20 years) and small ($25,000), then a charity can apply cy pres to the fund to change a restriction, after first giving notice to the attorney general but without obtaining court approval. The charity must wait 60 days before modifying the restriction, to give the attorney general time to take action if the attorney general finds a problem with the proposed modification. This provision addresses the problem that occurs when a restriction on a fund no longer makes sense, but the fund is too small to justify the costs of a court proceeding to request deviation or cy pres.

In keeping with the approach taken under trust law for modification using cy pres or deviation, the Act does not require notification of donors. Of course, a charity's self-interest in maintaining good donor relations will encourage contacting any known donors about any need to release or modify a restriction. UPMIFA does not change the general rule that donors do not have standing to bring a court challenge to a charity's actions. UPMIFA maintains the attorney general's traditional role in protecting donor intent and the public's interest in charitable assets.

Enactment
Now that the Uniform Law Commission has approved UPMIFA, legislatures will begin considering enactment. A copy of UPMIFA, including comments that provide additional information, can be found at www.nccusl.org or obtained by contacting Susan Gary at sgary@law.uoregon.edu. Prof. Gary is happy to answer questions, hear comments, and help with legislative efforts in connection with UPMIFA.

Program-Related Assets under UPMIFA

UPMIFA does not apply to "program-related assets." This brief article explains why the Drafting Committee chose to exclude program-related assets, the meaning of the term under UPMIFA, and the effect of excluding these assets from the scope of UPMIFA.

Why Does UPMIFA Exclude Program-Related Assets?

UPMIFA does three things: provides guidance for investment decision making, provides rules for spending from endowment funds, and provides rules for the modification of donor restrictions. The Drafting Committee decided that applying the prudent investor rules of UPMIFA to the buildings a charity uses to carry out its charitable purposes might be confusing, and for that reason decided to exclude a category of assets called "program-related assets." For example, a university may own classrooms, laboratories, and dormitories. Decisions about buying new buildings, renovating existing buildings, and managing those buildings will be governed by standards of prudence, but saying that the university should approach decision making with respect to those buildings as a "prudent investor" might seem puzzling to an administrator. The land might be more valuable if used for another purpose, but the university would need to keep the buildings for use by its faculty and students.

What is a Program-Related Asset?

Section 2(5)(A) of UPMIFA defines a program-related asset as "an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment." Of course, all funds held by a charity are held to carry out the charity's purposes (or should be), so this definition does not mean that a fund used to pay for scholarships or to buy food to distribute to those in need is a "program-related asset." If the dollars of a fund are used to pay for charitable activities, the fund will be governed by UPMIFA. Thus, almost all funds held by charities will be governed by UPMIFA.

The exclusion for program-related assets applies to tangible or real assets held by a charity for direct use in its charitable activities and, for a charity engaged in micro-finance as its charitable purpose, to a fund used to make loans. The laboratory equipment owned by a university, the house owned by a homeless shelter, and the food storage building and food preparation equipment owned by a soup kitchen are all program-related assets. These assets all have monetary value, and a charity might decide to sell assets of this sort and use the proceeds of the sale for another charitable purpose, but the charity uses the assets primarily to carry out the charitable activities of the charity. A fund used by a micro-finance charity to make low-interest loans might also be used "primarily to accomplish a charitable purpose."

Most assets held by a charity will either be clearly program-related assets or investment assets. Nearly all funds held by a charity are governed by UPMIFA. The funds may be used for operating expenses, may serve as an endowment for scholarships, or may be a development fund to be used to pay for a new building. All of these funds are institutional funds under UPMIFA. Sometimes, though, an asset may have a mixed purpose and determining whether the asset is a program-related asset may be more difficult. Two examples may help describe this sort of asset.

In the 1990s the area around Trinity College had become depressed and unsafe. The College bought properties adjacent to the College and began to provide low-interest loans to businesses willing to develop the properties. The College did not intend to use the properties directly for its educational purposes, and the low-interest loans were not the primary purpose of the College, but the College anticipated that revitalizing the area near the campus would result in benefits for the community and would likely increase student applications. Viewed entirely from an investment perspective, the acquisitions and loans would likely not have been prudent, but these uses of College resources made sense because they provided a degree of investment potential as well as other benefits for the College.

Micro-financing organizations use charitable funds to make loans to people who cannot otherwise obtain loans. The loans may be made to people with poor credit ratings and may be made with interest rates lower than market rates. The charity's program-related asset is a pool of money – not usually the form a program-related asset takes – because the dollars are used to carry out the charitable purpose. Even if a fund used to make loans is a program-related asset, the Comments remind the charity that the charity should create standards for the program to increase the likelihood that the loans will be repaid.

UPMIFA does not preclude a charity from acquiring and holding assets that have both investment purposes and purposes related to the organization's charitable purposes. Indeed, UPMIFA directs the decision maker to consider the purposes of the institution and of the fund in making investment decision. Thus, a prudent decision maker will take into consideration these charitable purposes in making an investment that may have a program-related purpose but not be primarily program-related, and a decision-maker should consider investment factors even in making a decision about an asset that is primarily program-related. The degree to which an institution uses an asset to accomplish a charitable purpose will affect the weight given that factor in a decision to acquire or retain the asset. UPMIFA does not intend, however, that a charity use a tangential charitable purpose as an excuse for failure to engage in prudent decision making with respect to an investment. A charity should not justify an imprudent investment by later asserting that the investment is somehow related to the charity's purposes.

What is the Effect of Treating an Asset as a Program-Related Asset?

If an asset is a program-related asset, UPMIFA does not apply to the asset and other state laws will govern decision making with respect to the asset. A charity must manage all of its non-investment assets under the prudence standards that apply to directors of nonprofit corporations or trustees of charitable trusts. For example, the Revised Model Nonprofit Corporation Act provides that directors must act "in good faith and with the care an ordinarily prudent person in a like position would exercise." A university must take care of its buildings, must make informed decisions about purchasing or selling buildings, and must manage the buildings with its educational purposes in mind. The fact that UPMIFA does not apply to these non-investment assets does not have a significant impact on the fiduciary duties of the directors or trustees with respect to those assets but changes the priorities to be considered. The charity's charitable purposes will take priority over any investment potential in the asset, and the fact that the asset presents risks or is likely to produce a low return will be countered by its importance to the activities of the charity.

A program-related asset will, by definition, not be an endowment, so the fact that UPMIFA's endowment spending rules do not apply to the asset has no impact on the asset. UPMIFA's modification rules will not apply to a program-related asset, and a charity will look to other state law if the charity needs to modify a donor restriction. A charity must comply with any donor restriction imposed on a gift it accepts. This well-established rule pre-dates UPMIFA, and UPMIFA does not change the requirement that a charity must follow donor restrictions. UPMIFA provides that the modification rules developed under trust law – the rules of cy pres and deviation – will apply to funds governed by UPMIFA. Courts have applied those trust rules to assets held by nonprofit corporations in the past, and a court might do so with respect to a restriction imposed on a program-related asset, but the charity would have to rely on the common law.

For example, assume that a donor gave a painting to a museum organized as a nonprofit corporation and not as a trust. The donor stipulates that the museum must always display the painting as part of its collection, that the painting cannot travel to other museums, and that the museum cannot sell the painting. The painting is a program-related asset, so UPMIFA does not apply to the painting. If the museum needs to modify the restriction, perhaps to permit the painting to be exhibited by other museums as a way to raise money to care for the painting, the museum may be able to use the common law doctrine of cy pres to request the modification. The museum will not be able to rely on the statutory authority for judicial modification provided under UPMIFA. The fact that the painting is a program-related asset does not affect the donor restriction, but it may affect the availability of court-ordered modification.

Conclusion

Although UPMIFA excludes program-related assets, the Drafting Committee did not intend to suggest that charities could act imprudently with respected to their program-related assets. Rather, UPMIFA recognizes that some charities use assets directly in carrying out their charitable purposes and that the application of prudent investment rules may not be appropriate as a way to guide the directors in making good decisions about the assets. If an asset has both an investment purpose and a charitable purpose, the charity should be conscious of both types of purposes in making decisions. If a charity has a fund it uses in paying for its charitable activities, investing in assets which may have a tangential charitable purpose should not be used as an excuse for failing to follow UPMIFA's prudent investment guidance.

UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-FIFTEENTH YEAR
HILTON HEAD, SOUTH CAROLINA

July 7-14, 2006

WITHOUT PREFATORY NOTE AND COMMENTS

October 10, 2006

Uniform Prudent Management of Institutional Funds Act (UPMIFA)

Drafted by:
National Conference of Commissioners on Uniform State Laws (NCCUSL)
211 E. Ontario Street, Suite 1300, Chicago, IL 60611
312-915-0195, www.nccusl.org

Brief description of act:
The Uniform Prudent Management of Institutional Funds Act (UPMIFA) is an update of the Uniform Management of Institutional Funds Act (UMIFA) which dates back to 1972. UPMIFA applies to funds held for charitable purposes by nonprofit, charitable institutions. The three principal issues addressed are scope of coverage, investment obligations and expenditure of funds. The earlier UMIFA did not include charitable trusts or necessarily nonprofit corporations. UPMIFA applies its rules to charitable institutions no matter how organized. That is its scope. Investment obligations are governed by prudent investment rules derived from the Uniform Prudent Investor Act. They sharply refine the investment obligations in the 1972 UMIFA. An express rule for prudent expenditure of appreciation as well as income replaces the older rule in the 1972 Act. Abolished is the concept of historic dollar value as a floor beneath which an endowment cannot be spent. The new rule allows a prudent use of total return expenditure. An optional provision allows a state to flag a total return expenditure of more than 7% of total return measured by a three year average as presumed imprudent. UPMIFA also provides a better, modern rule for exercise of cy pres that is changing an obsolete charitable purpose. Changing a charitable purpose will require notice to the appropriate regulator in a state.

Questions about UPMIFA?
For further information contact the following persons:
John McCabe, NCCUSL Legislative Director: 312-915-0195, john.mccabe@nccusl.org
Barry Hawkins, Chair of the UPMIFA drafting committee: bhawkins@goodwin.com

Notes about NCCUSL Acts:
For information on the specific drafting rules used by NCCUSL, the Conference *Procedural and Drafting Manual* is available online at www.nccusl.org.

Because these are uniform acts, it is important to keep the numbering sequence intact while drafting.

In general, the use of bracketed language in NCCUSL acts indicates that a choice must be made between alternate bracketed language, or that specific language must be inserted into the empty brackets. For example: “An athlete agent who violates Section 14 is guilty of a [misdemeanor] [felony] and, upon conviction, is punishable by [ ].

A word, number, or phrase, or even an entire section, may be placed in brackets to indicate that the bracketed language is suggested but may be changed to conform to state usage or requirements, or to indicate that the entire section is optional. For example: “An applicant for registration shall submit an application for registration to the [Secretary of State] in a form prescribed by the [Secretary of State]. [An application filed under this section is a public record.] The application must be in the name of an individual, and, except as otherwise provided in subsection (b), signed or otherwise authenticated by the applicant under penalty of perjury.”

The sponsor may need to be consulted when dealing with bracketed language.

UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Prudent Management of Institutional Funds Act.

SECTION 2. DEFINITIONS. In this [act]:

(1) "Charitable purpose" means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community.

(2) "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 does not include assets that an institution designates as an endowment fund for its own use.

(3) "Gift instrument" means 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.

(4) "Institution" means:

(A) a person, other than an individual, organized and operated exclusively for charitable purposes;

(B) a government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or

(C) a trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated.

(5) "Institutional fund" means a fund held by an institution exclusively for charitable

purposes. The term does not include:

(A) program-related assets;

(B) a fund held for an institution by a trustee that is not an institution; or

(C) a fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund.

(6) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(7) "Program-related asset" means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.

(8) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

SECTION 3. STANDARD OF CONDUCT IN MANAGING AND INVESTING INSTITUTIONAL FUND.

(a) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.

(b) In addition to complying with the duty of loyalty imposed by law other than this [act], each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

(c) In managing and investing an institutional fund, an institution:

(1) may incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution; and

(2) shall make a reasonable effort to verify facts relevant to the management and investment of the fund.

(d) An institution may pool two or more institutional funds for purposes of management and investment.

(e) Except as otherwise provided by a gift instrument, the following rules apply:

(1) In managing and investing an institutional fund, the following factors, if relevant, must be considered:

(A) general economic conditions;

(B) the possible effect of inflation or deflation;

(C) the expected tax consequences, if any, of investment decisions or strategies;

(D) the role that each investment or course of action plays within the overall investment portfolio of the fund;

(E) the expected total return from income and the appreciation of investments;

(F) other resources of the institution;

(G) the needs of the institution and the fund to make distributions and to preserve capital; and

(H) an asset's special relationship or special value, if any, to the charitable purposes of the institution.

(2) Management and investment decisions about an individual asset must 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.

(3) Except as otherwise provided by law other than this [act], an institution may invest in any kind of property or type of investment consistent with this section.

(4) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification.

(5) Within a reasonable time after receiving property, an institution shall 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 this [act].

(6) A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

SECTION 4. APPROPRIATION FOR EXPENDITURE OR ACCUMULATION OF ENDOWMENT FUND; RULES OF CONSTRUCTION.

(a) Subject to the intent of a donor expressed in the gift instrument [and to subsection (d)], an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. In making a determination to appropriate or accumulate, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

(1) the duration and preservation of the endowment fund;

(2) the purposes of the institution and the endowment fund;

(3) general economic conditions;

(4) the possible effect of inflation or deflation;

(5) the expected total return from income and the appreciation of investments;

(6) other resources of the institution; and

(7) the investment policy of the institution.

(b) To limit the authority to appropriate for expenditure or accumulate under subsection (a), a gift instrument must specifically state the limitation.

(c) 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", or "rents, issues, or profits", or "to preserve the principal intact", or words of similar import:

(1) create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund; and

(2) do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (a).

[(d) The appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of not less than three years immediately preceding the year in which the appropriation for expenditure is made, creates a rebuttable presumption of imprudence. For an endowment fund in existence for fewer than three years, the fair market value of the endowment fund must be calculated for the period the endowment fund has been in existence. This subsection does not:

(1) apply to an appropriation for expenditure permitted under law other than this [act] or by the gift instrument; or

(2) create a presumption of prudence for an appropriation for expenditure of an amount less than or equal to seven percent of the fair market value of the endowment fund.]

[SECTION 5. DELEGATION OF MANAGEMENT AND INVESTMENT FUNCTIONS.

(a) Subject to any specific limitation set forth in a gift instrument or in law other than this [act], an institution may 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 shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and

(3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.

(c) An institution that complies with subsection (a) is not liable for the decisions or actions of an agent to which the function was delegated.

(d) By accepting delegation of a management or investment function from an institution that is subject to the laws of this state, an agent submits 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.

(e) An institution may delegate management and investment functions to its committees, officers, or employees as authorized by law of this state other than this [act].]

SECTION 6. RELEASE OR MODIFICATION OF RESTRICTIONS ON MANAGEMENT, INVESTMENT, OR PURPOSE.

(a) If the donor consents in a record, an institution may 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. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

(b) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional 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. The institution shall notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard. To the extent practicable, any modification must be made in accordance with the donor's probable intention.

(c) If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument. The institution shall notify the [Attorney General] of the application, and the [Attorney General] must be given an opportunity to be heard.

(d) If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, [60 days] after notification to the [Attorney General], may release or modify the restriction, in whole or part, if:

(1) the institutional fund subject to the restriction has a total value of less than [$25,000];

(2) more than [20] 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.

SECTION 7. REVIEWING COMPLIANCE. Compliance with this [act] is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, and not by hindsight.

SECTION 8. APPLICATION TO EXISTING INSTITUTIONAL FUNDS. This [act] applies to institutional funds existing on or established after [the effective date of this act]. As applied to institutional funds existing on [the effective date of this act] this [act] governs only decisions made or actions taken on or after that date.

SECTION 9. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001, et seq., but does not modify, limit, or supersede Section 101(c) of that act,15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

SECTION 10. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 11. EFFECTIVE DATE. This [act] takes effect . . . .

SECTION 12. REPEAL. The following acts and parts of acts are repealed:

(a) [The Uniform Management of Institutional Funds Act]

Uniform Law Commissioners

The National Conference of Commissioners on Uniform State Laws

SUMMARY

Uniform Principal and Income Act (1997)

A trustee of a trust and the personal representative of a decedent's estate are called fiduciaries. They have special duties toward those who benefit from their administration. A trustee of a trust has a fiduciary obligation to satisfy both the interests of the trust's income beneficiaries during the life of the trust, and the interests of the remainder beneficiaries at the trust's termination. A personal representative may be required to allocate net income to certain individuals during the administration of the estate and to assure that certain expenses are paid out of an appropriate category of interests before finally distributing the assets of the decedent's estate to the heirs or devisees (heirs if there is no will, devisees if there is a will).

The trustee and the personal representative satisfy their obligations by making the proper allocations of assets to either principal or to income. Generally, assets allocated to principal serve the interests of remainder beneficiaries of a trust, and the interests of the final distributees of the assets in an estate. Assets allocated to income meet the requirements of income beneficiaries during the life of a trust, and those beneficiaries who must be paid out of the income derived during administration of an estate.

But the identification of principal and income, its allocation, and apportionment of assets between income and principal have always been a very tricky business. Distinguishing income from principal is not always self-evident. Therefore, the law has provided trustees with statutory help for a very long period of time. The Uniform Law Commissioners promulgated the first Uniform Principal and Income Act in 1931. A revision was promulgated in 1962. Almost all of the states in the United States have adopted one or the other of these earlier acts by 1997, when a new revision once again has been promulgated.

In 1997, 35 years after the 1962 revision, the Uniform Law Commissioners have promulgated the Uniform Principal and Income Act (1997) (UPIA 1997). Obsolescence over time is not the only stimulus for promulgating UPIA 1997. In the 1990's and especially since the promulgation of the Uniform Prudent Investor Act in 1994, a trustee's obligation to invest the assets of a trust as a prudent investor would invest them, has substantially altered the fiduciary obligations of a trustee. There is a strong relationship between the obligation to invest as a prudent investor and the obligation to satisfy income and remainder beneficiaries. The earlier Uniform Principal and Income Acts do not accommodate prudent investor rules. UPIA 1997 does, as will be discussed a little later in this summary.

UPIA 1997 provides some basic answers to questions that any trustee must ask in dealing with trust assets, and that personal representatives need to ask in the administration of an estate. The first question is whether an asset that becomes a trust or estate asset is either principal or income? Once established as either principal or income, the next question is, when is a beneficiary entitled to receive that asset?

The answers to these questions are strongly affected by the time at which the question is asked. There are three relevant times to consider -- the time before creation of an income interest, the time during which an income interest is current and the time after the income interest ends (an income interest is merely the interest of the income beneficiary -- the right to receive current payment). The time influences allocation of assets to principal or to income, and ultimately the rights of income and remainder beneficiaries.

The beginning and the end of the income interest are key, because (1) sometimes assets that would otherwise be income are allocated to principal if there is no current income interest; and (2) even if assets are allocated to income, when there is no current income interest, remainder beneficiaries will be entitled to a share of that income.

INITIAL RULE

The express language of the trust instrument, will or other applicable document will govern, notwithstanding conflict with any statutory rule. UPIA 1997 is entirely a default statute that operates only when the governing instrument is silent.

ALLOCATION TO PRINCIPAL OR INCOME

Principal is fundamentally defined as the property held in trust for distribution to a remainder beneficiary when the trust terminates. Income is the current return that any fiduciary receives from an asset that is principal. It has never been sufficient to provide a bare general definition in any of the Uniform Principal and Income Acts. There is, therefore, a group of rules that establish what is principal and what is income with respect to specific kinds of assets.

UPIA 1997 refines old rules and provides specific rules for assets that are not accounted for in the earlier acts. An example of the refinement of old rules concerns receipts from an entity. The earlier uniform acts provide for corporate distributions, generally allocating ordinary dividends to income and any other distribution in the form of additional equity to principal. UPIA 1997 addresses the broader category of receipts from an entity. A corporation is an entity, but so is a partnership, a limited liability company, a regulated investment company and a real estate investment trust. UPIA 1997 allocates the receipts from all entities in the same manner.

UPIA 1997 then simplifies the allocation question. Any money received by a fiduciary is regarded as income, unless it fits certain categories. For example, if money is received as part of a liquidation of the entity, it is principal. If money is received from an investment company (mutual fund) that labels a distribution as capital gain, the receipt is principal. All property received that is not money, i.e., a stock distribution, is principal. In addition, UPIA 1997 establishes what qualifies as a partial or complete liquidation of an entity. Fiduciaries will, thus, be better able to make judgments about receipts that are part of a liquidation. This is a more precise and logical set of rules for making allocations than exists in the earlier uniform acts, making fiduciaries' decisions easier and more certain.

There are certain kinds of assets that UPIA 1997 provides for that are just not within the scope of consideration in the earlier acts. One of them is derivatives. Another is asset-based securities. Receipts from derivatives, unless a trustee exercises powers available in the conduct of a business held in trust, are principal. Receipts from asset-based securities are either income or principal, depending upon the categorization of the asset backed security's payor.

APPORTIONMENT ISSUES

The beginning point and the ending point of an income interest in an estate or a trust provide particular problems, even though the incoming assets would clearly be income under the rules applied during the life of the income interest. Depending upon the time of receipt, an asset that is otherwise classified as income may have to be apportioned at least in part to principal to balance beneficiary interests. UPIA 1997 more precisely and simply provides for that apportionment than the earlier acts did.

UPIA 1997 provides, generally, that an income receipt is principal if it is due before a decedent dies in the case of an estate or before an income interest begins in the case of a trust. After death or after an income interest begins, it is classified as income. If there is income that is not distributed at the time the income interest ends, generally it is paid to income beneficiaries. But if the trust is revocable by an income beneficiary at an amount more than five percent of the trust's corpus immediately before the income interest ends, the undistributed income allocable to the revocable part, must be added to principal.

RIGHT TO PAYMENT

UPIA 1997 expressly requires distribution of net income and principal receipts to the appropriate beneficiaries when a decedent dies or when an income interest ends. There is discretion given to pay certain expenses out of either principal or income unless there is an adverse effect on estate tax marital deductions or income tax charitable deductions. General expenses of an estate are paid from principal. A specific pecuniary amount required to be paid, is paid from income unless insufficient. The deficiency is paid from principal. If there is any net income after the fact, it is distributed to remainder beneficiaries according to share in principal.

These rules assure orderly distribution of income when the decedent dies or an income interest ends. The earlier uniform acts make no attempt to deal with this distribution problem.

ADJUSTMENT POWERS

For Prudent Investment

A trustee must use prudent investment rules in any state that has adopted the Uniform Prudent Investor Act or equivalent statute, and in any case governed by the Restatement of the Law of Trusts III. The investment policy governing a trust's assets depends upon making the appropriate risk/return analysis and investing accordingly. Asset growth can be as significant an objective as income in setting the investment policy for a specific trust. Because a trustee may weight either growth or income significantly in making investment decisions, and because either may be greater or less than anticipated, the trustee may have to rebalance the interests of remainder and income beneficiaries as a result.

UPIA 1997 allows the trustee to adjust principal and income to the extent made necessary by prudent investment when a trust provides for a fixed income for the income beneficiary. This must be a careful decision before which a trustee shall consider all of the factors relevant to the trust and its beneficiaries. The express list of factors includes the nature, purpose, and expected duration of the trust; and the intent of the settlor. This is not a decision to be taken lightly -- the list of express factors to consider is long. Adjustments are forbidden in certain circumstances, such as when they diminish the income interest in a trust that requires all of the income to be paid at least annually to a surviving spouse and for which an estate tax or gift tax marital deduction would be allowed..., or if the trustee is a beneficiary of the trust... This list of forbidden situations, also, must be read with some care before a trustee decides to adjust allocations.

The earlier Uniform Acts did not deal with adjustment as a result of prudent investment. The whole notion of prudent investment, modern portfolio theory and total return came later than either of the two earlier acts. UPIA 1997 is absolutely necessary to making prudent investment work to its full capacity.

For Disbursements during the Administration of a Trust

Expenses and taxes must be paid during the administration of a trust. From which side of the ledger are they to be paid? Generally, UPIA 1997 provides for payment of ordinary expenses out of income, for payment of compensation to the trustee and legal proceedings from principal and income, dividing expenses in two, and payment of expenses peculiar to the remainder interest to principal. A trustee may transfer income to principal to make up for depreciation of an asset or to reimburse principal for disbursements that enhance income, i.e., repairs to assets that are necessary to maintain income. A trustee may make adjustments to principal and income to offset shifting of economic interests or tax benefits between income and remainder beneficiaries in certain instances.

During the Conduct of a Business Held in Trust

Under UPIA 1997, a trustee who conducts a business held in a trust may separate out the accounting for the business from that for other trust assets. The trustee, also, has the power to allocate net cash receipts to working capital, the acquisition or replacement of fixed assets, and other reasonably foreseeable needs of the business or activity, and the extent to which the remaining net cash receipts are accounted for as principal or income in the trust's general accounting records.

The earlier uniform acts treated net profit from a business as income, and losses as principal. There is no flexibility.

For Tax Purposes

UPIA 1997 allows a fiduciary to make adjustments between principal and income for tax purposes. Tax liabilities may accrue to either income or remainder beneficiaries. A fiduciary may have to make elections under the tax laws. Imbalances of interests that arise because of taxes can be remedied by the fiduciary.

The earlier uniform acts did not provide such discretion to the fiduciary.

CONCLUSION

It is essential for the drafting and administration of wills and trusts that UPIA 1997 be adopted in every state and jurisdiction as soon as possible. Drafting of instruments becomes considerably harder without a modern set of rules that, among other things, allows adjustment because of prudent investment decisions and because of tax laws. If an instrument is not adequately drafted, trustees will not be able to meet fiduciary obligations. The result will be, higher costs for setting up trusts, more conflict between trustees and beneficiaries and excessive litigation. UPIA 1997 will make life much easier for personal representatives, trustees and beneficiaries alike.

Uniform Law Commissioners
The National Conference of Commissioners on Uniform State Laws

A Few Facts About The...

UNIFORM PRINCIPAL AND INCOME ACT

PURPOSE:
This act revises the Uniform Principal and Income Act of 1931 and 1962, which has been adopted in 41 states. The purpose of the new act, like its predecessors, is to provide procedures for trustees administering an estate in separating principal from income, and to ensure that the intention of the trust creator is the guiding principle for trustees. A revision is necessary so that principal and income allocation rules can function with modern trust investment practices.

ORIGIN:
Completed by the Uniform Law Commissioners in 1997, and amended in 2000.

APPROVED BY:
American Bar Association

STATE ADOPTIONS:

Alabama
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
District of Columbia
Florida
Hawaii
Idaho
Indiana
Iowa
Kansas
Kentucky
Maine
Maryland
Massachusetts
Michigan
Missouri
Montana
Nebraska
Nevada
New Hampshire
New Jersey
New Mexico
New York
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Pennsylvania
South Carolina
South Dakota
Tennessee
Texas
Utah
Virginia
Washington
West Virginia
Wisconsin
Wyoming

2009 INTRODUCTIONS:

For any further information regarding the Uniform Principal and Income Act (1997), please contact Kieran Marion or Katie Robinson at 312-450-6600.

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Uniform Law Commissioners
The National Conference of Commissioners on Uniform State Laws

Why States Should Adopt the...

Uniform Principal and Income Act (1997)

The Uniform Principal and Income Act, originally promulgated by the Uniform Law Commissioners in 1931, revised in 1962, and adopted in 41 states, provides procedures for trustees administering an estate in separating principal from income. The basic purpose of the new act, like the 1931 and 1962 versions, is to ensure that the intention of the trust creator is the guiding principle for trustees.
Like its predecessors, this revision distinguishes between property that is principal, which will be distributed to remainder beneficiaries (persons entitled to receive principal when an income interest ends), and property that is income, distributed to income beneficiaries.

The Uniform Act has always provided the default rules for such allocations in the event the trust investment is silent.

There are many reasons why every state should adopt the Revised Uniform Principal and Income Act (1997).

- The law of trust investment has been modernized. It is now time to update the traditional income and allocation rules so that it can work with the doctrine of modern investment theory.
- The new act provides a means for implementing the transition to an investment regime based on principles embodied in the Uniform Prudent Investor Act, especially the principle for investing for total return instead of for a certain level of income.
- The new act better clarifies allocations of acquired assets, such as those from corporate distributions.
- An "unincorporated entity" concept has been introduced to deal with businesses operated by a trustee, including farming and livestock operations, and investment activities in rental real estate, natural resources, and timber.
- The new act provides for investment modalities that were not in existence in 1962, such as derivatives, options, deferred payment obligations, and synthetic financial assets.
- There is a new provision which deals with the problem of disbursements made because of environmental laws.
- New provisions which deal with the imbalances as a result of tax laws are also included. The act provides the power to make adjustments between principal and income to correct inequities caused by tax elections or peculiarities in the way the fiduciary income tax rules apply.

UNIFORMITY

This act will provide uniformity of law, necessary in an interstate investment environment. The Revised Uniform Principal and Income Act provides answers to long-standing problems in reconciling modern portfolio management with traditional rules of income allocation. It is important that every state adopt this act as soon as possible.

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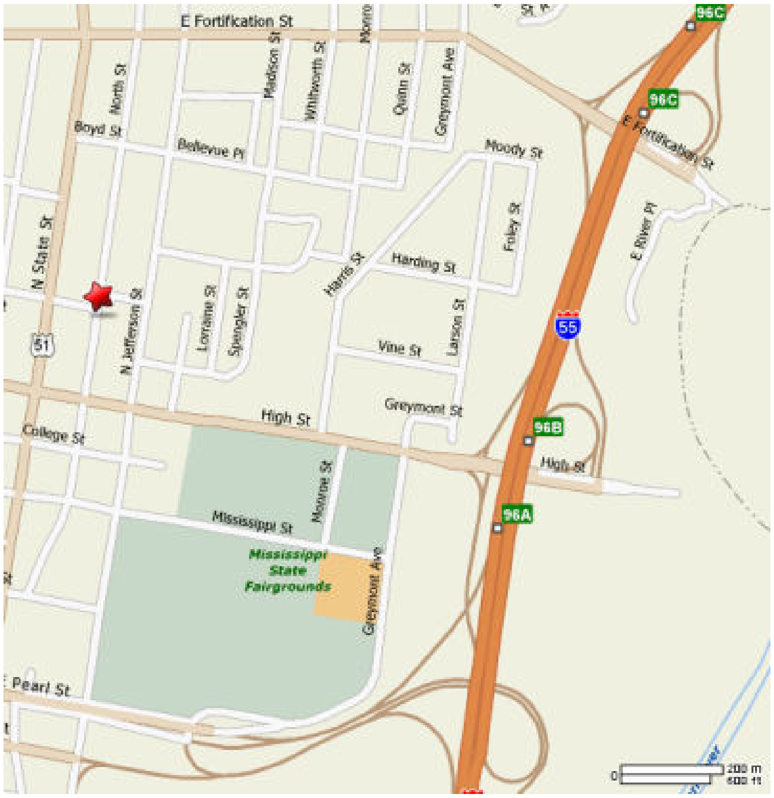
Map of 700 North Street
Jackson MS
MS Secretary of State

The Meetings will be located in the Secretary of State building.

PARKING FOR MEETINGS: Parking is permitted up and down North Street. *Parking is NOT allowed in the parking lots across from and behind the building*. If you park there you may be ticketed. Please do not park there.



Directions from I55.

Take the HIGH ST exit- EXIT 96B- toward FAIRGROUNDS. 0.2 miles

Stay STRAIGHT to go onto HIGH ST. 0.5 miles

Turn RIGHT onto NORTH ST.