

**ALASKA STATE LEGISLATURE
SENATE EDUCATION STANDING COMMITTEE**

March 20, 2009

7:59 a.m.

MEMBERS PRESENT

Senator Bettye Davis, Vice Chair
Senator Charlie Huggins

MEMBERS ABSENT

Senator Donald Olson
Senator Gary Stevens

COMMITTEE CALENDAR

SENATE BILL NO. 134

"An Act adopting and relating to the Uniform Prudent Management of Institutional Funds Act; relating to the investment of money for charitable purposes by institutions, including governmental institutions; and relating to the University of Alaska."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 134

SHORT TITLE: PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS

SPONSOR(S): SENATOR(S) PASKVAN

03/02/09	(S)READ THE FIRST TIME - REFERRALS
03/02/09	(S) EDC, FIN
03/20/09	(S)EDC AT 8:00 AM BELTZ 211

WITNESS REGISTER

SENATOR PASKVAN
Alaska State Legislature
Juneau, AK

POSITION STATEMENT: Sponsor of SB 134.

JAMES LYNCH, Associate Vice President
Finance
University of Alaska (UA)

POSITION STATEMENT: Supported SB 134.

ERIC WOHLFORTH, Chair

University Investment Committee
University of Alaska Foundation
POSITION STATEMENT: Supported SB 134.

LYNN LEVENGOOD
Uniform Law Commissioner
State of Alaska
POSITION STATEMENT: Supported SB 134.

KEN CASTNER, representing himself
POSITION STATEMENT: Supported SB 134.

ACTION NARRATIVE

[7:59:35 AM](#)

VICE CHAIR BETTYE DAVIS called the Senate Education Standing Committee meeting to order at 7:59 a.m. Present at the call to order were Senators Huggins and Davis.

SB 134-PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS

[7:59:47 AM](#)

CHAIR DAVIS announced consideration of SB 134.

SENATOR PASKVAN, sponsor of SB 134, said this bill will bring Alaska's guidance and requirements for the administration of endowments and charitable funds up to date and consistent with national standards. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) attempts to bring all of the various types of non-profit organizations and governmental entities under the same requirements and standards for administration of endowments and charitable funds. This act is default legislation which only applies in the absence of other more specific requirements or law or governing instruments. For example, this does not apply to the Permanent Fund because it has specific investment standards written into its act.

He said that UPMIFA replaces obscure and obsolete rules and concepts for the investment and management of endowments and charitable funds with current industry best practices. UPMIFA provides clear guidance on the standards of performance and prudent practices for the investment and management of endowments and charitable funds consistent with the Uniform Prudent Investment Act adopted by Alaska 10 years ago. UPMIFA defines specific factors to be considered in managing charitable funds such as the accumulation of earnings, the expenditure of endowment funds, and the obligation to provide for future

beneficiaries. The investment of funds including the obligation to manage to the overall objective of the funds in the portfolio to consider the investment horizon, cost of management, diversification, rebalancing, verification or relevant facts and use of special skills or expertise that a fiduciary possesses and a prudent delegation of investment and management functions.

He explained that UPMIFA minimizes the exposure of non-profits and volunteer trustees to disputes and legal challenges over issues related to obscure and outdated administrative rules and practices by clarifying the specific requirements in the applicable performance standards.

Further, he said, UPMIFA incorporates a less onerous and less expensive process for the modification or release of donor restrictions on gifts that may have become wasteful, impractical, unlawful or impossible to achieve. He said, as a member of an investment board, he believes these are some of the investment standards that are important to bring Alaska's investment standards in line with national standards.

8:03:31 AM

SENATOR HUGGINS asked if there are any organizations other than the Permanent Fund that do not come under UPMIFA.

SENATOR PASKVAN replied that he is not aware of any.

SENATOR HUGGINS asked if he could foresee any unintended consequences.

SENATOR PASKVAN replied no; and this is a step in the right direction to, for example, provide voluntary trustees who are making decisions on these institutional funds a better understanding of prudent investment practices.

8:04:58 AM

SENATOR HUGGINS asked if this wouldn't require a staff of three lawyers to administer.

SENATOR PASKVAN answered no; "the point of this is to not have that happen."

8:05:28 AM

JAMES LYNCH, Associate Vice President, Finance, University of Alaska (UA), said he has managed their endowments for the last 25 years and supported SB 134. He related that UPMIFA was approved by the Uniform Law Commission in 2006 and in subsequent

years has been adopted by 26 states and the District of Columbia. In 2009 it was adopted by three more states, and bills were introduced to implement these UPMIFA in 14 other states. There are two reasons for that: one is that for most states this is an update of prior uniform regulation that came out in the 1970s, and most states have operated under similar standards for the last 30-40 years. Alaska never adopted the original Uniform Management Act. The other reason is that it provides a lot of flexibility for managers during economic turmoil and economic downturn. This update was developed because of confusion that arose in the last market decline and the bursting of the tech bubble in 2001/2.

[8:08:32 AM](#)

MR. LYNCH explained that the Act is a compilation of best practices for charitable foundations and endowments; it protects donors by making their intent paramount in determining what can and should happen to donations and endowments. It authorizes such things as the total return concept, which allows managers of endowments to use current investment techniques and strategies. Otherwise they end up with a lot of fixed income investments, and there's almost no way that investing in fixed income can inflation-proof a fund. It also provides the charitable organizations with the flexibility they need in these economic times to deal with market conditions.

He explained that when you manage an endowment, you have three objectives. The first one is to maximize the returns, next is to inflation-proof to be able to retain the purchasing power. When these endowments are used at the University for supporting a faculty member's salary or a scholarship, for instance, those costs go up annually. The endowment has to be inflation-proofed so that spending can increase as needed. Third, management tries to stabilize distributions. It's not much value to find out that the investment market is down this year, but the student still has to pay tuition. The same is true for a faculty member's salary.

[8:11:13 AM](#)

Stabilization is probably the most important of the three, he emphasized. The Act protects the non-profit community and its many volunteers. It protects them from the failure to follow what are really outdated rules and obscure practices on managing these funds.

He explained that it does a couple of other small things that are important for administration of funds. Two sections relate

exclusively to the University; one makes sure that this Act does apply to the University. Second, it's to correct an unintended consequence that occurred during establishment of the Retirement Management Board. The authority for the Board of Regents to manage its endowments and the land grant trust fund basically came from a statutory reference to the Alaska Pension Board in AS 14.25.180 that dealt with some of the fiduciary duties of the Pension Board and applied those to the University. It also indicated that AS 37.10.071, which is the fiduciary responsibilities toward state funds, applies to the Board of Regents. When the reference was changed to the Retirement Management Board, provisions were inserted for managing pensions that don't apply to endowments at all, and it is not clear as to whether other state statutes on fiduciary responsibilities do apply. This corrects that situation.

8:14:02 AM

ERIC WOHLFORTH, Chair, University Investment Committee, University of Alaska, said this bill would apply in a case where the trust instrument is silent with regard to the terms of management and the provisions for payouts. He explained the typical gift to the University establishing a scholarship fund is silent on such things as what the payout can be for the scholarship. Trust law in Alaska now says you can't go below the original cost of the fund, so a lot of University scholarships this year won't have a payout. This bill applies in all cases where the original gift instrument is silent and says you can have a percent of market value payout. However documents with other stated payout provisions in them would prevail over this law.

This bill also gives portfolio managers freedom in the kind of assets that can be invested in the portfolio according to very elaborate rules relating to prudence. It does not attempt to specify what sorts of investments are legally required. The default nature of this bill is important as well as the broader authority for investing that previously existed.

8:17:03 AM

SENATOR HUGGINS asked about his use of the terms "endowment" and "principle." He asked if this legislation allows his investment organization to dip into the principal when it was silent where without this legislation that couldn't be done.

MR. WOHLFORTH said that is correct. The original Uniform Management of Institutional Funds Act of 1970 said you could distribute current yield and capital appreciation. The updated

UPMIFA says you can distribute any money in the endowment and if it drops below the original gift value you can continue to make distributions, but you have to inflation-proof the fund. It allows you to basically borrow against future earnings. However, there are a lot of requirements imposed. You have to take into consideration general economic conditions, the effect of inflations, expected tax consequences, the roll of the investment itself within the portfolio, the expected total return and the other resources of the institution. It allows flexibility, but it is all governed by what is prudent.

SENATOR HUGGINS said his concern is the present financial debacle where the economic paradigm most people have lived by has been thrown out the window. He mentioned the current arguments for and against the Permanent Fund paying out a dividend this year because the principle has dropped below the original deposits.

MR. WOHLFORTH agreed that this is an unprecedented period where a whole new paradigm of investment is slowly emerging, but this legislation in general does not tie them to any particular era or time with regard to what is an appropriate payout rule. Until 1970, endowments could only invest in bonds and pay out interest - period. That was replaced by the total return concept that allows investments in common stocks as well as bonds. That notion became part of the accepted investment tool and is part of this legislation. What has happened in the last year and a half has thrown almost every calculation out of kilter, but he didn't think it had thrown the total return notion out of kilter. He thinks that flexibility is necessary so that as a new paradigm develops, people can get a better idea of what investment philosophy ought to be going forward.

[8:23:07 AM](#)

SENATOR HUGGINS continued; it appears to him at the national level the prevailing thought is decreasing flexibility in favor of more regulation and asked him to comment on that.

MR. WOHLFORTH responded that is true, but those considerations of decreasing flexibility to deal with "the bizarre instruments that have developed" do not seem to apply at the endowment level. This legislation doesn't tie endowments to a return environment, which is based on 100-percent fixed income, but rather it provides for operating in different environments but with prudent investment guidelines.

[8:25:14 AM](#)

MR. LYNCH added that one of the reasons UPMIFA was developed is due to the market downturn in 2001/2 - because at that time boards and institutions made a number of erratic decisions. Some of them looked at their whole pool of endowments - the University, for instance, has over 600 endowments, 250 of which are currently "under water." Those won't have any more scholarship distributions. Others decided to make payouts anyhow. What this bill does is offer a happy medium based on good judgment, which can't be legislated. You can lay out standards and principles and then trust the trustees to make prudent decisions. You can borrow against principal, but not spend it. Your borrowing has to be judged based on the circumstances surrounding it.

[8:28:22 AM](#)

LYNN LEVENGOOD, Uniform Law Commissioner, State of Alaska, said the commission provided the legislation to the national body to make sure it would still qualify as a uniform law, because minor changes were made that were unique to Alaska. The national governing body found the changes were not substantial, and that the legislation still qualified as a uniform state law.

However, they thought one issue needed to be corrected and that is the title, which says that this is "a uniform, prudent management of institutional funds act." The key words are "institutional funds", which is broader than the term "endowment". Under AS 13.70.090 definitions, "endowment fund" is defined as "an institutional fund or part of an institutional fund," so the term "endowment" is narrower than the term "institutional fund". The glitch is in the bill's last paragraph on "applicability" where they think "endowment fund" should be changed to "institutional fund" because that is broader in scope and is consistent with the title and focus of the bill which is to govern the management of institutional funds.

[8:32:11 AM](#)

KEN CASTNER said he serves as a fiduciary on a couple of community foundation boards and is active in investment committees of both of those boards; he supported SB 134. He said this bill simply gives the attorney general very specific authority to act, which was absent now. Without this, a donor may bequest to a University for a specific purpose, and then the gift might not get used for that intent. The donor would be completely frustrated from asserting the intent of the original gift. This gives the attorney general the authority to intercede to make sure the donor's wishes are followed.

All the other things Senator Huggins was concerned about are already being acted on under other national standards, he said, with various federal regulations. What was prudent in 2005 is different than what is prudent today; an endowment is in perpetuity so you don't want to have a sinking fund. This bill provides for a balance between prudence and maintaining public purpose.

[8:35:25 AM](#)

CHAIR DAVIS closed public testimony.

SENATOR PASKVAN agreed to write up an amendment based on Mr. Levensgood's suggestions.

[8:37:26 AM](#)

SENATOR HUGGINS asked why "and relating to the University of Alaska" is in the title.

SENATOR PASKVAN responded that as Mr. Lynch testified that they are amending the statutes to make sure the principles apply to the Board of Regents management of the University endowments on page 7. This language makes it very clear that the Board can make distributions from the principal if it is prudent.

VICE CHAIR DAVIS held SB 134 in committee.

[8:38:58 AM](#)

There being no further business to come before the committee, Vice Chair Davis adjourned the meeting at 3:38.