FPLG: BLOG

New Law Clarifies Investment Standards for California Charities

05.03.16 | Linda J. Rosenthal, JD

In 2015, the California Legislature had a busy and productive year. In addition to high-profile, landmark legislation affecting the population as a whole, lawmakers passed several bills directly affecting nonprofits.

One that we haven't yet discussed is AB 792, signed by Governor Brown on July 6, 2015, and effective January 1, 2016. It was sponsored by the Nonprofit Organizations Committee of the Business Law Section of the California State Bar, supported by leading nonprofits in the state, and passed easily.

This new law is relatively short but significant, nevertheless. It clears up an ambiguity in the proper standards for directors of nonprofit public benefit and religious corporations to use when making investment-asset decisions. Specifically, it amends California Corporations Code sec. 5240 (public benefit corporations) and sec. 9250 (religious corporations).

The full text, along with legislative history, is here.

Background

"The Nonprofit Public Benefit Corporation Law and the Nonprofit Religious Corporation Law each require a board of directors for a corporation formed under its provisions to manage corporate investments in compliance with prescribed investment standards."

The problem, though, was that there were two separate standards, each potentially applicable:

- The California Nonprofit Corporation Law (sec. 5240 [public benefit corporations] and sec. 9250 [religious corporations]; *and*
- the Uniform Prudent Management of Institutional Funds Act (UPMIFA), Probate Code sections 18501 – 18510.

This led to "a confusing interplay of rules, which cause[d] most practitioners to advise clients to attempt to –

> *comply with both sets of rules, resulting in an overly conservative investment approach. As just one example, the sponsor cites the provision of Section 5240 that prohibits "speculation" for each individual investment, but fails to define what is meant by speculation. The prohibition against speculation in connection with individual investments is inconsistent with UPMIFA, which articulates a focus on the overall fund, rather than on specific investments, and which avoids use of the term speculation, but instead specifies a variety of factors that should be used when vetting an investment, including a consideration of the risk of the investment and the appropriateness of that risk to the institution.*

The solution proposed was a way to "clarify the investment standards" and "provide greater investment flexibility…."
Specifically, the Corporation Code provisions were amended to allow (optional) use of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). If the corporation selects the UPMIFA standard, that will constitute "compliance with the investment standards applicable under the Nonprofit Corporation Law."

Conclusion

With AB 792 now in effect, charities should "be able to more confidently invest and manage their investment assets under the standards articulated in UPMIFA."