

A PRACTICAL GUIDE TO THE NEW YORK PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT



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The Charities Bureau of the New York State Attorney General's Office offers this guide on the New York Prudent Management of Institutional Funds ("NYPMIFA" or "the Act"), which took effect on September 17, 2010. This guide provides an overview of the Act and includes practical guidance that is intended to assist charities and other institutions in complying with the Act's new requirements. This guide contains general information and is not a substitute for legal advice from an attorney.

BACKGROUND

NYPMIFA – New York's version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") – governs the management and investment of funds held by not-for-profit corporations and other institutions. It replaces and updates key provisions of the Uniform Management of Institutional Funds Act ("UMIFA"), which was adopted in New York in 1978.

NYPMIFA makes important changes to the rules governing the spending of endowment funds – funds that are not wholly expendable on a current basis due to donor-imposed restrictions on spending. In particular, and unlike prior law, it allows institutions to spend endowment funds below their original dollar amount ("historic dollar value") without court approval or Attorney General review, if the institution's board of directors concludes that such spending is prudent. NYPMIFA also provides standards for the prudent management and investment of institutional funds, the delegation of management and investment functions to outside advisors, and procedures for lifting or modifying donor-imposed restrictions on the management, expenditure or use of institutional funds.

Recognizing that the proposed uniform legislation (UPMIFA) gives boards of directors broader authority to spend donor-restricted endowment funds than they had under prior law, New York's version of the legislation built in additional requirements for institutions and their boards and additional protections for donors – provisions unique among the 47 states that had thus far adopted UPMIFA. Among other things, NYPMIFA requires that boards determine whether it is appropriate to consider alternatives before deciding whether to authorize expenditure of an endowment fund. It also requires that a notice be given to available donors of endowment funds who executed the gift instrument before September 17, 2010, allowing these donors to opt out of the new rule permitting institutions to spend below the historic dollar value of endowment funds. In addition, the Act includes several provisions that strengthen corporate governance with respect to oversight of institutional funds and delegation of management and investment functions. These additional provisions are designed to encourage and assist boards to exercise their broader spending powers responsibly.

The text of the Act can be found on the Charities Bureau website at www.charitiesNYS.com.

OVERVIEW OF THE ACT

The Act adds a new Article, 5-A (§§ 550-558), to New York's Not-for-Profit Corporation Law (N-PCL)¹, which addresses four principal areas:

- Standards of conduct for prudently managing and investing institutional funds (new N-PCL § 552);
- Rules that boards must follow in deciding whether to appropriate from or accumulate endowment funds (new N-PCL § 553);
- Standards for delegating management and investment functions to outside agents (new N-PCL § 554); and
- Rules pertaining to the lifting or modification of donor restrictions on management and investment of institutional funds, and on donor restrictions on use of such funds (new N-PCL § 555).

The Act applies to all entities defined as "institutions" under the Act, including all New York not-for-profit corporations, corporations formed under the Religious Corporations Law and education corporations as defined in Education Law § 216-a.² Under the Act, whenever an action is required to be taken by an institution, such action must be authorized by the institution's governing board. N-PCL § 551(d).

Standard of Conduct in Managing and Investing Institutional Funds (N-PCL § 552)

The Act provides that 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." N-PCL § 552(b). The Act sets forth basic requirements for satisfying the standard of prudence, including a requirement that an institution make a reasonable effort to verify facts relevant to the management and investment of the fund, and that an institution only incur costs that are reasonable and appropriate.

The Act also requires that the following factors, if relevant, be considered in managing and investing an institutional fund:

- (1) general economic conditions;
- (2) the possible effect of inflation or deflation;
- (3) the expected tax consequences, if any, of investment decisions or strategies;
- (4) the role that each investment or course of action plays within the overall investment portfolio of the fund;

¹ The Act also amends portions of N-PCL Article 5 and N-PCL § 717, as well as sections of the Religious Corporations Law, the Estates Powers and Trusts Law, the Surrogate's Court Procedure Act, and the Executive Law. L.2010 ch.490 §§ 2-14. The existing special rules for cemetery corporations continue to apply. *See* N-PCL § 1507.

² N-PCL § 551(d)(3) defines "institution" as: "(1) a person, other than an individual, organized and operated exclusively for charitable purposes; (2) a trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated; or (3) any corporation described in subparagraph five of paragraph (a) of section 102 (Definitions)."

- (5) the expected total return from income and the appreciation of investments;
- (6) other resources of the institution;
- (7) the needs of the institution and the fund to make distributions and to preserve capital; and
- (8) an asset's special relationship or special value, if any, to the purposes of the institution.

N-PCL § 552(e)(1).

Additionally, the Act requires that investments of an institutional fund be diversified "unless the institution prudently determines that, because of special circumstances, the purposes of the fund are better served without diversification." N-PCL § 552(e)(4). A decision not to diversify must be reviewed as frequently as circumstances require, but at least annually.

The Act also requires every institution to adopt a written investment policy setting forth guidelines on investments and delegation of management and investment functions. N-PCL § 552(f).

Expenditure of Endowment Funds (N-PCL § 553)

Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets (*i.e.*, may not be spent) until they are "appropriated for expenditure" by the institution. N-PCL § 553(a). Although this term is not defined in the Act, an appropriation is generally understood to mean a decision by the governing board to release a portion of an endowment fund from the donor-imposed restriction on spending, thus authorizing it to be spent in accordance with the terms of the gift instrument. Funds appropriated for expenditure need not be spent immediately; such funds may be appropriated on one date and spent at a later date or over a period of time. Effective September 17, 2010, decisions to appropriate from endowment funds are governed by N-PCL § 553.

Under prior law, an institution could appropriate for expenditure so much of the net appreciation as the board determined was prudent; however, the institution could not appropriate below the historic dollar value of an endowment fund without court approval unless the gift instrument permitted such appropriation. *See* former N-PCL § 513(c). The Act removes the prohibition on appropriations below the historic dollar value of endowment funds; however, the donor of an endowment fund established before September 17, 2010 who is "available" as defined in the Act may opt to retain the historic dollar value limit with respect to that fund by responding to a notice sent by the institution (see below). Furthermore, as under prior law, the donor of an endowment fund may include an explicit spending limitation in the gift instrument. The Act continues to require that decisions to appropriate for expenditure from endowment funds be made prudently, but adds specific criteria for determining when this standard is met.

In deciding whether to appropriate from an endowment fund, the institution must act "in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances," and must 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;
- (7) where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the institution; and
- (8) the investment policy of the institution.

N-PCL § 553(a)(1)-(8).

The seventh factor, requiring an institution to consider alternatives to expenditure, is unique to New York and is discussed further in the Guidance below.

Contemporaneous Records

An institution must make a contemporaneous record of the consideration it gave to each of the factors in deciding to appropriate. If the institution decides to accumulate rather than appropriate from an endowment fund, it must also keep a record of such action. N-PCL § 553(a), (f).

Presumption of Imprudence

For endowment gifts made after September 17, 2010, the Act creates a rebuttable presumption of imprudence if an institution appropriates more than 7% of the fund's fair market value (averaged over a period of not less than the preceding five years) in any year. The presumption of imprudence does not apply to appropriations permitted by law or by the gift instrument. An appropriation of 7% or less of an endowment fund's value in any year is not presumptively prudent. N-PCL § 553(d)(1), (2).

Notice to Donors of Endowment Funds

The Act allows "available" donors of endowment gifts made pursuant to gift instruments executed before September 17, 2010 to opt out of the new rule permitting institutions to appropriate below the historic dollar value of endowment funds. A donor is considered available if the donor can be found with reasonable efforts and is living (if an individual) or conducting activities (if an entity). The institution must send each available donor a written notice describing the donor's two options, which contains language substantially as follows:

Attention, Donor:

Please check Box #1 or #2 below and return to the address shown above.

- #1 The institution may spend as much of my gift as may be prudent.
 #2 The institution may not spend below the original dollar value of my gift.

If you check Box #1 above, the institution may spend as much of your endowment gift (including all or part of the original value of your gift) as may be prudent under the criteria set forth in Article 5-A of the Not-for-Profit Corporation Law (The Prudent Management of Institutional Funds Act).

If you check Box #2 above, the institution may not spend below the original dollar value of your endowment gift but may spend the income and the appreciation over the original dollar value if it is prudent to do so. The criteria for the expenditure of

endowment funds set forth in Article 5-A of the Not-for-Profit Corporation Law (The Prudent Management of Institutional Funds Act) will not apply to your gift.

N-PCL § 553(e)(1).

If the donor does not respond within 90 days from the date notice was given, or if the donor returns the notice within 90 days and checks Box #1, NYPMIFA's new spending rules will apply to the donor's endowment gift. If the donor checks Box #2, the institution may not appropriate for expenditure below the historic dollar value of the endowment gift but may spend the income and appropriate the appreciation over historic dollar value if it is prudent to do so, unless otherwise prohibited by the gift instrument. Institutions must keep a record of all notices sent to donors. *See* N-PCL § 553(f).

Donor notice is not required in three circumstances:

- The gift instrument already permits spending below historic dollar value;
- The gift instrument expressly limits spending in the manner set forth in § 553(b) of the Act; or
- The donor made the gift in response to an institutional solicitation but did not include a separate statement restricting use of the funds.

N-PCL § 553(e)(2).

Delegation of Management and Investment Functions to Outside Agents (N-PCL § 554)

NYPMIFA sets forth legal standards that govern the delegation of management and investment functions by boards of directors to agents outside of the institution (external agents). The Act requires that boards use prudence in selecting, continuing or terminating an agent, and that they consider, among other things, the agent's independence including any conflicts of interest that such agent has or may have.

Standard of Care for Delegation

The Act provides that, subject to any specific limitation set forth in a gift instrument or another law, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that such a delegation is prudent under the circumstances. In order to delegate prudently, an institution must act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances in:

- (1) selecting, continuing or terminating an agent, including assessing the agent's independence including any conflicts of interest such agent has or may have;
- (2) establishing the scope and terms of the delegation, including the payment of compensation, consistent with the purposes of the institution and the institutional fund; and

- (3) monitoring the agent's performance and compliance with the scope and terms of the delegation.

N-PCL § 554(a)(1)-(3).

Standard of Care for External Agent Performing Delegated Duties

In performing a delegated function, an external agent owes a duty to the institution to exercise reasonable care, skill and caution to comply with the scope and terms of the delegation. N-PCL § 554(b). The Act continues to require that any contract that delegates a management or investment function to an external agent must provide that the contract may be terminated at any time, without penalty, with up to 60 days prior notice. N-PCL § 554(e).

Release of Donor-Imposed Restrictions on Management, Investment, or Purpose of an Institutional Fund (N-PCL § 555)

The Act modifies the standards for releasing donor-imposed restrictions on institutional funds, including restrictions on the management and investment of funds, the expenditure of funds (endowment restrictions), and the purposes for which a fund may be used. It also sets forth procedures for seeking court release of restrictions, and a new procedure for releasing restrictions on funds valued at less than \$100,000 that have been in existence for more than 20 years.

As under prior law, an institution may obtain the donor's written consent to release or modify a restriction on management or investment. If the donor is available and withholds such consent, or if the donor is not available, an institution may seek court approval to release or modify a restriction regarding the management or investment of an institutional fund if the restriction is impracticable or wasteful, impairs management or investment or if, because of circumstances not anticipated by the donor, a modification or release would further the purposes of the fund. To the extent practicable, any modification must be made in accordance with the donor's probable intention. N-PCL § 555(a), (b).

Similarly, an institution may obtain the donor's written consent to release or modify a use restriction. If the donor is available and withholds such consent, or if the donor is not available, an institution may also seek court approval to release a donor's restriction on the use of a fund if the restriction becomes impossible, impracticable, unlawful or wasteful. N-PCL § 555(c).

A key difference from prior law is that under NYPMIFA an institution may seek court release from a restriction if the donor does not consent to the release. Notice of the court proceeding must be provided to the donor and to the Attorney General, both of whom will have an opportunity to be heard. N-PCL § 555(b), (c). However, under the Act, the executors or heirs of a deceased donor are not included in the definition of "donor" and thus are not entitled to notice.

In addition, the Act provides a new procedure whereby an institution may lift or modify a donor-imposed restriction on the management, investment, or purpose of an institutional fund if the fund is less than \$100,000 in value and has been in existence for more than 20 years. If an institution determines that such a restriction is unlawful, impracticable, impossible to achieve, or wasteful, the institution may release or modify the restriction, in whole or part, without court

approval, after giving written notice to the Attorney General, unless the Attorney General objects to the release or modification within 90 days. If the Attorney General does not notify the institution within 90 days, the institution may proceed with the release or modification. N-PCL § 555(d).

The institution's written notice to the Attorney General must contain the following:

- An explanation of (i) the institution's determination that the restriction is unlawful, impracticable, impossible to achieve, or wasteful, and (ii) the proposed release or modification;
- A copy of a record of the institution approving the release or modification; and
- A statement of the proposed use of the institutional fund after such release or modification.

N-PCL § 555(d)(2), (3).

The notice must also be given to the donor, if available.³

After releasing or modifying the restriction, the institution must use the property in a manner consistent with the purposes expressed in the gift instrument. N-PCL § 555(d)(1)(C).

Solicitations for Endowment Funds (Executive Law § 174-b[2])

The Act also amends Executive Law § 174-b[2] to require a disclosure when institutions solicit for endowment funds. Under the new provision, the solicitation must include a statement that, unless otherwise restricted by the gift instrument pursuant to N-PCL § 553(b), the institution may expend so much of the endowment fund as it deems prudent after considering the factors set forth N-PCL § 553(a).⁴

³ Although the Act provides that notice to the donor need not be given for funds described in N-PCL § 553(e)(2)(B), this appears to be a drafting error. The intended reference may have been to § 553(e)(2)(C), where the gift consists of funds received as a result of an institutional solicitation without a separate statement by the donor expressing a restriction on the use of funds. Absent clarification by the Legislature, it is the view of this Office that notice pursuant to N-PCL § 555(d) should be given to any donor that is available.

⁴ L.2010 ch.490 §14 (amending Executive Law § 174-b[2]).

GUIDANCE

In the following sections, we provide practical guidance for institutions on key topics covered by the Act. This guidance is subject to change and may be supplemented from time to time. The views expressed here are those of the Attorney General's Charities Bureau; the meaning and effect of the provisions of the Act are ultimately matters for determination by the Courts of this State.

Notice to Donors of Endowment Funds

Is notice to donors required?

The Act states that unless an exception applies, an institution "must" provide 90 days notice to available endowment donors who executed gift instruments prior to September 17, 2010 before applying the new endowment spending rules in N-PCL § 553(a) for the first time. The notice requirement as written is not optional; the institution must send the notice before appropriating from the endowment fund. (The three exceptions to the notice requirement are described on page 5 above.)

It is possible that in the interim between September 17, 2010 and the issuance of this guidance some institutions, acting in good faith, may have appropriated from endowment funds before sending notice to the donors as required by N-PCL § 553(e)(1). In this case, the institution should promptly send the notice to donors if it has not already done so. If the donor responds by checking Box #2 on the notice, it is the view of this Office that the institution must restore the fund to its historic dollar value if any pre-notice appropriation reduced the fund below that level. (The rules that apply when the donor checks Box #2 are discussed below.)

Questions have been asked about whether notice is required if the endowment fund is above historic dollar value and the institution has no present intention to appropriate below historic dollar value. It is the view of this Office that notice is required. The Act makes no distinction between funds that are above historic dollar value or below; the notice is required in either case. If notice were not required while the fund is above historic dollar value, institutions could delay sending the notice, perhaps indefinitely, which is not, in our view, what the Legislature intended.

Read in the context of N-PCL § 553 as a whole, the notice serves two related but distinct policy objectives: (1) to provide the donor with *information* about the change in law with regard to an institution's authority to appropriate for expenditure below the historic dollar value of endowment funds, and (2) to give the donor an *opportunity to clarify or amend* the terms of the donor's gift with regard to such appropriations. The informational purpose of the notice is not served if the notice is not given. Furthermore, although a particular endowment fund may be "above water" now, the fund may drop below historic dollar value at some point in the future when the donor may no longer be available to clarify or amend the terms of the gift. Delaying the notice or withholding it altogether would deprive the donor of the statutorily-mandated opportunity to clarify or amend the terms of the gift with regard to appropriations below historic dollar value. For these reasons, it is this Office's view that institutions are required to send the

notice to all available donors of endowment gifts who executed the gift instrument before September 17, 2010, unless a statutory exception applies.

May an institution appropriate from an endowment fund during the 90-day period after notice is sent?

Although not expressly addressed in the Act, it is this Office's view that the Legislature did not intend the notice requirement to harm organizations by prohibiting any appropriation of endowment funds before the notice process is completed. A reasoned interpretation of the notice requirement is that, after notice is sent, an institution may appropriate the income and the net appreciation over historic dollar value of an endowment fund during the 90-day notice period, if it is prudent to do so in accordance with N-PCL § 553(a). Expenditures above historic dollar value after giving notice to the donor would not prejudice donors who may check Box #2 because principal would remain preserved during the 90-day notice period. An institution may not, however, appropriate for expenditure below the historic dollar value of an endowment fund until the 90-day notice period ends, unless the donor has returned the notice and checked Box #1.

What rules apply to the endowment fund if the donor checks Box #1 on the notice?

If the donor checks Box #1, all decisions to appropriate and spend endowment funds, as well as decisions to accumulate and not spend those funds, are governed by N-PCL § 553(a). The historic dollar value limitation on endowment appropriations that existed under prior law no longer applies.

What rules apply to the endowment fund if the donor checks Box #2 on the notice?

If the donor checks Box #2, the institution may not appropriate below the historic dollar value of the endowment fund without first obtaining court approval on notice to the Attorney General and the donor, if available. The institution may spend the income and appropriate the appreciation over the historic dollar value of the fund if it is prudent to do so. As under prior law, the historic dollar value of a "Box #2" endowment fund and the amount, if any, of appreciation of the fund that is available for appropriation is determined on a fund-by-fund basis, not by simply aggregating the asset values of multiple endowment funds. Also, as under prior law, if an institution appropriates below the historic dollar value of such an endowment fund (for example, as a result of applying a spending policy), it is the view of this Office that the institution has a duty under N-PCL §§ 553(e)(1) and 717 to restore the endowment fund to its historic dollar value.

Questions have been raised about the effect of language in the notice stating that if Box #2 is checked "the criteria for the expenditure of endowment funds set forth in Article 5-A of the Not-for-Profit Corporation Law (The Prudent Management of Institutional Funds Act) will not apply to your gift." When read in the context of the overall notice provision, it is apparent that this language was intended to clarify that the statutory criteria permitting expenditures below historic dollar value do not apply when Box #2 is checked. It is this Office's view that, other than the historic dollar value limitation, Article 5-A continues to apply to these endowment funds. Thus, for example, if the donor checks Box #2, the governing board must still determine that any appropriation from the endowment fund is prudent after considering the factors enumerated in § 553(a), and the board must make a contemporaneous record of each determination to

appropriate from the fund. To conclude otherwise would take "Box #2" endowment funds out of the Act entirely, with no statutory standard governing appropriation and accumulation of funds, which is a result the Legislature could not have intended.

While the Act requires that the notice to donors contain language substantially as set forth in N-PCL § 553(e)(1), institutions may wish to add an assurance to donors that if Box #2 is checked, all decisions to appropriate from the endowment fund must still be prudent under the Act and that the endowment fund will remain subject to other provisions of the Act.

Does the term "original dollar value" in the required notice have the same meaning as "historic dollar value"?

The Act does not define "original dollar value"; however, when read in the context of the statutory notice set forth in N-PCL § 553(e)(1), it is this Office's view that this term is intended to be a plain-English equivalent of "historic dollar value" as defined in N-PCL § 102(a)(16). That section defines "historic dollar value" as "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." That section goes on to state that "[t]he determination of historic dollar value made in good faith by the corporation is conclusive."

What steps should an institution take to determine whether a donor is "available" such that notice is required?

A donor who is an individual is "available" if the donor is living and can be identified and located with reasonable efforts. If the donor of a particular fund is not known, the institution should make reasonable efforts to identify the donor. For donors whose current address is unknown, the institution should make reasonable efforts to locate the donor, including Internet searches and contacting known associates of the donor, such as an attorney who represented the donor when the gift was made. The statute requires institutions that send the N-PCL § 553(e)(1) notice to keep a record. The record should document the institution's efforts to locate donors even if those efforts ultimately did not succeed.

Expenditure of Endowment Funds

How does the Act modify previous concepts of endowment spending?

Traditional endowment concepts focused on preserving "principal" and spending "income." In the 1970s, UMIFA expanded permissible spending to include a prudent amount of the appreciation of the endowment fund; this remained the law until September 17, 2010. The Act takes a different approach, reflecting the view that a prudent investment strategy requires institutions to invest their endowments and other institutional funds for "total return," which may result in increases (or decreases) in principal, income or both. The Act thus requires institutions to determine spending based on the total assets of the endowment fund. As the drafters of UPMIFA have noted:

Although the Act does not require that a specific amount be set aside as “principal,” the Act assumes that the institution will act to preserve “principal” (i.e., to maintain the purchasing power of the amounts contributed to the fund) while spending “income” (i.e. making a distribution each year that represents a reasonable spending rate, given investment performance and general economic conditions). Thus, an institution should monitor principal in an accounting sense, identifying the original value of the fund (the historic dollar value) and the increases in value necessary to maintain the purchasing power of the fund.⁵

Must the board consider all eight factors for every endowment fund appropriation?

The Act states that the board must consider the eight factors “if relevant,” so at a minimum the board must consider each factor to determine whether or not it is relevant. As discussed below under “Contemporaneous Records,” if the board determines that any factor is not relevant, it should document how it reached that conclusion.

If a factor is relevant, the board should go on to consider to what extent the factor affects the decision whether or not to appropriate or how much to appropriate. Although the factors should be considered individually, the board should also look at the “big picture” and consider how the factors, considered together and weighted appropriately, affect the decision at hand. The nature and extent of the board’s consideration of the factors may vary from institution to institution, depending on the institution’s size, purposes, programs, financial condition and other circumstances.

May an institution make a single appropriation decision for multiple endowment funds?

In this Office’s view, the Act contemplates that decisions to appropriate from endowment funds will ordinarily be made on a fund-by-fund basis and documented in a separate contemporaneous record for each endowment fund.⁶ A question has arisen as to whether there are circumstances in which the Act would permit an institution to make a single decision to appropriate from multiple endowment funds and document that decision in a single contemporaneous record. The question is of particular interest to larger institutions holding numerous endowment funds, for example, a community fund with numerous endowment donors or an educational institution with hundreds or even thousands of endowment funds for scholarships, endowed chairs and other purposes.

In this Office’s view, the governing board of an institution may make a single decision to appropriate from multiple endowment funds, and this decision may be documented in a single contemporaneous record, provided that the endowment funds are similarly situated. The

⁵ National Conference of Commissioners on Uniform State Laws, Uniform Prudent Management of Institutional Funds Act (2006), available at http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf (“UPMIFA”) § 4, Comment at p. 21.

⁶ This is evidenced by N-PCL § 553’s consistent use of the defined terms “donor,” “endowment fund” and “gift instrument,” each of which is phrased in the singular. See also the definitions of these terms in N-PCL § 551(a-1), (b) and (c).

governing board should develop written procedures for determining when a group of funds is similarly situated for this purpose. Such a determination may be based on factors including the purposes of the funds as stated in the gift instruments, the spending restrictions imposed in the gift instruments, the durations of the funds, the financial condition of the funds, whether the funds are invested similarly, and such other factors as may be relevant under the circumstances.

A decision to treat a group of endowment funds as similarly situated group should be made with care to ensure that any decision to appropriate from the funds collectively would be justified if the factors in N-PCL § 553(a) were applied to each fund individually.

What is meant by "alternatives to expenditure of the endowment fund," and how should institutions give consideration to that factor?

As noted above, N-PCL § 553(a) requires that, in making a determination to appropriate or accumulate from an endowment fund, the board must consider, if relevant, eight factors, including "(7) where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the institution." In this Office's view, the inclusion of this factor, which is unique among all states that have adopted UPMIFA, was intended to ensure that boards do not automatically decide to appropriate from endowment funds when circumstances warrant considering whether reasonable alternatives are available. For example, if an endowment fund has diminished in value, the board may determine that it is appropriate to take steps to avoid or reduce further spending of the fund. Such steps might include, where appropriate, fund-raising efforts, expense reductions, sale of non-essential assets, or reductions in non-essential staff. The board might also consider whether certain expenditures can prudently be deferred. The board should identify the particular alternatives that might be appropriate in the circumstances and discuss to what extent these steps are feasible as an alternative to endowment spending, including what impact such alternatives would have on the institution's operations and programs. The consideration of alternatives should be appropriately documented (see "Contemporaneous Records," below).

Contemporaneous Records of the Determination to Appropriate

What should the contemporaneous record address?

The contemporaneous record of the determination to appropriate should address each of the eight factors included in N-PCL § 553(a) and discuss the consideration that the board gave to each factor. In this Office's view, it is not sufficient to state in a conclusory fashion that the board considered a particular factor; rather, the record should describe the substance of the consideration given to each factor. If any factor was deemed not relevant to the board's decision, the record should explain why.

As stated above, if the governing board of an institution makes a single decision to appropriate from multiple endowment funds that are similarly situated, it is this Office's view that the decision may be documented in one contemporaneous record.

How should the contemporaneous records be documented?

The form of the record is less important than the substance. The record may be made in the board's minutes; alternatively, boards may wish to develop a record especially for the purpose of documenting their decisions to appropriate endowment funds for expenditure. Contemporaneous records of decisions to appropriate from endowment funds should be maintained as part of the permanent records of the institution. The Charities Bureau may request production of these records in the exercise of the Attorney General's supervisory authority over institutions.

When should contemporaneous records be prepared?

To be contemporaneous, the record should be prepared at the time the board makes a decision to appropriate from an endowment or immediately thereafter. If the board relies on advice and information from professionals (such as lawyers, accountants or investment advisors) when it decides to appropriate endowment funds for expenditure, it may (but is not required to) incorporate all or part of such written advice in its contemporaneous record, to the extent such advice is not privileged, confidential or proprietary.

Presumption of Imprudence

Does the presumption of imprudence mean that an institution can safely appropriate up to 7% of the value of its endowment funds each year?

The Act makes it clear that an appropriation of 7% or less of the value of an endowment fund in any year does not create a presumption of prudence. The level of appropriation for each endowment fund held by an institution must be determined in accordance with the prudence standard in N-PCL § 553(a) of the Act, after consideration of the enumerated factors.

Does an endowment spending policy of 7% or less per year in itself ensure that the presumption of imprudence will not be triggered?

No. The Act's 7% standard is based on the endowment fund's fair market value averaged over at least *five years* immediately preceding the year in which the appropriation for expenditure is made (or over the life of the fund if the fund has been in existence less than five years). If, for example, an institution's spending policy is based on fair market value averaged over a shorter period, the spending policy may result in appropriations that are presumptively imprudent under the Act. All spending policies should be reviewed to determine how they interact with the presumption of imprudence. If necessary, institutions must perform a separate calculation, averaging the fund's fair market value over at least the preceding five years, in order to determine whether a proposed appropriation would be presumptively imprudent.

Managing and Investing Institutional Funds

What topics should the investment policy address?

There is no "one size fits all" investment policy that applies to all institutions. The contents of the investment policy will depend on factors including the extent of the financial resources of the institution, the types of investments it holds, the charitable purposes of the institution, and nature and scope of the institution's activities or programs. Examples of the subjects an investment policy may include:

- (1) general investment objectives;
- (2) permitted and prohibited investments;
- (3) acceptable levels of risk;
- (4) asset allocation and diversification;
- (5) procedures for monitoring investment performance;
- (6) scope and terms of delegation of investment management functions;
- (7) the investment manager's accountability;
- (8) procedures for selecting and evaluating external agents;
- (9) processes for reviewing investment policies and strategies; and
- (10) proxy voting.

The board should review the investment policy at regular intervals and whenever a change in the institution's financial condition or other circumstances so require.

Delegation of Management and Investment Functions to Outside Agents

What steps should a board take to assess an outside investment agent's independence?

Governing boards should be diligent in assessing the independence of outside investment agents – both before and after retaining them. Outside investment agents should be selected based on the agent's competence, experience, past performance, and proposed compensation, and not on any business or personal relationships between the agent and board members or other insiders. It is essential that board members are capable of objectively assessing and monitoring investment performance and risk without regard to those relationships.

Before retaining an agent, the governing board should consider whether any business or personal relationships would reasonably be expected to interfere with the ability of the board to provide proper oversight. For example, assume a chairman of the board asks the board to transfer management of institutional funds to his private investment firm. The board must decide whether it is prudent to do so under the circumstances, and whether it feels it can objectively oversee and monitor the agent's performance going forward. The governing board should also consider whether the retention of outside agents who have business or personal relationships with board members or other insiders might prevent the board from receiving independent advice on investment strategy and risk. For example, assume the board chair wishes to switch investments to his firm, in part to invest in derivative products developed by his firm. Can the board of directors, based on advice it receives from investment advisors employed by the board chair's firm,

determine in good faith that such an investment strategy is in the best interests of the organization?

To avoid these situations and alleviate the pressure that board members may experience, some boards may determine that the best course of action is to adopt a policy requiring that all outside agents be independent. Although not required by the Act, it is this Office's view that institutions are well-advised to adopt policies that require full disclosure of relationships with outside agents and implement practices that ensure objective oversight by the board. At a minimum, an institution should have a conflict of interest policy and follow the policy in selecting, continuing or terminating the agent. Such a policy would generally include procedures for determining whether any of the institution's officers or directors have a substantial financial interest in the agent or have any other material business or personal relationship with the agent. If so, the policy should provide for reporting such relationships or interests to the board and should address abstention or recusal of the director or officer in question.

Release of Donor-Imposed Restrictions

What should an institution do before seeking court release of a donor-imposed restriction on an institutional fund?

Because a court proceeding can be expensive and time-consuming, an institution may first wish to inquire whether the donor is available and willing to consent in writing to the proposed release or modification in accordance with N-PCL § 555(a). The donor's written consent would obviate the need for court approval.

If it is necessary to seek court release or modification of a donor-imposed restriction, when should the institution contact the Attorney General's Office?

Although not required by law, we urge institutions and their counsel to submit a draft petition to the Attorney General's Charities Bureau for review and discussion before filing the petition with the court. A copy of the gift instrument and other relevant documentation should also be submitted in advance. Advance review by the Charities Bureau can help to identify and resolve potential issues, thus simplifying the proceeding and saving time. Petitions should be submitted to the Charities Bureau at the earliest possible time to allow sufficient time for review. Please confirm that the Charities Bureau's review has been completed before commencing a proceeding in court.

What procedures apply when submitting a notice to the Attorney General under N-PCL § 555(d) to release or modify a restriction on a "small, old" fund?

The institution should first determine whether the donor, if available, will consent to the release, thus avoiding the need to submit a notice to the Attorney General. If the donor is not available or is unwilling to consent, then the institution must comply with § 555(d) in order to release the restriction. First, the institution must make a record (typically, a resolution of the board) approving the release or modification of the restriction. A copy of this record must be submitted to the Attorney General's Charities Bureau together with a written notice of the

institution's intention to release the restriction and explaining why the restriction has become unlawful, impracticable, impossible to achieve, or wasteful. The notice must also describe the proposed use of the fund if the restriction is released.

In addition to meeting the above statutory requirements, the notice to the Attorney General's Charities Bureau should include a copy of the gift instrument and other documentary evidence sufficient to show that the fund's total value is less than \$100,000 and that more than 20 years have elapsed since the fund was established. Additionally, if the donor is available, and particularly if the donor has withheld consent, the notice should include copies of any correspondence between the institution and the donor with regard to the proposed release or modification. If the donor has been notified pursuant to N-PCL § 555(d)(4), a copy of this notice should be included in the notice sent to the Attorney General.

Notices to the Attorney General pursuant to N-PCL § 555(d) should be sent as follows:

If sent by e-mail with PDF attachment (preferred method), to:
section555notice@ag.ny.gov

If sent by regular mail, to:
Attorney General of the State of New York
Attention: Chief, Charities Bureau
120 Broadway, 3rd Floor
New York, NY 10271

What procedures apply after the § 555(d) notice is submitted to the Charities Bureau?

If the Charities Bureau has questions or requires further information, or if the Charities Bureau objects to the proposed release or modification, the Charities Bureau will notify the institution in writing within 90 days. If such notice is received, the institution should not release or modify the restriction unless and until it receives a further written notice from the Charities Bureau stating that any questions or objections have been resolved to the satisfaction of the Attorney General. We anticipate that many such issues will be resolved after discussions with the institution or its counsel.

CONCLUSION

For further information, please contact the Attorney General's Charities Bureau at the address shown above.

This and other Charities Bureau booklets, forms and instructions are available on the Attorney General's website at http://www.charitiesnys.com/guides_advice_new.html.

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