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Attorney General Issues Guide on the New York Prudent Management of Institutional Funds Act

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On March 17, 2011, the New York State Attorney General's Charities Bureau published "A Practical Guide to the New York Prudent Management of Institutional Funds Act". The Guide provides a summary of the New York Prudent Management of Institutional Funds Act (NYPMIFA), as well as practical guidance on its application. While the Guide is not an official regulation, since the Charities Bureau is tasked with enforcement of NYPMIFA, not-for-profit institutions are well advised to take this guidance into serious consideration.

NYPMIFA was enacted into law on September 17, 2010. It updates the Uniform Management of Institutional Funds Act, which had governed charitable endowment funds since 1978, with New York's unique version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). By doing so, New York became the forty-seventh state to have enacted a version of UPMIFA.

NYPMIFA makes several important changes to prior law. Most importantly, NYPMIFA drops the requirement that institutions maintain the "historic dollar value" or original dollar amount of a gift. Instead, NYPMIFA sets forth certain investment and expenditure standards to ensure that endowment funds are used and maintained in a prudent manner. To balance this grant of broader discretion to charitable institutions, NYPMIFA also imposes new notice, decision making, and corporate governance requirements on institutions and their boards.

Prior Donor Notice

In the Guide, the Charities Bureau highlights several key issues. First, the Guide addresses questions regarding the required notice to donors of gifts made prior to September 17, 2010. NYPMIFA provides that an institution must give 90 days prior written notice to “available” donors (those who are living and can be found with reasonable efforts) before exercising its new power to invade the historic dollar value of the gift. The notice grants each donor an opportunity to opt out of appropriations below the historic dollar value of the gift. If a donor chooses to opt out of appropriations below historic dollar value, the prudent investment and expenditure standards enacted by NYPMIFA still apply to the gift. During the 90-day notice period, an institution can continue to appropriate from these funds as long as no expenditure below historic dollar value is made until the donor has granted his or her approval or the 90 day period expires.

The statute (N-PCL § 553(e)(1)) requires that the notice 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.

Institutions may wish to add an assurance to donors that their gifts will still be subject to the prudent use standards enacted by NYPMIFA even if they opt out of below historic value appropriations by checking Box #2.

The statutory language describing the notice requirement raised the question of whether notice is required if the institution has no present plans to appropriate below historic dollar value. The Guide answers this question definitively, stating that notice is required to all prior donors, regardless of the institution's expenditure plans. There are only three exceptions to the notice requirement: (1) the gift instrument already permits spending below historic dollar value; (2) the gift instrument expressly prohibits spending below historic dollar value; (3) the donor made the gift in response to an institutional solicitation but did not include a separate statement restricting use of the funds.

Expenditure Decisions

NYPMIFA provides eight prudent use factors to be considered, if relevant, in all endowment fund appropriation decisions:

- the duration and preservation of the endowment,
- the purpose of the institution and the fund,
- general economic conditions,
- the possible effect of inflation or deflation,
- the expected total return from income and appreciation of investments,
- the institution's other resources,
- the alternatives, where appropriate, to spending and due consideration to the impact of those alternatives on the institution, and
- the institution's investment policy.

The Guide clarifies that an institutional board must either consider each factor or make a specific determination that the factor is not relevant. The consideration of the factors and any determinations that a factor is irrelevant must be documented in a contemporaneous record. The record must describe the substance of the consideration rather than making a conclusory statement. The form of the record is not important; meeting minutes are sufficient, but a board can choose to develop a separate record. The record may, but need not, incorporate any written advice the board receives from professionals in making its decisions.

The seventh factor, the consideration of alternatives to spending, is unique among the states that have adopted UPMIFA. The Guide explains that the factor is intended to ensure that boards do not automatically turn to endowment expenditure when alternatives such as fund-raising, expense reductions, sale of assets, staff reductions, or deferred expenditures would better serve the institution and the fund. All considered alternatives should be documented in the record of the decision.

While these factors are meant to be applied on a fund-by-fund basis, the Guide indicates that a single decision can be made regarding multiple endowment funds provided the funds are “similarly situated.” Written procedures for determining when a group of funds is similarly situated should be developed and may include factors such as the purposes, restrictions, financial condition, investment status, and duration of the funds. Even if a group appropriation decision is made, the decision should be justified if the prudent use factors were applied to each fund individually.

Investment Policy

NYPMIFA requires that charitable institutions have a written investment policy that applies to their endowment funds. While the statute provides a list of factors that should be considered in making investment decisions, NYPMIFA does not prescribe the contents of an institution’s investment policy. The Guide indicates that there is no ideal investment policy; however, it gives examples of subjects a policy may wish to address, such as:

- general investment objectives,
- permitted and prohibited investments,
- acceptable levels of risk,
- asset allocation and diversification,
- procedures for monitoring investment performance,
- scope and terms of delegation of investment management functions,
- the investment manager’s accountability,
- procedures for selecting and evaluating external agents,
- processes for reviewing investment policies and strategies, and
- proxy voting.

Regular review and revision of the policy is recommended.

An institution’s investment policy also must set forth guidelines for any delegation of management and investment functions. The Guide advises institutional boards to be diligent in assessing the independence of outside investment agents both before and after retaining them. While NYPMIFA does not prohibit business or personal relationships between the board and its agents, the Guide cautions against the use of agents who may interfere with a board member’s ability to make independent decisions and provide proper oversight. The best course of action may be to adopt a policy requiring all outside agents to be independent. The Guide advises boards ideally to adopt a policy of full disclosure of relationships with outside agents. At a minimum, boards should adopt and follow a conflict of interest policy in making decisions about outside agents.

Releasing Gift Restrictions

NYPMIFA expanded on existing options for an institution to seek the release of donor-imposed restrictions on an institutional fund. The preferred and easiest method is a release granted through the donor’s written consent. If consent is not possible or not granted, an institution may seek judicial release of the restriction after notifying available donors and the Attorney General. The Guide advises institutions to submit a draft of any judicial petitions to the Charities Bureau prior to filing in order to resolve potential issues.

For “small, old” funds (funds that are less than $100,000 in value and have been in existence for more than 20 years) NYPMIFA also creates a non judicial method for releasing fund restrictions. The institution must provide notice to the Attorney General and to available donors of the intent to modify or release the restriction. If the Attorney General does not respond within 90 days of the notice, the institution may proceed without further requirements.

The statutory language provides a limited exception to the donor notice requirement for the release of a “small, old” fund. As drafted, NYPMIFA states that notice to the donor is not required when the gift instrument limits the institution’s ability to appropriate below historic dollar value (as set forth in N-PCL § 553(e)(2)(B)). However, the Charities Bureau believes that the exception provision contains a drafting error and should in fact refer to funds received as a result of an institutional solicitation without a separate statement by the donor expressing a restriction on the use of the funds (N-PCL § 553(e)(2)(C)).

Regardless, the Guide advises institutions to always provide notice to available donors.

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