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New York Prudent Management Institutional Funds Act

New York State's NYPMIFA statute is designed to achieve three goals: (i) set standards for the administration of institutional funds; (ii) allow more flexibility in the use of endowment funds; and (iii) modify the rules for the release of restricted assets.

NYPMIFA has broad application because it covers charities[1] formed in New York that manage institutional funds. An institutional fund is "a fund held by an institution" but does not include "program related assets." NPCL §551(e)(1).[2] Because the definition of Institutional Funds is so broad, even nonprofit corporations without complicated financial investments should take steps to ensure investment decisions are made in compliance with this statute, and that appropriate investment policies have been adopted by the board of directors.

Standard for Managing Institutional Funds

NYPMIFA requires that the people responsible for managing Institutional Funds must "manage and invest the fund in good faith and with care an ordinarily prudent person would exercise under similar circumstances." NPCL §552(b). This is known as the prudence standard. Institutions must diversify their investments and weigh the following factors in making investment decisions:

1. General economic conditions;
2. Possible effect of inflation or deflation;
3. Expected tax consequences;
4. Role each investment or course of action plays within the overall investment portfolio of the fund;
5. Expected total return from income and appreciation of investments;
6. Other resources of the institution;
7. Needs of the institution and 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.

[1] NYPMIFA covers institutions. "Institution means: (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; and (3) any corporation described in subparagraph five of paragraph (a) of section 102 (Definitions)." NPCL §551(d).

[2] Additionally, excluded from the definition of Institutional Fund are "(2) a fund held for an institution by a trustee that is not an institution; or (3) 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." NPCL §551(e).

NPCL §552(e)(1). Institutions are required to adopt written investment policies and must make decisions about how to manage a specific asset in the context of the institution's overall investment strategy and its ability to tolerate risk. NPCL §552(f) & §552(e)(2). The Charities Bureau suggests that investment policies may include the following factors:

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. Procedures for reviewing investment policies and strategies; and
10. Proxy voting.

The investment policy should be subject to regular review and amendment as required by the circumstances of the organization and financial conditions.

While an organization can delegate the management of its Institutional Funds to an outside expert or a board member, the individual who is selected to manage the funds or that has "special skills or expertise" has a "duty to use those skills or expertise in managing and investing institutional funds." NPCL §552(e)(6). The selected individual should be subject to continuing oversight by an objective committee of the board. Any selection process should require full disclosure of any personal or business relationships between the organization and the proposed manager, and, if necessary, reviewed pursuant to the conflicts of interest policy. The manager should be engaged by written agreement, terminable at any time upon sixty (60) days notice.

<u>Expenditure from Endowment Funds</u>

An endowment fund "means an institutional fund or part thereof that, <u>under the terms of a gift instrument</u>, is not wholly expendable by the institution on a current basis." NPCL §551(b). Board restricted assets are not considered endowment funds. <u>Id</u>. It is important to distinguish an endowment, which is restricted by the donor, from a "board restricted endowment." The former is governed by NPCL §551(b) ad described below, while a board restricted endowment is governed by the more general standards described above and as set forth in NPCL §552(e)(1).

Gifts made to an endowment fund after NYPMIFA's enactment, subject to donor intent, can be expended if the board determines in good faith that the expenditure is prudent and consistent with the purpose for which the endowment fund was created. In making this determination, the board should consider eight (8) factors:

1. Duration and preservation of the endowment fund;
2. The purposes of the institution and 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 such alternatives may have on the institution; and
8. The investment policy of the institution.

NPCL §553(a). Every time a board appropriates (authorizes) expenditure from an endowment fund it needs to make an immediate record in the organization's permanent records (such as including the discussion in board minutes or a new record expressly dedicated to endowment decisions) describing the consideration given to each factor. Id. Any description of decisions in the record should include a discussion of each alternative considered and the potential affect of each on the organization and its financial position.

Expenditures of more than seven (7) percent of the fair market value of the endowment fund (averaged over the last five years) within one (1) year will be presumed to be unwise or imprudent. This is called the rebuttable presumption of imprudence. Fair market value of the endowment fund is "calculated on the basis of market value determined at least quarterly and averaged over a period of at least five years immediately preceding the year in which the appropriation for expenditure is made." NPCL §553(d). An expenditure of less then seven (7) percent within one year will not automatically be considered wise or prudent. § NPCL 553(d)(2). Decisions to appropriate any fund should be made on a fund by fund basis unless the funds are similarly situated based on their restrictions, duration, financial status and types of investments, etc. Any analysis relied upon to appropriate a group of funds should equally apply to each fund individually.

If a nonprofit organization wants to apply the NYPIMFA expenditure rules to endowment funds received prior to September 17, 2010, it must provide donors with ninety (90) days written notice to the donor, if available, prior to withdrawing money from the endowment fund for the first time under the new standards. NPCL §553(e)(1). According to the Charities Bureau guidance, the purpose of the notice is to inform donors of the new law and to provide donors the opportunity to clarify or amend the conditions of the gift. The donor has the option of requiring the organization to apply the prior law to their gift[3] rather than NYPMIFA. A donor is available if the donor is: (i) a natural person and is living; or (ii) if not a natural person (e.g. a corporation or foundation) is in existence and conducting activities; and (iii) can be identified and located with reasonable efforts. NPCL §551(j). An organization may appropriate funds above the historic value of the endowment fund during the 90-day notice period; however, the organization may not appropriate below the historic value until after 90-days or until receipt of donor's response authorizing such expenditure, whichever comes first.

The notice must include a form to be used by the donor and must contain the following language:

[3] Under the prior law, subject to donor intent, only "net appreciation" over historic dollar value was available for expenditure.

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 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 appreciation over the original dollar value if it is prudent to do so. The criteria for expenditure of endowment funds set forth in Article 5-A of the Not-for-Profit Corporation Law (the Prudent Management of Funds Act) will not apply to your gift.[4]

NPCL §553(e)(1).

There are limited circumstances under which it is not necessary to give a donor notice prior to applying NYPMIFA. NPCL §553(e)(2).

Release from Restriction

A donor may, in writing, modify or release a restriction it placed on a gift. NPCL §555(a). Under the prior law, if a donor was available, only the donor had the ability to modify or release a gift restriction. Now an organization can seek court authorization to modify or release a gift, on notice to the donor (if available) and the Attorney General if the organization determines that: (i) the restriction has become impracticable or wasteful; (ii) it impairs the management or investment of the fund; or (iii) because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. NPCL §555(b). Prior to filing with the court, the organization should submit the draft petition along with the gift instrument and relevant documentation to the Charities Bureau for review. Charities Bureau review must be completed prior to filing with the court.

There are limited circumstances under which an organization can release a restriction on a gift upon ninety (90) days notice to the attorney general and the donor (if available) and not seek court approval. Any such notice must include record of the organization's appropriation decision. An organization can take advantage of this option if it determines that: (i) the restriction contained in the gift instrument is unlawful, impracticable, impossible to achieve or wasteful; (ii) the value of the restricted asset is less then $100,000; (iii) the gift was made over

[4] The Charities Bureau has suggested that this sentence be modified to clarify that when a donor chooses Box #2, NYPIMFA will apply to all expenditures of the endowment; but will not permit expenditures below the historic value.

20 years ago; and (iv) the organization will expend the funds consistent with it charitable purposes. NPCL §555(d)(1). If the Attorney General does not respond within ninety (90) days the organization can lift the restriction. NPCL §555(d)(3).

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