Schulte Roth & Zabel

Alert

Recent Enactment of Prudent Management of Institutional Funds Act Will Affect New York State Independent School Endowments

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On Sept. 17, 2010, New York state enacted the New York Prudent Management of Institutional Funds Act (the "Act")[1], modernizing the Uniform Management of Institutional Funds Act, which had been incorporated into New York law in 1978. Not-for-profit independent schools in New York state, and other entities incorporated under the New York Not-For-Profit Corporation Law, will now have greater flexibility in appropriating their endowment funds.[2]

The Act eliminates the concept of "historic dollar value," which prohibited expending principal of an endowment fund where the value of such principal had depreciated below the value of the original gift. The Act provides that an institution may appropriate so much of an endowment fund as the institution determines, subject to the intent of the donor expressed in a gift instrument, is prudent for the uses, benefits, purposes and duration for which the endowment fund is established.[3] The Act provides factors that institutions must consider when making decisions about expenditure or accumulation of endowment funds. These factors include: the duration and preservation of the endowment fund; the purposes of the institution and the endowment fund; general economic conditions; possible effect of inflation and deflation; expected total return from income and the appreciation of investments; other resources of the institution; the investment policy of the institution, and where appropriate, alternatives to expenditure of the endowment fund, giving consideration to the effect such alternatives may have on the institution. The Act requires that an institution keep a contemporaneous record describing the consideration given by the governing board or committee to each of the factors.[4]

The Act also introduces a rebuttable presumption of imprudence. Expenditure in any year of greater than 7 percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of not less than five years immediately preceding the year of appropriation, creates a rebuttable presumption of imprudence.[5] This presumption applies only to appropriation from gift instruments executed on or after Sept. 17, 2010.

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[1] The Act is New York's version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

[2] An "endowment fund" is an "institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis." An endowment fund does not include assets that an institution itself designates as not expendable on a current basis. N.Y. Not-For-Profit Corp. Law § 551(b).

[3] N.Y. Not-For-Profit Corp. Law § 553(a).

[4] *Id*. § 553(a).

[5] *Id*. § 553(d).

The Act requires institutions to notify "available" donors[6] 90 days in advance of applying the new endowment rules for gift instruments executed before Sept. 17, 2010. A donor is "available" if the donor (i) is living or, if the donor is not a natural person, is in existence and conducting activities, and (ii) can be identified and located with reasonable efforts.[7] The Act specifies that notification should be substantially in the form of boxes that the donor may check providing either that (i) the institution may spend as much of the endowment gift as is prudent, or (ii) the institution may not spend below the original dollar value (synonymous with historic dollar value). If the donor does not respond during the 90-day period, the new rules will automatically apply, and the institution will not be subject to the original dollar value limitation.

The Act also provides that an institution may seek court release or modification of a restriction regarding the management or investment of an endowment 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. In addition, if an institution determines that a restriction on the management, investment or purpose of an institutional fund is unlawful, impracticable, impossible to achieve or wasteful, after 90 days notice to the attorney general and the donor (if available), the institution may release or modify a restriction contained in a gift instrument without approval by a court if (i) the fund has a total value of less than $100,000; (ii) more than 20 years have elapsed since the fund was established; and (iii) the institution uses the property in a manner consistent with the purposes expressed in the gift instrument.[8]

The Act amends Section 174-b(2) of the New York Executive Law to require that solicitations for an endowment fund must include a statement that unless the gift instrument otherwise restricts it, the institution may expend so much of an endowment fund as it deems prudent after considering the factors required by the Act.

The Act also sets forth obligations with respect to the management and investment of institutional funds generally, including overall duties of loyalty and prudence as well as rules regarding written investment policies, diversification, and delegation of management and investment functions. Except as otherwise provided in a gift instrument, the Act provides that an institution must diversify the investments of an institutional fund unless the institution determines prudently that in light of special circumstances, the purposes of the fund are better served without diversification. The institution must review a decision not to diversify as frequently as necessary under the circumstances and at least once a year. Additionally, the Act requires institutions to adopt written investment policies reflecting the requirements of the Act. This written investment policy must be taken into consideration when making decisions about expenditure or accumulation of endowment and other institutional funds (as described above).

A governing board may delegate management and investment functions to its committee, officers, or employees in accordance with the prudence standard. If the institution delegates authority for investment decisions to external advisors or managers, it must act in good faith with the care of an ordinarily prudent person in a like position in (i) selecting, continuing or terminating the agent and assessing its independence; (ii) establishing the scope and terms of the delegation including compensation; and (iii) monitoring the agent's performance and compliance with the scope and terms of the delegation.

We recommend that schools review the new law and its potential applicability to their existing endowment funds.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[6] The term "donor" is defined as the person or entity that grants or transfers property to an institution pursuant to a gift instrument, or a person or entity designated in the applicable gift instrument to act in the place of the donor, but does not otherwise include the person's executors, heirs, successors, assigns, or transferees.

[7] *Id*. § 551(j).

[8] *Id*. § 555(d).

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