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Alert

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

April 11, 2011

On March 17, 2011, the New York State Attorney General Charities Bureau released "A Practical Guide to the New York Prudent Management of Institutional Funds Act" (the "Guidance"), which provides an overview of the New York Prudent Management of Institutional Funds Act (the "Act") and is intended to assist charities and other institutions in complying with the Act's requirements. The Guidance does not contain law, and the meaning and effect of the Act are ultimately matters for determination by the courts. Nonetheless, the Guidance provides important insight on how the Charities Bureau will enforce the law. For background on the Act, please see our previously issued client alert. Below is a summary of the Guidance; the full text can be found at http://www.charitiesnys.com/pdfs/NYPMIFA-Guidance-March-2011.pdf.

Notice to Donors of Endowment Funds
For gift instruments executed by donors before Sept. 17, 2010, the Act requires an institution to provide 90-days advance notice to the donor, if available, before appropriating from the endowment fund. The Act requires that notice be substantially in the form of boxes that the donor may check providing that (i) the institution may spend as much of the endowment gift as is prudent (Box #1), or (ii) the institution may not spend below the original dollar value of the endowment gift (Box #2). If the donor does not respond within 90 days from when the notice was sent, the institution will not be subject to the original dollar value[1] limitation. If the donor does respond, the institution must follow the donor's direction.[2]

The Guidance provides that institutions which, acting in good faith, appropriated from endowment funds between Sept. 17, 2010 and the issuance of the Guidance, without giving the required notice, should promptly send the notice to donors. If the donor responds by checking Box #2, the institution must restore the fund to its historic dollar value if any pre-notice appropriation reduced the fund below that level. The Guidance further provides that notice is required even if an endowment fund is above historic dollar value and the institution has no present intention to appropriate below historic dollar value. The Guidance explains that although a particular endowment fund may be "above water" now, the fund may drop below the historic dollar value at some point in the future when the donor is no longer available to clarify or amend the terms of the gift. Delay 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.

The Guidance explains that once the notice is sent, the institution may appropriate income and net appreciation over the original dollar value during the 90 day donor response period, but the institution may not

[1] The Guidance confirms that the attorney general views the terms "original dollar value" and "historic dollar value" as synonymous.

[2] Donor notice is not required where: (i) the gift instrument already permits spending below historic dollar value; (ii) the gift instrument expressly limits spending in the manner set forth in 553(b) of the Act or (iii) the donor made the gift in response to an institutional solicitation but did not include a separate statement restricting use of the funds.

invade original dollar value during this period. The Guidance clarifies that if a donor checks Box #2, the institution may not appropriate below the historic dollar value, but the institution may spend income and appropriate the appreciation over the historic dollar value of the fund if it is prudent to do so. According to the Guidance, institutions may wish to add an assurance to donors that if Box #2 is checked, all decisions to appropriate from the fund must still be prudent under the Act and the endowment fund will remain subject to other provisions of the Act. Finally, the Guidance provides that to determine if a donor is "available" for purposes of a notice, an institution should make reasonable efforts to locate the donor, including conducting internet searches and contacting known associates of the donor. The institution should document the search even if it is not successful.

Contemporaneous Recording
The Act provides that an institution may appropriate so much of an endowment 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 is established. The Act lists eight factors for an institution to consider and requires that the institution keep a contemporaneous record describing consideration to each. The Guidance clarifies that the record-keeping requirement may be fulfilled through documentation in governing board or committee minutes, among other ways. If a factor is determined to not be relevant to the decision, the board or committee must document specifically how it reached that conclusion. The records of decisions to appropriate from endowment funds should be maintained as part of the permanent records of the institution.

The Guidance further provides that the governing board or committee may appropriate from multiple similarly-situated endowment funds simultaneously. The Guidance advises that the governing board or committee develop written procedures for determining when a group of funds is similarly situated. In determining if it is appropriate to treat multiple funds as similarly-situated, the Attorney General indicated that the board or committee should consider the purposes of the funds, the spending restrictions applicable to the funds, the durations of the funds, the financial condition of the funds, whether the funds are invested similarly and other such factors as may be relevant.

Release and Modification
Under the Act, an institution may seek court release or modification of a restriction placed on a gift by a donor even if the donor is available, with notice to the attorney general and the donor. The Guidance suggests, however, that because a court proceeding can be expensive and time-consuming, an institution may first want to inquire whether a donor is available and willing to consent in writing to any proposed release or modification, in which case court approval would not be necessary. Although not required, the Guidance also suggests that if an institution wishes to seek court approval for release or modification of a restriction, that the institution first submit the petition to the Charities Bureau for review. The attorney general believes this will expedite the court approval process since the Act requires institutions to give notice to the attorney general when applying to the court for a release or modification.

The Act also establishes a new procedure by which an institution may release or modify a restriction without court approval for a fund with a total value of less than $100,000, where more than 20 years have elapsed since the fund was established (so-called "small, old" funds). In such a situation, the Guidance suggests that the institution first inquire whether the donor is available and willing to consent to the release, thus avoiding the need to notify the attorney general. If the donor is not available or is unwilling to consent to the release, the institution may release the restriction, but only if the attorney general has received notice of the release and has not objected to such release within 90 days of receiving such notice. The Guidance details the documentation the institution must submit to the attorney general in connection with such notice. The Guidance also expresses the opinion that the exception in the Act that states that notice need not be given to donors of "small, old" funds if the gift instrument already limits the institution's ability to appropriate below original dollar value is the result of a drafting error, most likely intended to provide an exception for funds that were received as a result of an institutional solicitation. The Guidance therefore recommends that, absent clarification by the Legislature, notification of a release or modification of a restriction of a "small, old" fund be given to any donor that is available, including a donor that created the fund in response to an institutional solicitation.

Other Recommendations of the Charities Bureau
In response to the Act's requirement that institutions adopt a written investment policy, the Guidance suggests possible topics for inclusion, but emphasizes that the contents of the 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 the nature and scope of the institutions activities or programs. Suggested subjects include: 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.

The Act further provides that appropriation in a year of greater than seven 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. The Guidance provides that an endowment spending policy of seven percent or less per year in itself will not ensure that the presumption of imprudence will not be triggered. The seven percent standard is based on the fund's fair market value averaged over at least five years immediately preceding the year in which the appropriation for expenditure is made. If, for example, the spending policy is based on fair market value averaged over a shorter period, the spending policy may result in appropriations that are presumptively imprudent. The Guidance suggests that a separate calculation may be necessary to determine whether a proposed appropriation is presumptively imprudent.

Finally, the Guidance interprets the Act's requirement that institutions which use an external advisor or manager for investment decisions assess that agent's independence. The Guidance provides that agents should be selected based on the agent's competence, experience, past performance, and proposed compensation, and not on business or personal relationships between the agent and board members or other insiders. 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. Although not required by the Act, it is the attorney general's view that institutions should adopt policies that require full disclosure of relationships with outside agents and implement practices that ensure objective oversight by the board. At a minimum, institutions should have conflicts of interest policies which would include procedures for determining whether any of the institutions officers or directors have a financial interest in the agent or have any other material business or personal relationship with the agent, and if so, the policy should provide for reporting and should address abstention or recusal.

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