

# NYPMIFA Guide for New York Not-For-Profit Corporations

March 17, 2011

These materials are intended as a guide for New York not-for-profit corporations in light of the recent adoption of the state's version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), known as the New York Prudent Management of Institutional Funds Act or "NYPMIFA." They reflect the guidance from the Office of the Attorney General's Charities Bureau released March 17, 2011, and replace our prior materials on the subject.



The best publicized aspect of the statute, adopted as Article 5-A of the Not-for-Profit Corporation Law ("N-PCL"), is the liberalization of the ability of an institution to apply its total return spending formula to newer endowment funds which have not yet experienced positive investment returns. The full impact of the statute, however, affects many different parts of the institution, and so should be considered at many levels — including the development office, finance committee, investment committee or function, and even the governing Board — to be sure that the impact is optimal for the institution. Moreover, the effective date of the statute was its date of adoption on September 17, 2010, so entities need to be in compliance presently.

This Guide is broken into different sections, based not so much on the statute itself as on the affected functions within the institution. You will want to review: solicitation and restriction (impacting the gift acceptance policy and standard gift acceptance form); investment and delegation of investment management (impacting the investment policy and investment manager agreements, as well as investment committee minutes); restricted fund reporting and expenditure (impacting internal accounting systems, establishment of spending rates, and Board/committee reporting); and donor relations (including the required notice to existing, available endowment donors).

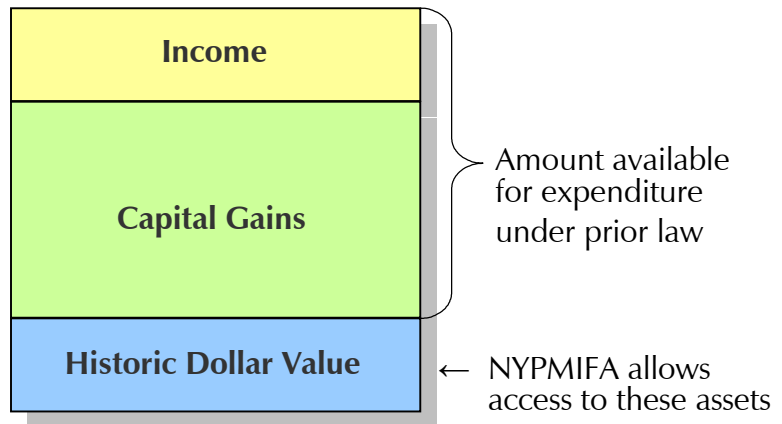
Our hope is that this Guide, along with the guidance from the Charities Bureau and other resources, provides part of the basis for governing Board, investment committee, and staff communication on the subject of managing institutional funds. We recognize that many institutions see little benefit in being an early adopter in areas as complex and delicate as modern investment management or donor relations, especially in what has continued to be in many ways a challenging financial environment. With proper guidance, however, institutions should be able to distinguish themselves by their familiarity with the new rules, and gain even greater donor credibility.

We note that NYPMIFA also can affect an institution's accounting presentation and so potentially its compliance with financial ratios and bond or debt covenants. This impact, while very real, is an outcome of accounting rules, not legal ones. So there may seem to be disagreement with respect to NYPMIFA when viewed from each of these disciplines. They each have their own lens, however, and so the organization must understand and bear the effects of each.

# Dipping into Underwater Endowments

Some history provides the context. Prior to the enactment of the Uniform Management of Institutional Funds Act (“UMIFA”) in New York in the 1970’s, institutions had an incentive to invest endowment for current return in order to meet the spending needs of the institution, as well as to preserve capital so as to honor the endowment restriction imposed by donors. This resulted in a heavy concentration in investments with fixed returns such as bonds, and compromised the ability of the institution and endowment fund to invest in equity and other investments which over time provided a higher total return of both current income and appreciation.

The adoption of UMIFA allowed charitable institutions to recharacterize certain gains as income currently available for expenditure. This appropriation for expenditure was accomplished by the governing Board (or a committee delegated the function) usually at a stated percentage of the total value of the fund on a given date, then averaged over the



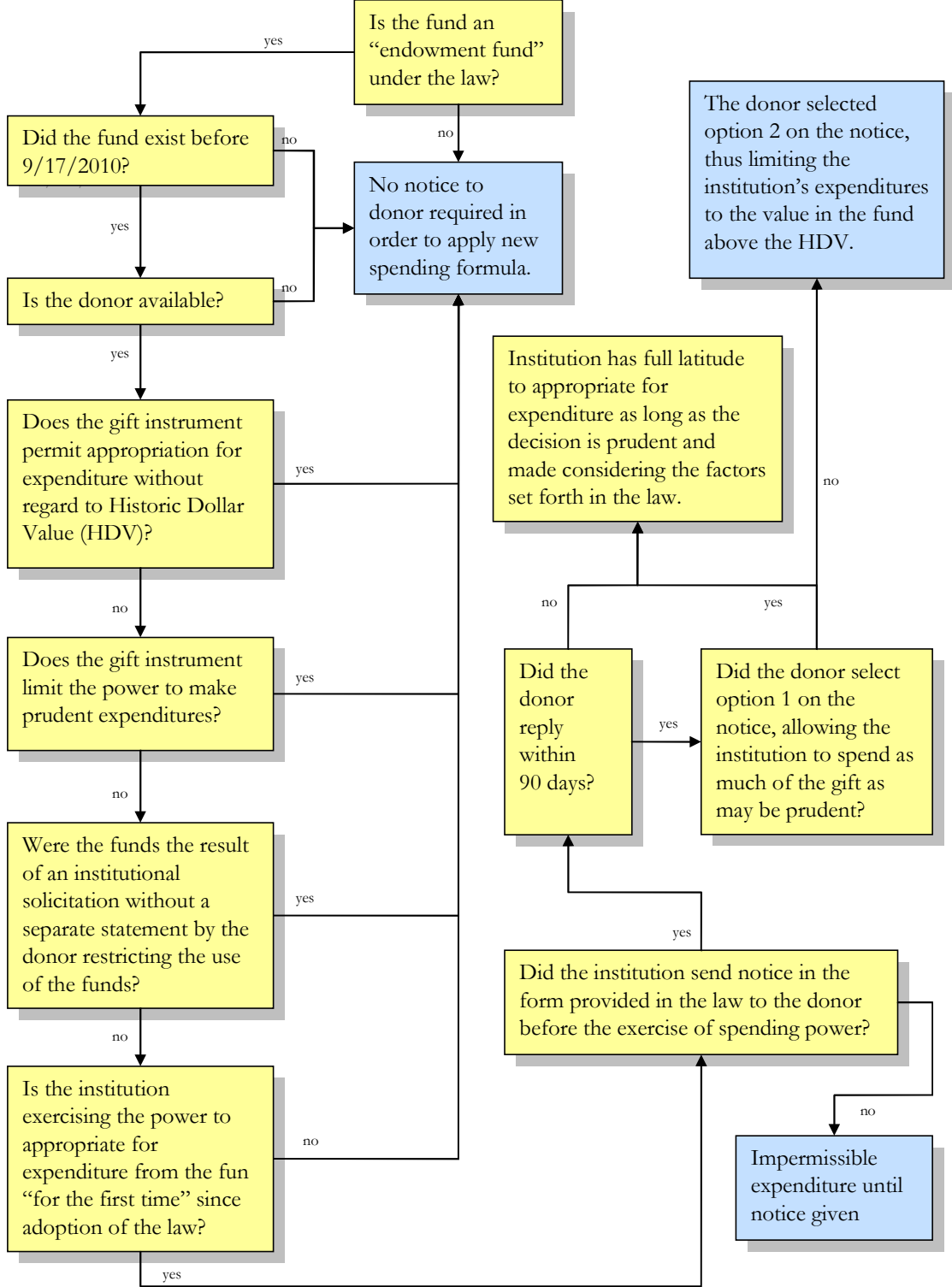
most recent 12 or 20 quarters to smooth the impact of market changes. There then developed a number of variations on this theme of total return spending and investment, which had the effect of driving higher investment returns, diversifying the portfolio, and making returns more predictable and thus more manageable.

An endowment fund could be thought of in a number of layers, where the historic dollar value (“HDV”) — that amount originally gifted as endowment by the donor—was held inviolate under the law. Newer endowment funds, which have not had an opportunity to enjoy capital growth given the recent market drop, have been allocated only limited amounts of expendable income (e.g., interests, dividends and so on) with no recharacterized capital gains to support their charitable goals. Institutions were free to contact available donors and ask for relief from this restriction, as well as to seek court relief in appropriate cases.

With the adoption of NYPMIFA, the governing Board is subject to a general standard of prudence in applying a total return spending policy to the entire endowment fund, subject to the specific standards set forth in the statute, allowing invasion of the historic dollar value. N-PCL Section 553(A).

While many charities will welcome this flexibility, governing Boards are still required to balance historic market performance and the need for current income against inflation, preservation of capital, and a number of other factors. Organizations may elect not to exercise this new ability to invade endowment corpus, or they may still decide to preserve some amount of HDV on a fund-by-fund basis, regardless of what the spending formula may otherwise allow. Donors, too, will want to consider whether they wish to restrict their endowed or other use-restricted gifts through explicit language in the gift agreement, a practice specifically contemplated by NYPMIFA. The new statute thus does not so much do away with HDV (despite the deletion of the definition from the law) as it changes the impact of that value as fiduciaries exercise their new powers.

# Decision tree for donor notice on existing endowments



*–Applying a total return spending policy—the impact of a donor notice requirement*

Other jurisdictions enacting UPMIFA did not see the need to provide special notice to prior endowment donors about the change in the law concerning access to historic dollar value. As under the predecessor UMIFA statute, the statute simply applies retroactively to existing donor funds, thus avoiding the need for institutions to account separately for assets received before a certain date, and manage them accordingly.

New York has an additional requirement, however, intended to provide donors of endowment funds existing on September 17, 2010, with the ability to prevent the application of the prudent spending power otherwise allowed under the statute to the historic dollar value of the endowment. So New York institutions are faced with the prospect of having some of their existing endowment funds subject to the full total return spending formula, while other funds still must be managed subject to the prohibition against access to HDV. In every case, the internal accounting systems of the organizations will still need to reflect HDV.

The notice requirement in the statute, N-PCL Section 553(E)(1), is unequivocal in its application, a point emphasized by the Charities Bureau. Based on this, the first time an institution is going to appropriate for expenditure from an endowment fund using a total return formula under N-PCL Section 553(A), it must give the donor to the fund, if available, notice of the opt out provision.

This aspect of NYPMIFA is perhaps much broader than the drafters of the statute realized. The notice requirement in the statute does not distinguish funds that are “underwater”—currently below historic dollar value - from other “old and cold” funds with sufficient appreciation to otherwise allow the application of total return. The power to appropriate for expenditure under the old statute has been repealed by the new law. And it was less than clear whether the “first time” requirement pertains to the prudent establishment of the spending rate by the Board (or investment committee) post-enactment or the actual spending from endowment funds, which may occur throughout the year. The guidance from the Charities Bureau clarifies that it is the fiduciary action to appropriate which requires notices to be sent, but does not require responses necessarily to be received. After all, the effect of the response at most would be to maintain the former law’s strict maintenance of HDV in a particular fund, not impose new restrictions.

Accordingly, the first time after September 17, 2010, that an institution’s Board acts to establish a spending formula for its endowment funds—appropriating funds for expenditure—it needs to be sure that the statutory notice of N-PCL Section 553(E)(1) has been provided to available donors.

**Donor notice language in NYPMIFA:**

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.

The organization's auditors may inquire on this point, along with others occasioned by the changes in their accounting standards.

The statute does not specifically address the fate of multiple donor endowments, such as class funds, memorial funds, and the like. The Charities Bureau guidance expresses the 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." The statutory notice requirement and the guidance thus require the institution to look closely at the circumstances of each multiple donor endowment, and establish whether indeed notice is required to each contributor. For example, both the availability of the donor and the institutional endowment solicitation exception should be closely considered.

The notice requirement in the statute is very specific, with language that must be in "substantially" the form set forth in N-PCL Section 553(E)(1). That language is confusing and perhaps even misleading to the vast majority of endowment donors, who no doubt are unfamiliar with the arcane *patois* of endowment spending. Thus, the development office, working together with the finance function and legal counsel, will need to settle on a notice that is sufficient under the law. Donor responses—especially those precluding the full use of the appropriation power—will need to be recorded in writing and incorporated into the institution's fund management.

The Charities Bureau in its guidance has spoken to the steps to be taken to determine whether a donor is "available." In particular, where the donor's current address is unknown, the institution's reasonable efforts to contact should include Internet searches and contacting known associates of the donor, such as an attorney who represented the donor when the gift was made. Further, the Charities Bureau emphasizes that an institution should maintain records of the notice, even if those efforts ultimately did not succeed in making contact.

## Development Office

NYPMIFA is not generally perceived as a statute affecting the fundraising function, but the special notice requirement for available donors to existing endowment funds is obviously one of these. There are several other provisions in the law which demand immediate attention from institutional advancement to assure that the organization is protecting itself properly.

### *- Proper classification of gift restrictions*

A necessary starting point for any analysis of donor restricted funds is a proper legal classification of these assets as they are accepted by the institution. For example, to constitute a true endowment under New York, the restriction must arise from a clearly expressed donor limitation. "Board-restricted endowment" or "quasi-endowment" is not really legally restricted at all. And New York law is clear that, whether under N-PCL Section 513(b), Estates, Powers, and Trusts Law Section 8-1.1, or New York's judge-made common law, any gift received with donor restrictions must be applied in accordance with those restrictions. To do otherwise is a breach of fiduciary duty of the institution's governing Board.

Importantly, N-PCL Section 513(b) requires that the governing Board cause accurate accounts to be kept of donor restricted assets separate and apart from the accounts of other assets of the institution. Unless the terms of the particular gift instrument provide otherwise, the treasurer must make an annual report to the members (if there are members) or else to the governing Board

concerning the assets held and the use made of them and their income. This is not a change from prior law, but recognizes the need for accurate accounting and reporting so that the Board can meet its obligations to donors.

- *Defining the “donor”*

More so perhaps than in any other jurisdiction adopting the uniform act, NYPMIFA provides the greatest degree of donor involvement and oversight. Institutions have obligations under the statute to identify and track restricted-fund donors, so the identification of this special class is very important.

The term “donor” under the statute includes not only the person (such as an individual, a corporation or a foundation) who makes a gift, but also any person designated in a gift instrument to act in the place of the donor. N-PCL Section 551(A-1). The donor’s executors, heirs, successors, assigns, transferees, or distributees are not considered the “donor” for the purposes of the statute, unless they are so designated by the donor.

This means that the development office needs to be aware of any gift agreement which provides the donor with the ability to designate, whether in the agreement itself or afterward, someone else to act as donor’s representative under the statute.

To be effective under NYPMIFA, notice must be provided personally or in writing to the recipient’s last known address on record with the institution. If the organization has no address on record with the institution, then it is obligated to make “reasonable efforts” to attempt to find and notify the recipient. N-PCL Section 551(F).

Interesting, the definition of “donor” under the statute is limited to those circumstances in which the gift is made “pursuant to a gift instrument.” The law therefore puts a heavy emphasis on the existence of a “gift instrument,” N-PCL Section 551(C), which can also include an institutional solicitation. Absent some form of writing or other record by which the gift is made, there appears to be no “gift instrument” and so no “donor” under NYPMIFA.

- *Other issues of donor standing and notice*

In order to bring a valid legal challenge with respect to the use of non-profit assets, a party must have legal “standing.” The general rule in New York State to this point in time is that donors, absent a specific agreement to the contrary or special circumstances, do not have legal standing to bring a lawsuit against a charity. Compare *Smithers v. St. Luke’s Roosevelt Hosp. Ctr.*, 281 A.D.2d 127 (1st Dep’t 2001) (where a New York court granted standing to a spouse, who had been named the special administratrix of her husband’s estate, to enforce the intent of her husband’s donation to a hospital) with *Rettek v. Ellis Hospital*, 2010 U.S. App. LEXIS 1863 (2d Cir. 2010) (denying standing).

**Required notice to donors under NYPMIFA:**

- On application of total return to existing endowment funds
- On court-ordered modification of restriction on the management or investment of a fund
- On court-ordered modification of use restriction
- On relief for small, “old-and-cold” funds
- For consent to release or modification, in whole or in part, a restriction contained in a gift instrument

There are several circumstances under NYPMIFA, however, where donor notice is required. And although the statute does not explicitly provide for donor standing in such cases, it is clear that the consent of the donor will be an important element in securing the relief the organization seeks.

The notice requirements of the statute establish a clear need to maintain accurate and accessible information on gift instruments, including an institutional solicitation, under which gifts are made via an institutional fund. The precise nature of those gift records is a matter to be decided in light of the requirements of the law and the facilities of the institution, but would appear to require at a minimum information about the identity and address of the donor, the gift amount, and any specific restrictions on the use of the funds. HDV is still a relevant consideration in endowment spending, and so should be recorded and taken into account.

#### - *Gift acceptance policy*

A comprehensive gift acceptance policy is an essential tool for the development office, helping to shape the conversation on complex gifts so that the institution and the donor are satisfied with respect to their impact on the institution for years to come. Charities are well-counseled to review and update their gift acceptance policy regularly.

NYPMIFA requires that the institution, “[w]ithin a reasonable time after receiving property,” decide whether to retain gifted property or liquidate it. N-PCL Section 552(E)(5). The statute provides a greater amount of flexibility in retaining gifted assets than perhaps in the past. See, e.g., N-PCL Section 552(E)(1)(h) on an asset’s “special relationship” or “special value” to the purposes of the institution. The common provision in a gift acceptance policy requiring liquidation of gifts “as soon as practicable” now has a statutory basis, and should reflect institutional practices on gift liquidation.

#### **Elements of a comprehensive gift acceptance policy**

A gift acceptance policy sets forth not only the types of gifts the institution is willing and able to accept, but it also addresses issues such as donor recognition and receipting, gift substantiation, naming opportunities, and donor reporting. Charities need to consider the extent to which their gift acceptance policies are incorporated by reference into their gift agreements with donors, providing a consistent and achievable structure for donor relations with respect to the gift into the future.

#### - *Endowment gift solicitation*

New York’s Executive Law Article 7-A deals generally with charitable solicitations in the state. It has a registration and annual reporting regime, as well as mandates on charitable solicitations so that the programs and activities supported are clearly described. Religious institutions are exempt from its coverage generally and educational institutions are also excepted from certain registration requirements. Executive Law Sections 172-a(1) and 172-a(2)(g).

The statute has been amended at Section 174-b(2) to require that any endowment solicitation by an institution subject to NYPMIFA include a statement making prospective donors aware that, unless otherwise restricted, the organization may expend so much of an endowment fund as it deems prudent, consistent with the requirements of NYPMIFA. The language of the required disclosure is somewhat tortured, and has a high probability for confusion within the donor community, so the development office will need to review with counsel how best to make the required disclosure.

#### - *Gift agreements*

NYPMIFA recognizes that donors can modify the application of the statute in the structuring of their particular gifts. Such special provisions can ease or complicate the administration of donor

restricted funds, and should be thoroughly discussed both internally and with the donor to assure that the institution can meet its obligations. The use of standard form gift agreements, acceptable within the institution and approved ahead of time by legal counsel, is an essential element to assuring success across a broad range of donors.

There are a host of donor reporting and naming opportunity provisions that should ideally be standardized for institutional use. Even a governing law clause of a gift agreement can have an important impact. Some organizations reserve in their standard form agreements the ability of a majority of the governing Board to vary the use or management of a restricted fund on certain conditions, without the involvement of, or notice to, the donor, a court, or the Attorney General. NYPMIFA permits as much. Organizations with single page fund agreements may quickly find themselves out of step with their peer institutions in the prudent practice of establishing fundamental gift parameters at the time a fund is created.

## Finance Office

### *- Allocable costs*

The costs allocable to the management and investment of institutional funds is an issue which deserves attention in both the gift acceptance policy and the investment policy. Donors may want to know what costs are charged against a fund, and those costs might be reflected in any voluntary report to the donor.

The new statute clarifies that the institution may only incur those costs that are “appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution.” N-PCL Section 552(C)(1). There is no explicit language in the statute about the ability to clarify or amplify such charges, although the responsibilities of the institution are generally subject to the intent of a donor expressed in a gift instrument. N-PCL Section 552(A). Accordingly, the institution needs to decide which costs are properly allocable to restricted funds, likely including that portion of management and custodial fees and perhaps taxes related to a particular fund.

### *- Annual reporting*

Remember that in addition to the reporting on restricted funds which accompanies the new Form 990, N-PCL Section 513(b) requires that governing Boards cause accurate accounts to be kept of donor restricted assets separate and apart from the accounts of other assets of the institution. Unless the terms of the particular gift instrument provide otherwise, the treasurer must make an annual report to the members (if there are members) or else to the governing Board concerning the assets held and the use made of them and their income.

### *- Modifying existing funds*

NYPMIFA changes the statutory regime for the modification of donor restricted funds expanding the process and making the options and steps clearer. Of particular interest is the power at N-PCL Section 555(D) for smaller funds—those below \$100,000 in value that are over twenty years old—which now require notice to the Attorney General and any available donor. No court approval is required in such cases.

Institutions are well-advised to review their existing funds to determine which, if any, are candidates for modification generally. The new law also liberalizes compared to the former law the ability to seek modification of existing endowment funds. The courts, Attorney General, and donors might be more familiar and thus receptive to requests for such changes immediately after adoption of NYPMIFA. Guidance from the Charities Bureau indicates a best practice of soliciting donor consent (if the donor is available) prior to submission of a request for a release from a gift restriction from the court or the Attorney General.

## Investment Function

### - *Written investment policy*

New York law now requires that an institution have a written investment policy which must be consistent with the provisions of NYPMIFA. N-PCL Section 552(F). Most organizations already have a policy for the management of their investment, versus operating, assets. NYPMIFA's adoption offers two questions: to what extent must our current policy incorporate or reference the statute; what other changes to the policy may be required or appropriate to comport with the statute?

As to the first inquiry, mere reference to NYPMIFA or sections of it will hardly have the desired effect of directing fiduciaries and the institution on the proper use of assets. Some incorporation of NYPMIFA's terms will be necessary, and their consideration reflected in regular meeting minutes.

As to the second question above, the contents of the institutional investment policy goes far beyond the legal requirements of NYPMIFA. This policy provides the basis for making investment decisions and communicating institutional imperatives to investment advisors and managers. It offers institutional advancement a vehicle to educate fund donors on how their contributions will be invested. As a result, the institutional investment policy will be in many ways unique to the institution and so should be modified with the assistance of legal counsel, based on institutional practices and resources.

### - *Internal and external delegation*

NYPMIFA preserves the ability of a governing Board to delegate responsibility for investment matters to a Board committee or other officers or persons within the organization. N-PCL Section 554 governs external delegation to an independent investment advisor, investment counsel or manager, bank, or trust company. N-PCL Section 551(K). The emphasis here is on independent external advisors; N-PCL Section 554(A)(1) requires that in selecting, continuing or terminating an agent, the institution must assess the agent's independence, including any conflicts of interest.

Consider, for example, an investment management consultant's role is as a non-discretionary advisor to the investment committee. Investment advice

### **Beyond the contract with the advisor**

N-PCL Section 554(B) requires that an external agent performing a delegated function owes a duty to the institution to exercise reasonable care, skill and caution to comply with the scope and terms of the delegation. This is a statutory duty independent of any provisions in the contract with the agent, and has important implications for the incorporation by reference of the institutional investment policy into the adviser agreement. Further, N-PCL Section 554(D) provides that, by accepting the delegation, the external agent submits to the jurisdiction of New York courts in all proceedings arising out of delegation or its performance.

concerning the management of the investment assets is offered consistent with the investment objectives, policies, guidelines and constraints as established in the investment policy. That reliance on the investment management consultant is a delegation best covered by NYPMIFA, and to take full benefit of the reliance on that expertise the contractual and other requirements of the statute would need to be met. The same would apply to each investment manager having full discretion to make investment decisions for the assets placed under its jurisdiction, all within the investment policy. The failure to make a proper delegation means that the governing Board still retains full fiduciary responsibility for these assets.

Such a delegation should be explicit, concise, and in writing. It is vitally important to do so, because a proper delegation means the institution (and its Board) are not liable for the decisions or actions of an agent to which the function was delegated. N-PCL Section 554(C). New York law still requires that each contract pursuant to which authority is so delegated provide that it may be terminated by the institution at any time, without penalty, upon not more than sixty days' notice. N-PCL Section 554(E). Oddly, this requirement still pertains to delegations internally under N-PCL Section 514(a), though it is unlikely that there will be any "contract" in such situations.

In making or continuing the delegation to each agent, the institution must act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. N-PCL Section 554(A). The absence of conflicts should be noted in the minutes. The institution will establish or reaffirm the scope and terms of the delegation, including the payment of compensation, consistent with the purposes of the institution and the institutional fund. N-PCL Section 554(A)(2). The institution must monitor the agent's performance and compliance with the scope and terms of the delegation.

- *Prudent investor standard*

The new law brings New York into the new millennium with a prudent investor standard requiring the institution to manage and invest its funds in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. N-PCL Sections 552(B), 553(A), and 554(A). In a long-awaited move to gender equality, N-PCL Section 717(a) has been amended to replace the prudent "man" standard with that of a prudent "person."

A person with special skills or expertise, whether inside or outside the institution, is required by law to use them, thus creating a different standard of care for these individuals or firms. N-PCL 552(E)(6). This standard should be made clear to both internal and external delegates.

- *General investment considerations*

N-PCL Sections 552(A) and 552(E)(1)(a-h) require that the investment function within the institution consider the following factors, if relevant, in managing and investing each institutional fund, except as otherwise provided by a gift instrument:

- The purposes of the institution;
- The purposes of the institutional fund;
- General economic conditions;
- The possible effect of inflation or deflation;
- The expected tax consequences, if any, of investment decisions or strategies;

- The role that each investment or course of action plays within the overall investment portfolio of the fund;
- The expected total return from income and the appreciation of investments;
- Other resources of the institution;
- The needs of the institution and the fund to make distributions and to preserve capital; and
- An asset's special relationship or special value, if any, to the purposes of the institution.

These elements should be set forth explicitly in the minutes of any meeting at which they are considered, as this is the best way to demonstrate their proper review. Guidance from the Charities Bureau comports with the current common practice to group similarly-situated endowment or other funds for investment and spending purposes.

*- Investment performance reporting*

The new law has a specific provision requiring the institution to make a reasonable effort to verify facts relevant to the management and investment of each fund. N-PCL Section 552(C)(2). The focus is clearly on the losses arising out of the Madoff and similar scandals, and the lack of verifiable information available to fiduciaries.

*- Diversification*

N-PCL Section 552(E)(4) requires that the institution diversify the investments of each fund. It is possible for the institution to determine—prudently—that because of special circumstances the purposes of the fund are better served without diversification. Such a finding should be explicitly set forth in the accompanying minutes, and must be reviewed as frequently as circumstances require, but at least annually. The diversification consideration should be an issue imbedded in the standard form of the meeting minutes of the investment committee, along with the review of investment performance, review of investment guidelines and appropriation of endowment for expenditure.

*- Setting the endowment fund spending policy*

N-PCL Section 553(A) contains a specific requirement that the institution keep a contemporaneous record describing its decision-making on establishing its total return spending formula. It only makes sense, therefore, for any minutes of a meeting of the investment committee dealing with the issue to make a number of findings:

- The institution has identified those endowment funds which are not subject to explicit donor intent, expressed in the gift instrument, limiting the ability of the institution to apply its total return spending formula.
- The institution has identified those endowment funds which, as a result of a response to a specific notice provided to the donor, are subject to a limitation on the ability to apply its total return spending formula to the historic dollar value of the fund.
- The institution, in accord with written procedures it has developed, identifies similarly situated endowment funds to allow for a single decision to appropriate from multiple endowment funds.
- In establishing the total return formula, the institution has acted in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and has considered, to the extent 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.

The seventh item in the list above is particular to New York and turns the common exercise of the appropriation approval on its head. NYPMIFA now requires that fiduciaries consider alternatives to expenditure of the endowment fund before imposing the spending formula. This would seem to be contrary to donor intent in establishing the fund—where the primary expectation is that the assets will be expended to further the purposes of the institution, and only accumulated to achieve that goal into the future.

Formerly, New York law also distinguished between readily marketable assets and those which were not with respect to application of the total return spending formula. That distinction is not explicitly present in NYPMIFA, but may still affect investment decisions as a function of liquidity.

Guidance from the Charities Bureau emphasizes this particular requirement, and indicates that, where the investment function is separated by the investment committee from the finance committee, it would be the latter body — with its broader command of institutional resources and needs — which would be responsible for establishing the endowment spending rate. Without an understanding of the demands of the annual budget and alternative resources, one would be hard-pressed adequately to consider alternatives to expenditures from an endowment fund. This responsibility needs to be set forth in the investment policy and adequate consideration given as evidenced by statutorily-required minutes.

- *The “Massachusetts Rule”*

The Commonwealth of Massachusetts, in adopting its version of UPMIFA in July of 2009, dropped what had become known as the “Massachusetts Rule.” New York, however, saw fit to include the rule for the first time in its law. N-PCL Section 553(d).

Absent donor direction to the contrary, a rebuttable presumption of imprudence applies to gift instruments executed upon or after September 17, 2010, for the appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund. That ceiling, however, is 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 in which the appropriation for expenditure is made. For an endowment fund in existence for fewer than five years, the fair market value of the endowment fund must be calculated for the period the endowment fund has been in existence.

This five year look-back is a relatively long period of time and may not be supported by existing accounting systems within the institution. As the Massachusetts rule only applies to new endowment funds, institutions will strongly consider whether explicitly to except out its application in donor

agreements or choose to apply the law of another state which does not have the requirement. Either course should only be taken after consulting with legal counsel.

## In Conclusion

NYPMIFA is a long-awaited change in New York law, with far-ranging effects on not-for-profit corporations, especially charities. The operational and accounting changes that result are best considered with a full legal understanding of the statute and an appreciation of the resources and needs of the institution. To gain such an understanding, please feel free to call any of the contact numbers below or your regular Nixon Peabody LLP representative.

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