

LEGAL UPDATE

October 2010 By: Tracy Green Landauer

NEW RULES FOR INVESTMENTS: THE NEW YORK PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

New York's version of the Uniform Prudent Management of Institutional Funds Act, which became law on September 17, 2010, significantly impacts non-profits incorporated in New York and certain wholly charitable trusts in several ways. Directors, financial officers and development officers are all likely to be involved in bringing their organizations into compliance with the new law's requirements as soon as possible.

OVERVIEW

Specifically, the new law:

- Allows spending from an "underwater" endowment whose value has dropped below the original gift amount, provided that this is deemed prudent under an organization's policies and is deemed permitted by the donor;
- Restricts expenditures of earnings on an endowment in excess of the organization's spending policy;
- Requires each non-profit to adopt written investment and spending policies, including a process for delegation of investment management functions (which must incorporate certain statutory standards)
- Presumes that annual spending in excess of 7% of an endowment's market value is imprudent (this presumption can be rebutted)
- Requires written notice to all existing endowment donors to determine whether those donors will allow spending below the original gift amount (which was not permitted under prior law).

STANDARD OF CONDUCT IN MANAGING AND INVESTING FUNDS

The responsible officers and directors must act with prudence (as under prior law) after considering the following required factors:

- General economic conditions;
- The possible effect of inflation or deflation;
- The expected tax consequences, if any, of investment decisions or strategies (such as "unrelated business" taxable income);
- 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 appreciation of investments;
- The other resources of the organization;
- The needs of the organization to make distributions and preserve capital; and
- Any special relationship or value of an asset to the charitable purposes of the organization.

The organization must also diversify the investments of a fund unless donor restrictions or special circumstances (after prudent consideration) dictate that the fund is better served without diversification. Any decision not to diversify must be revisited at least annually.

The written investment policy must reflect these factors.

EXPENDITURE OR ACCUMULATION OF ENDOWMENT FUNDS

Subject to any donor restrictions, spending from an “underwater” endowment whose value has dropped below the original gift amount is permitted, provided that this is deemed prudent after consideration of:

- The duration and preservation of the endowment fund;
- The purposes of the organization and the fund;
- General economic conditions;
- The possible effect of inflation and deflation;
- The expected total return from income and appreciation of investments;
- The other resources of the organization;
- Any alternatives to expenditure of the fund and the effect of the alternatives on the organization; and
- The organization’s investment policy.

The organization must keep a contemporaneous record of its consideration of each factor (with the minutes of the meeting would be appropriate), and bear in mind that for new endowments, annual spending in excess of 7% of an endowment’s market value is presumed to be imprudent though this presumption can be rebutted by the organization.

HOW DOES THIS AFFECT EXISTING ENDOWMENT FUNDS?

The new law provides an interesting opportunity for discussion with an organization’s endowment donors. For an endowment fund that was in existence on the effective date of the new law, no appropriation of the endowment fund can be made unless 90 days advance notice has been given to available donors and permission is received as outlined below.

Written notice is required to be sent in the form of boxes that a donor can check to indicate that either:

- The organization can spend as much of the endowment as is prudent, or

- The organization may not spend below the original dollar value of the gift (as under prior law).

Notice is not required where clear permissions or restrictions are already in place, but must otherwise be sent to all endowment donors who are living (or in existence and operating in the case of an entity) and can be located with reasonable efforts. If the donor responds, the organization must of course follow the donor’s directions. If the donor fails to respond, the organization will not be subject to the original dollar limitation on that donor’s endowment fund.

In the case of endowments that have become impractical or wasteful to administer, court modification may be available, even without donor consent, provided the donor receives notice of the proceeding and an opportunity to be heard. For funds that are valued at less than \$100,000 and more than 20 years old, an organization may release restrictions in certain circumstances after providing 90 days advance notice (including details and documentation of the manner in which the organization meets that statutory requirements for such release) to the Attorney General and the donor, if available

IMPORTANT ACTION ITEMS

Since the law became effective immediately, non-profits should attend to the following items as soon as possible:

1. **Financial officers** must reclassify unspent earnings from each unrestricted endowment as “temporarily restricted” in accordance with the new law and FASB Staff Position 117-1. This may, of course, have an impact on financial statements.
2. The **Board of Directors** must adopt written policies for investment, the delegation of investment management functions, and spending, as described above
3. **Development officers** must contact the available donors of existing endowment funds to determine whether they wish to allow spending where an endowment is below the initial gift value. Notice requirements are described above.

4. **Development officers** should revise gift acceptance policies and donor agreements to reflect the new rules.
5. Investment advisor agreements should reflect the new duties on advisors required by law.

We recommend that directors, financial officers and development officers work quickly to determine the effect of the new law on their organization, so they may bring their policies and procedures into compliance with the new law's requirements as soon as possible.

The foregoing is merely a discussion of the New York Prudent Management of Institutional Funds Act. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Tracy Green Landauer at 212-326-0253 or tlandauer@pryorcashman.com.

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ABOUT THE AUTHOR



TRACY GREEN LANDAUER

Partner

Direct Tel: 212-326-0253

Direct Fax: 212-515-6955

tlandauer@pryorcashman.com

Tracy Green Landauer organizes and provides ongoing and special issue representation to tax-exempt organizations including arts, community, research, charitable, literary and trade organizations. She advises clients on issues of governance, unrelated business income, self-dealing, private inurement, excess benefits, foreign and domestic grant-making, complex structures, fundraising and lobbying. Tracy also provides personal estate, tax, charitable gift and retirement planning to a broad range of individuals, tailoring plans to the needs and goals of each client.

The services Tracy provides to her tax-exempt clients include:

- Counseling both new and established tax-exempt entities (including various national humanitarian research, arts and literary organizations) on issues of formation, exemption, board governance and policies, choice of entity and complex structures
- Counseling charitable organizations on:
 - Compensation planning and IRS compensation audits
 - IRS and state reporting requirements
 - Compliance issues in domestic and international grant-making
 - Unrelated business income, prohibited transactions, private inurement and operational issues
- Helping publicly supported organizations comply with state fundraising/solicitation requirements for traditional and electronic media

Tracy's services to individuals include:

- Developing comprehensive estate plans for a broad range of business owners, professionals and entrepreneurs
- Gift, estate and generation-skipping transfer tax planning
- Succession planning for business owners
- Charitable gift and income tax planning
- Developing multi-generational wealth preservation plans
- Administering decedents' estates and trusts