

EVOLUTION, NOT REVOLUTION: A LEGISLATIVE HISTORY OF THE NEW YORK PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

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INTRODUCTION	379
I. HISTORY OF LAW ON INVESTMENT MANAGEMENT	382
II. OVERVIEW OF UPMIFA AND NYPMIFA	390
A. UPMIFA	391
B. NYPMIFA	393
III. ANALYSIS OF NYPMIFA	394
A. Scope of NYPMIFA	394
1. Applicability to “Institutions”	395
a. Legislative History	397

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2.	Institutional Funds	398
a.	Evolving Definition	398
b.	Legislative History	401
B.	The Governing Board	401
1.	Evolving Use	401
2.	Legislative History	402
C.	Standard of Conduct in Managing and Investing an Institutional Fund	402
1.	Prudence Standard	402
a.	UMIFA Approach	402
b.	N-PCL Approach	404
c.	UPIA Approach	405
d.	UPMIFA Approach	406
e.	NYPMIFA Approach	408
f.	Legislative History	409
2.	Diversification	409
a.	UMIFA and N-PCL: No Duty to Diversify	409
b.	UPIA	409
c.	UPMIFA	411
d.	NYPMIFA	412
e.	Legislative History	412
3.	Special Skills or Expertise	413
a.	UMIFA and N-PCL	413
b.	UPIA	413
c.	UPMIFA	413
d.	NYPMIFA	414
4.	Investment Policy	414
D.	Appropriation for Expenditure or Accumulation of Endowment Fund	415
1.	Elimination of Historic Dollar Value	415
a.	UMIFA	415
b.	N-PCL	417
c.	UPMIFA	417
d.	NYPMIFA	419
e.	Legislative History	419
2.	Ability to Appropriate for Expenditure	421
a.	UMIFA	421
b.	N-PCL	423
c.	UPMIFA	423
d.	NYPMIFA	424
e.	Legislative History	424

f.	Retroactive Application of the Rule of Construction	425
3.	Rebuttable Presumption of Imprudence	426
a.	NYPMIFA	427
b.	Legislative History	428
4.	Notice	430
a.	Legislative History	431
E.	Delegation of Management and Investment Functions	432
1.	UMIFA	432
2.	N-PCL	433
3.	UPIA	433
4.	UPMIFA	434
5.	NYPMIFA	434
a.	Delegation to External Agents	434
b.	Internal Delegation	435
6.	Legislative History	436
F.	Release or Modification of Restrictions on Management, Investment, or Purpose	437
1.	UMIFA	438
2.	UPMIFA	439
3.	NYPMIFA	441
4.	Legislative History	442
IV.	NYPMIFA'S IMPACT ON OTHER NEW YORK LAWS	443
A.	Changes to Other Parts of the N-PCL	443
B.	Executive Law	445
C.	Education Law	445
D.	Religious Corporation Law	446
E.	Miscellaneous	446
V.	INTERNAL AFFAIRS DOCTRINE	446
VI.	UNIFORMITY OF INTERPRETATION	453
VII.	ACCOUNTING CHANGES DUE TO ENACTMENT OF UPMIFA—FASB 117-1	455
VIII.	CALL TO CLEAN UP PROBLEMS	457
A.	Technical Corrections	457
B.	Substantive Amendments	458
C.	Regulatory Advice	458
	CONCLUSION	460

INTRODUCTION

In 2007, New York University was forced to freeze salaries and cut costs to pay for financial aid that its endowments could no longer

support.¹ Hartwick College in Oneonta, New York, and Colgate University, in Hamilton, New York, also had to cut spending or ask donors for help in order to continue funding scholarships during the economic downturn of 2008–2009.² Long Island’s Vanderbilt Museum came close to shutting its doors, despite holding a multi-million dollar endowment, because the endowment stopped generating sufficient returns.³ Long Island University reduced the amount it gave in scholarship money by seventy-five percent in 2009.⁴ All of these institutions, and many others, had endowment funds with significant assets, yet due to laws prohibiting the spending of the “historic dollar value”⁵ of the funds, the institutions could not access these assets to support programs for their charitable beneficiaries during a time of heightened need.

On September 17, 2010, New York Governor David Patterson signed into law the New York Prudent Management of Institutional Funds Act (NYPMIFA or the Act),⁶ which changed this paradigm for New York not-for-profit corporations. NYPMIFA passed the New York State Assembly⁷ and the New York State Senate⁸ unanimously, and it largely (but not completely) follows the language of the Uni-

1. See Oliver Staley, *Endowments Trapped by Losses at NYU Expose Dated Laws*, SAN DIEGO SOURCE, Jul. 28, 2009, <http://www.sddt.com/News/article.cfm?SourceCode=20090728fy#U1AAifldVo0>.

2. See *id.*

3. See Jennifer Barrios, *Endowments Are Not So Giving*, NEWSDAY (Long Island), Sept. 3, 2009, at A24.

4. See *id.*; see also, e.g., L. Nicholas Deane, *Special Report: Underwater Endowment Funds*, NONPROFIT TIMES, Apr. 1, 2004, available at http://listserv.fundsvcs.org/cgi-bin/wa?A3=ind0508&L=FUNDVCS&E=base64&P=3067803&B=—%3D_C1E39A1B.54355395&T=application%2Fmsword;%20name=%22Underwater%20Endowments.doc%22&N=Underwater%20Endowments.doc&attachment=q (describing scholarship cutbacks and underwater endowments at other institutions); Martha Waggoner, *Some Nonprofits Can’t Touch Their Money*, U-T SAN DIEGO, Mar. 1, 2009, <http://www.utsandiego.com/news/2009/Mar/01/untouchable-endowments-030109/> (same).

5. For a discussion of the meaning of “historic dollar value,” see *infra* text accompanying notes 62–64.

6. N.Y. Prudent Management of Institutional Funds Act, ch. 490, § 1, 2010 N.Y. Laws 1334 (codified at N.Y. NOT-FOR-PROFIT CORP. LAW §§ 550–558 (McKinney Supp. 2014)) [hereinafter NYPMIFA].

7. The New York State Assembly approved the adoption of New York’s version of UPMIFA on June 29, 2010. *Bill No. A07907 Actions*, N.Y. ST. ASSEMBLY, <http://assembly.state.ny.us/leg/?default.fld=&bn=A07907&term=2009&summary=Y&Actions=Y> (last visited Mar. 17, 2014).

8. The New York State Senate approved the adoption of New York’s version of UPMIFA on June 30, 2010. *Id.*

form Prudent Management of Institutional Funds Act (UPMIFA)⁹ as promulgated by the Uniform Law Commission (ULC)¹⁰ in 2006. New York was the forty-seventh jurisdiction to adopt UPMIFA. The Act was effective immediately upon signing by the Governor.

Uniform laws have laid the groundwork for the regulation of charitable and not-for-profit assets in New York since 1978 when New York adopted the Uniform Management of Institutional Funds Act (UMIFA).¹¹ However, the New York State Legislature has always put its own unique stamp on these laws. In 2002, the ULC determined that the existing uniform law governing charitable assets, UMIFA, should be updated to reflect modern portfolio theory better.¹² This resulted in UPMIFA which, as discussed in detail below, sets forth a detailed prudence standard that institutions must follow in managing, investing, and appropriating funds, and eliminates the concept of an historic-dollar-value floor, replacing it with a procedure by which institutions may prudently appropriate from the historic dollar value of their endowment funds. Beginning in 2008, the Commission on Independent Colleges and Universities (cIcu),¹³ along with other not-for-profit corporations and individuals working in the not-for-profit field, began to push for adoption of the uniform law in New York.

9. UNIF. PRUDENT MGMT. OF INSTITUTIONAL FUNDS ACT (2006) [hereinafter UPMIFA], available at http://www.uniformlaws.org/shared/docs/prudent%20mgt%20of%20institutional%20funds/upmifa_final_06.pdf.

10. The Uniform Law Commission (ULC), formerly called the National Conference of Commissioners on Uniform State Laws (NCCUSL), is a non-profit unincorporated association with representatives from all fifty states, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands, with the objective of promoting uniformity among jurisdictions through model statutes. No uniform law is effective until a state legislature adopts it. See *About the ULC*, UNIFORM L. COMMISSION, <http://uniformlaws.org/Narrative.aspx?title=About%20the%20ULC> (last visited Feb. 28, 2014).

11. UNIF. MGMT. OF INSTITUTIONAL FUNDS ACT (1972) [hereinafter UMIFA], available at <http://www.uniformlaws.org/shared/docs/management%20of%20institutional%20funds/umifa1972%20complete.pdf>.

12. The drafting committee began its work in 2002. See Susan N. Gary, *Charities, Endowments, and Donor Intent: The Uniform Prudent Management of Institutional Funds Act*, 41 GA. L. REV. 1277, 1288 (2007) (setting forth the legislative history of UPMIFA by the UPMIFA Drafting Committee's reporter). For a discussion on modern portfolio theory, see JONATHAN R. MACEY, THE AM. COLL. OF TRUST AND ESTATE COUNSEL FOUND., AN INTRODUCTION TO MODERN FINANCIAL THEORY 20 (1991). A fairly complete selected bibliography of articles discussing UPMIFA and NYPMIFA is attached as Appendix A to this article.

13. The Commission on Independent Colleges and Universities represents the public policy interests of 113 independent colleges and universities in New York. See *About cIcu*, COMMISSION ON INDEPENDENT C. & U., <http://www.cicu.org/about/> (last visited Feb. 28, 2014).

The process leading up to the adoption of NYPMIFA was, however, both complex and occasionally contentious; it resulted in NYPMIFA differing from UPMIFA in important and sometimes confusing ways. This article will outline the most important provisions of the Act and set forth the Act's legislative history in order to further understanding of how and why certain provisions—especially those that are not uniform—came into being. Moreover, an analysis of the differences among prior law, UPMIFA, and the unique provisions of NYPMIFA will provide insight into the law governing funds held by not-for-profit corporations in New York and offer guidance to donors, institutions, and practitioners regarding how the Act should be interpreted and applied. Most importantly, this article will set forth the reasons why amendments must be made to the Act as soon as possible, focusing on the Act's burdensome obligations that do disservice to donors, institutions, and beneficiaries.

Part I of this article examines the history of the laws that have addressed investment management and appropriation of charitable and not-for-profit assets. Part II provides an overview of the current uniform law as well as the version enacted in New York. Part III reviews the Act in detail, examining what types of organizations and funds come within the Act's scope, assessing the evolution of the individual provisions, and, where relevant, discussing selected controversies and legislative drafting issues. Part IV reviews the Act's impact on other New York laws. Part V addresses the so-called internal affairs doctrine and related choice of law issues. Part VI examines the importance of uniformity of interpretation of law. Part VII considers selected financial accounting rules. Finally, Part VIII concludes the article with suggestions for further action—via technical corrections, substantive amendments, and regulatory guidance—that are recommended for clarification or correction of NYPMIFA's current provisions.

I.

HISTORY OF LAW ON INVESTMENT MANAGEMENT

The "prudent man rule," as it was called prior to the early 1990s, dates back to the 1830 decision of the Massachusetts Supreme Judicial Court in *Harvard College v. Amory*.¹⁴ John McLean had died in 1823 leaving what was then a substantial estate of about \$228,000.¹⁵

14. 26 Mass. (9 Pick.) 446, 447 (1830).

15. This figure is equivalent to almost \$5 million today, according to at least one Consumer Price Index conversion estimate. 3 HISTORICAL STATISTICS OF THE UNITED

Among his holdings were over \$100,000 of stock of manufacturing companies, \$48,000 of stock of insurance companies, and almost \$25,000 of stock of banking companies. He left \$50,000 in trust, the income of which was for his wife during her life, and the remainder of which (after her death) was to go equally to Harvard College and to the Massachusetts General Hospital. He named Jonathan and Francis Amory as his executors and as trustees of the trust, and in his Will directed them: “to loan the same upon ample and sufficient security, or to invest the same in safe and productive stock, either in the public funds, bank shares or other stock, according to their best judgment and discretion”¹⁶ The Amorys thus owed fiduciary duties both to John McLean’s wife, as income beneficiary, and to Harvard College and the Hospital, as remaindermen.

In early December of 1823, the executors wrote to the remaindermen suggesting that they choose a committee to consult with the executors on investments. The College and the Hospital rejected that proposal, suggesting instead that the entire \$50,000 be turned over to them, and that they would then pay the surviving spouse \$3,000 per year during her life (a fixed six percent return). On December 13, 1823, the executors wrote back, rejecting that proposal in turn, because (as they viewed it) John McLean had enjoined *them* to invest the trust assets. The executors proposed to invest in stocks according to the ratio of such holdings in the estate (they comprised about half of the estate’s assets), believing that to be what John McLean would have wished. In the alternative, the executors offered to transfer the trust property to the Hospital and the College if they would pay Mrs. McLean the sum of (1) six percent interest on \$25,000 (representing half of the trust assets), and (2) an amount equal to the dividends paid from time to time on \$25,000 of stock of two named manufacturing companies.¹⁷

On December 20, 1823, the remaindermen wrote back, rejecting this counter-proposal, and adding that they had confidence that the executors “will, in conformity to the testator’s injunction, keep the capital entire,” and—further—“that in their opinion, any investment

STATES: ECONOMIC STRUCTURE AND PERFORMANCE 3-158 tbl. Cc1-2 (Susan B. Carter et al. eds., 2006).

16. *Harvard College*, 26 Mass. (9 Pick.) at 447. The court later clarified the then meaning of “public funds,” when it referred to “stocks depending upon the promise of the government, or, as they are called, the public funds” *Id.* at 460. The Amorys were, respectively, the brother and the cousin of Mrs. McLean. *Id.* at 461.

17. *Id.* at 448–49.

of this capital in trade or manufactories cannot be considered by them as a safe and discreet investment.”¹⁸

The battle lines were drawn. The executors proceeded to invest the entire \$50,000 fund in common stock, of which one-sixth was bank stock, just under one-third was insurance company stock, and the remainder (just over one-half) was manufacturing company stock.¹⁹

The executors then filed their accounting, and cited the College and Hospital to object to it (as the law required). Although there is no evidence that Harvard College objected, the Massachusetts General Hospital *did*. On February 9, 1824, after hearing all objections, the probate court approved the executors' actions, and disallowed the Hospital's objections. No appeal was taken from this decree. The fund was turned over to the trustees (who were, of course, the same individuals as the executors).²⁰

Four years later, in October 1828, the surviving trustee, Francis Amory, presented his final account as trustee. By that time, the value of the stocks held by the trust had declined from \$50,000 to \$29,450 (although, in the interim, fairly substantial dividends—amounting to over \$20,000—had been paid by the corporations and turned over to Mrs. McLean). The College and the Hospital objected to the settlement of Amory's accounts on various grounds. The probate court nevertheless accepted it, on January 12, 1829, and Harvard College and the Hospital appealed.²¹

The opinion of the appellate court, per Putnam, J., is widely regarded as enlightened, flexible, and well reasoned. In response to the argument that “the manufacturing and insurance stocks are not safe, because the principal is at hazard,”²² the Court replied:

It will not do to reject those stocks as unsafe, which are in the management of directors, whose well or ill directed measures may involve a total loss. Do what you will, the capital is at hazard. If the public funds are resorted to, what becomes of the capital when the credit of the government shall be so much impaired as it was at the close of the last war?²³

A few paragraphs later, after discussing the risks inherent even in mortgages and real estate investments, the Court wrote these words,

18. *Id.* at 449.

19. *Id.* at 449.

20. *Id.* at 449–50.

21. *Id.* at 450–52.

22. *Id.* at 460.

23. *Id.* at 461.

which are quite famous, and are taken to be the genesis of what came to be called the “prudent man rule”:

All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.²⁴

Applying this standard, the Court held that the Amorys had the right to invest in the stocks they purchased, “and that they acted in the premises according to their best skill and discretion.”²⁵

Interestingly, the Court went on to discuss the earlier probate decree of February 9, 1824, approving the accounts of the executors, from which no appeal was ever taken. It held that the earlier decree was dispositive, and protected the trustees as successors to the executors.²⁶ Thus, the Court affirmed the decree of the probate judge. Given its reliance on the earlier (1824) probate decree, its justifiably famous discussion of the prudent man rule is at best an alternative holding and at worst mere dictum. Despite that, the standard articulated by Justice Putnam has been cited many hundreds of times and established the bedrock foundation of the growth of the law in this area.²⁷

Justice Putnam’s formulation of the prudent man rule involved no classification of stocks (or any other form of investment) as per se imprudent, adopting instead a flexible standard. Nevertheless, as the rule later developed and aged—in cases, through legislation, and in scholarly commentary—its arteries hardened. In 1869, for example, the New York Court of Appeals held that common stock investments were per se imprudent.²⁸ Further, “[b]y 1900 both the majority of states and the great majority of trust funds were subject to [‘legal list’] statutes.”²⁹ The first *Restatement of Trusts* (1935) and the first edition of *Scott on Trusts* (in 1939) rephrased and elaborated on the prudent

24. *Id.*

25. *Id.*

26. *Id.* at 463–65.

27. See, e.g., Ronald A. Brand, *Investment Duties of Trustees of Charitable Trusts and Directors of Nonprofit Corporations: Applying the Law to Investments that Acknowledge Social and Moral Concerns*, 1986 ARIZ. ST. L.J. 631, 633–43 (discussing application of the prudent man rule).

28. *King v. Talbot*, 40 N.Y. 76 (1869).

29. BEVIS LONGSTRETH, MODERN INVESTMENT MANAGEMENT AND THE PRUDENT MAN RULE 12 (1986). See also Robert J. Aalberts & Percy S. Poon, *The New Prudent Investor Rule and the Modern Portfolio Theory: A New Direction for Fiduciaries*, 34 AM. BUS. L.J. 39, 43 (1996).

man rule.³⁰ Because of the extraordinary influence of Professor Scott's scholarship—he was the Reporter for the *Restatement* as well as the author of the *Treatise*—his words and examples had a force that is difficult to exaggerate. These were carried forward without any significant change into the second *Restatement* in 1959,³¹ and through two subsequent editions of his treatise (the latter of which is dated 1967).³² Most current commentators agree that Scott's formulation was much less flexible than the original.³³

While the legal rules continued to become more constrained, significant new insights were beginning to emerge about how properly to analyze portfolio risk and maximize portfolio efficiency. In 1952, Harry Markowitz published a seminal paper on the theory of portfolio analysis.³⁴ Scholars in finance agree that it “is generally viewed as the

30. The American Law Institute's first *Restatement* explained that “[t]he trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property.” If the trustee's skills exceeded the theoretical prudent man, then he was obligated to use such skill. RESTATEMENT (FIRST) OF TRUSTS § 174 (1935). The comments on the *Restatement* explained that this was “the external standard” and that the trustee would be liable for losses resulting from failing to adhere to this rule. Even if a trustee did not possess greater-than-ordinary skills but had represented as much in order to procure his position, he would be liable for failing to perform to that level. *Id.* §174 cmt. a. Furthermore, the comments made clear that the prudent man analysis would be applied based on the trustee's knowledge and perspective at the time of his action, and not based on what he later came to know. *Id.* § 174 cmt. b. Ignorance of the terms of the trust was no defense to liability. *Id.* § 174 cmt. c. Trusts explicitly reserved the right to modify the *Restatement's* standards. *Id.* § 174 cmt. d. In his treatise, Austin Wakeman Scott laid out what he termed the “only general rule” for trust investing: “the trustee is under a duty to make such investments as a prudent man would make of his own property” if his goal was “preservation of the estate and regularity of income” to be received. 2 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 227 (1st ed. 1939). Scott explicitly rejected as “not sound” the standard of treating trust property as you would ordinarily your own and furthermore explained that the appropriate standard was an objective one. *Id.* Quoting from a Delaware case, Scott emphasized the “safety” of the trust property. *Id.* at 1198 (citing *In re Cook's Trust Estate*, 171 A. 730 (Del. Ch. 1934)). Interestingly, Scott recognized early on that advances in the “scientific” analysis of investments were slow to make an impact on court decisions, noting in particular the tendency of courts to consider investments piecemeal instead of in the context of the whole portfolio. *Id.*; see also discussion *infra* and text accompanying notes 34–43.

31. RESTATEMENT (SECOND) OF TRUSTS § 174 (1959).

32. 2 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 227 (2d ed. 1956); 2 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 227 (3d ed. 1967).

33. See, e.g., Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U. L. REV. 52 (1987).

34. Harry M. Markowitz, *Portfolio Selection*, 7 J. FIN. 77 (1952); see also HARRY M. MARKOWITZ, PORTFOLIO SELECTION: EFFICIENT DIVERSIFICATION OF INVESTMENTS (1959). Mr. Markowitz won the Nobel Prize in Economics in 1990 for his work in this area.

origin of the modern portfolio theory approach to investing.”³⁵ Among its most important insights was that the total risk in a portfolio is not the sum of or even the average of the risks of the individual securities held.³⁶ For example, if security A has a risk (or volatility) of 12.6 and security B has a risk (or volatility) of 15.7, the portfolio risk from holding both A and B is neither the sum (28.3) nor the average (14.15) of their separate risks.³⁷ Instead, the overall portfolio’s risk depends on whether A and B positively or negatively co-vary, and to what extent. If A and B co-vary negatively, the combined portfolio risk would be less than the risk of either security taken alone. It follows that, in such a situation, adding security B (a higher-risk security) to the portfolio will *reduce* overall portfolio risk.³⁸

From this insight, it becomes clear that one of the greatest constraining aspects (or, from the modern perspective, sins) of the prudent man rule, as it developed, was that it treated the prudence of any investment in isolation rather than as part of an overall portfolio. This fundamental misunderstanding operated to restrict severely the development of sophisticated, efficient, and prudent portfolio management.³⁹

It took decades for the legal rules to catch up with the teachings of modern portfolio theory. By 1969, seventeen years after the publication of Harry Markowitz’s paper, the enactment of section 4944 of the Internal Revenue Code—imposing an excise tax on private foundations that invest “in such a manner as to jeopardize the carrying out of any of its exempt purposes”⁴⁰—demonstrated a growing, albeit quite imperfect, awareness of proper portfolio management. Although the statute contained no definition of a “jeopardizing investment,” the regulations, adopted three years later, provided one. The good news is that U.S. Treasury regulations demonstrated at least some familiarity

35. WILLIAM F. SHARPE, GORDON J. ALEXANDER & JEFFREY V. BAILEY, *INVESTMENTS* 167 (5th ed. 1995); Stewart E. Sterk, *Rethinking Trust Law Reform: How Prudent Is Modern Prudent Investor Doctrine?*, 95 *CORNELL L. REV.* 851, 858 (2009).

36. Markowitz, *supra* note 34, at 82–90.

37. Risk, or volatility, is generally measured as the standard deviation of dispersion of returns around the mean return. *See, e.g.*, EDWIN J. ELTON & MARTIN J. GRUBER, *MODERN PORTFOLIO THEORY AND INVESTMENT ANALYSIS* 49–51 (5th ed. 1995).

38. *Id.* at 51–54. As Elton and Gruber put it, “the variance of a combination of two assets may be less than the variance of either of the assets themselves.” *Id.* at 51. For further discussion of modern portfolio theory, see Patricia R. Beauregard & Jessie A. Gilbert, *The New Environment in Connecticut for the Investment and Management of Trust and Charitable Assets*, 14 *QUINNIPIAC PROB. L.J.* 419, 424–28 (2000).

39. Aalberts, *supra* note 29, at 52–54 (noting that the old prudent investor rule may induce suboptimal investing behavior on the part of fiduciaries who invest in inefficient portfolios).

40. I.R.C. § 4944(a)(1) (2012).

with portfolio theory, stating that “[t]he determination whether the investment of a particular amount jeopardizes the carrying out of the exempt purposes of a foundation shall be made on an investment by investment basis, in each case taking into account the foundation’s portfolio as a whole,”⁴¹ and that “[n]o category of investments shall be treated as a *per se* violation of section 4944.”⁴² The beginning and end of the first quoted sentence and the entire second quoted sentence are fine; the middle language in the first sentence—requiring scrutiny “on an investment by investment basis”—is anachronistic and muddle-headed. The even worse news is that the regulations go on to call for close scrutiny of “[t]rading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of ‘puts’ and ‘calls’ and ‘straddles,’ the purchase of warrants, and selling short.”⁴³ This emphasis on any particular type of investment, without regard to its role in the overall portfolio, is seriously at odds with modern portfolio theory.

The regulations later adopted under the Employee Retirement Income Security Act⁴⁴ are more sophisticated: they only call for “a determination . . . that the particular investment or investment course of action is reasonably designed, *as part of the portfolio* . . . to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action”⁴⁵

Despite these faint signs that portfolio management insights were beginning to permeate the legal scene, progress did not really begin to accelerate until the mid-1980s. In 1986, a very thoughtful and influential book was published documenting the growth of learning about prudent portfolio management, pointing out the areas where the legal rules had ossified and were in need of modification, and recommending that appropriate changes be made.⁴⁶ In response, the American Law Institute, after careful study, in 1992 published an update to the old and sclerotic *Restatement of Trusts* that clearly and properly sets forth the teachings of modern portfolio theory.⁴⁷ It states that the prudent-investor standard “is to be applied to investments not in isola-

41. 26 C.F.R. § 53.4944-1(a)(2)(i) (2013).

42. *Id.* (emphasis in original).

43. *Id.*

44. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 404(a)(1)(B), 88 Stat. 829 (codified as amended at 29 U.S.C. § 1104(a)(1) (2012)).

45. 29 C.F.R. § 2550.404a-1(b)(2)(i) (2013) (emphasis added).

46. LONGSTRETH, *supra* note 29.

47. In describing an update to the RESTATEMENT OF TRUSTS, Sterk notes that “[t]he ALI approved and published a volume of the Restatement (Third) on the prudent

tion but in the context of the trust portfolio and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.”⁴⁸

In the wake of the *Restatement (Third)*, the ULC, in 1994, approved a model Uniform Prudent Investor Act (UPIA).⁴⁹ According to the Commissioners of the ULC, the new UPIA makes five fundamental changes in the former criteria for prudent investment:⁵⁰

- The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments.⁵¹ In the trust setting, the term “portfolio” embraces all the trust’s assets.
- “The tradeoff in all investing between risk and return is identified as the fiduciary’s central consideration.”⁵²
- All categorical restrictions on types of investments have been abrogated. The trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing.
- The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investment.⁵³
- “[T]he much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has

investor rule . . . more than ten years before it published any other volume of the *Restatement (Third)*.” See Sterk, *supra* note 35, at 862.

48. RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227(a) (1992). Note that not only has the rule been modernized but it has become gender neutral. For a discussion of diversification strategies under the modernized rule, see Frederick B. Taylor, *Private Equity and the New Prudent Investor*, TR. & EST., Jan. 1996, at 8.

49. UNIF. PRUDENT INVESTOR ACT (1994) [hereinafter UPIA], available at http://www.uniformlaws.org/shared/docs/prudent%20investor/upia_final_94.pdf. For a discussion of the UPIA, see Carolyn D. Duronio, *Fiduciary Concerns Under the Prudent Investor Standard*, TR. & EST., Dec. 1996, at 33, and Christopher P. Cline & Marcia L. Jory, *The Uniform Prudent Investor Act: Trust Drafting and Administration*, 26 ESTATE PLAN. 451 (1999).

50. UPIA, *supra* note 49, at 1 (Prefatory Note).

51. *Id.* at 2. One leading commentator explained: “The key to this approach is process. Prudence is to be found principally in the process by which investment strategies are developed, adopted, implemented, and monitored in light of the purposes for which funds are held, invested, and deployed. Prudence is demonstrated by the process through which risk is managed, rather than by the definition of specific risks that are imprudent.” LONGSTRETH, *supra* note 29, at 591.

52. UPIA, *supra* note 49, at 1.

53. For discussion, see John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 646–47 (1996) [hereinafter Langbein, *UPIA and the Future of Trust Investing*]. See also Douglas Moore & Ajay Badlani, *Investment Challenges for Private Foundations*, TR. & EST., June 2005, at 46, 49–51 (discussing application of diversification presumption for foundations).

been reversed. Delegation is now permitted, subject to safeguards.”⁵⁴

UPIA has been adopted in forty-three jurisdictions as of the date of this article.⁵⁵ Although by its terms UPIA applies to trusts and not to charitable corporations, it served to inform the investment responsibilities of directors and officers of charitable corporations.⁵⁶

Thus, by the end of the 20th century—a little more than four decades after Harry Markowitz published his seminal paper—the legal rules in the U.S. had largely caught up with the lessons of modern portfolio theory and sound investment analysis.⁵⁷

II.

OVERVIEW OF UPMIFA AND NYPMIFA

Historically, charitable institutions looked to trust law for guidance on investment and management of assets.⁵⁸ However, during the same four decades in which modern portfolio theory gained traction, states began adopting not-for-profit corporation laws that specifically govern institutions that are not trusts, and institutions began to rely less on the precepts of trust law. Although the prudent man rule and modern portfolio theory were finally joined together in UPIA, these concepts did not fully permeate the laws applicable to not-for-profit corporations until the promulgation of UPMIFA. This portion of the article will outline the rationale for the drafting of UPMIFA and present an overview of the version of UPMIFA adopted by New York.

54. UPIA at 1; see Alyssa A. DiRusso & Kathleen M. Sablone, *Statutory Techniques for Balancing the Financial Interests of Trust Beneficiaries*, 39 U.S.F. L. REV. 1, 12 (2005); see also Langbein, *UPIA and the Future of Trust Investing*, *supra* note 54, at 650–53.

55. As of this writing, UPIA has been adopted in forty-one states and the District of Columbia and U.S. Virgin Islands. See *Legislative Fact Sheet – Prudent Investor Act*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Prudent%20Investor%20Act> (last visited Mar. 6, 2012).

56. See UPIA, *supra* note 49, at 3.

57. An empirical study of the impact of UPIA concludes that its adoption significantly affected the composition of the portfolios of institutional trust funds, increasing their exposure to equities by between 1.5 and 4.5 percentage points. See Max M. Schanzenbach & Robert H. Sitkoff, *The Prudent Investor Rule and Trust Asset Allocation: An Empirical Analysis*, 35 AM. C. TR. & EST. COUNS. J. 314 (2010).

58. See Gary, *supra* note 12, at 1280–83; see also Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593 (1999).

A. UPMIFA

The ULC promulgated UPMIFA in order to update those provisions of UMIFA that had become outdated or difficult to administer since UMIFA's drafting in 1972.⁵⁹ UPMIFA updates laws on investment management to conform better to modern portfolio theory, modernizes the rules governing appropriation from endowment funds, provides stricter guidelines on spending from endowment funds, and gives institutions flexibility to cope with fluctuations in the value of endowment funds.⁶⁰ The goal of the ULC in drafting UPMIFA was to "balance[] protection of donor intent with the flexibility that will enable charities to cope with economic upturns and downturns."⁶¹

One of the most significant changes made by UPMIFA is the elimination of the concept of "historic dollar value" for endowment funds.⁶² UMIFA defined "historic dollar value," or "HDV," as the "aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund."⁶³

Under UMIFA, institutions generally were required to maintain the HDV of each endowment fund; this was intended to attempt to preserve the original nominal value of the endowment in perpetuity.⁶⁴ Under UPMIFA, a prudence standard governs appropriation from endowment funds and there is no requirement to maintain HDV.

In addition, in order to protect both charitable institutions and the interests of donors, UPMIFA imposes more defined duties on gov-

59. See UPMIFA, *supra* note 9, at 1 (Prefatory Note).

60. For a discussion of what constitutes an endowment fund under UPMIFA, see Gary, *supra* note 12, at 1304–07.

61. *Id.* at 1332–33.

62. Susan E. Budak, *Financial Reporting Implications of UPMIFA*, BUS. OFFICER (Apr. 2007), http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/April_2007/Up_to_Speed_on_UPMIFA.html.

63. UMIFA, *supra* note 11, § 1(5), at 5. If the gift instrument creating the endowment fund directed that some or all appreciation be accumulated rather than spent, such appreciation also would be included in the fund's HDV.

64. UMIFA provided no adjustment to HDV to take inflation into account. For a discussion of HDV, and the impact that the HDV rule had on not-for-profit institutions prior to UPMIFA, see *infra* text accompanying notes 188–215. NYPMIFA uses the term "original dollar value," which is probably to be interpreted as synonymous with HDV. See ERIC T. SCHNEIDERMAN, CHARITIES BUREAU, A PRACTICAL GUIDE TO THE NEW YORK PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT 10 (2011) [hereinafter AG GUIDE], available at <http://www.charitiesnys.com/pdfs/NYPMIFA-Guidance-March-2011.pdf>. The AG Guide is reprinted as Appendix B to this article. UPMIFA does not make reference to "original dollar value" or "historic dollar value."

erning boards and those who manage and invest institutional funds than UMIFA did.⁶⁵ Individuals who manage and invest institutional funds are required to (i) give primary consideration to donor intent as expressed in a gift instrument,⁶⁶ (ii) act in good faith with the care an ordinarily prudent person in a like position would exercise,⁶⁷ (iii) incur only reasonable costs in investing and managing charitable funds,⁶⁸ (iv) make a reasonable effort to verify relevant facts,⁶⁹ (v) make decisions about each asset in the context of the portfolio of investments as part of an overall investment strategy,⁷⁰ (vi) diversify investments unless, due to special circumstances, the purposes of the fund are better served without diversification,⁷¹ (vii) dispose of unsuitable assets,⁷² and, in general, (viii) develop an investment strategy appropriate for the fund and the institution.⁷³ All of the requirements of UPMIFA are default rules, subject to the intent of the donor as expressed in the applicable gift instrument.⁷⁴

As of April 2014, UPMIFA has been adopted in forty-nine states, the District of Columbia, and the U.S. Virgin Islands.⁷⁵

65. See UPMIFA, *supra* note 9, at 1–2. While UMIFA and UPMIFA are significantly concerned with the possibility of institutions spending too much, the Internal Revenue Code and regulations focus on preventing institutions from spending too little. For a discussion of congressional goals as seen through federal tax law and a comparison of these goals with UPMIFA, see Johnny Rex Buckles, *Should the Private Foundation Excise Tax on Failure to Distribute Income Generally Apply to “Private Foundation Substitutes”?* *Evaluating the Taxation of Various Models of Charitable Entities*, 44 NEW ENG. L. REV. 493, 530–39 (2010).

66. See UPMIFA, *supra* note 9, § 3(a), at 11.

67. See *id.* § 3(b), at 11.

68. See *id.* § 3(c)(1), at 11.

69. See *id.* § 3(c)(2), at 11.

70. See *id.* § 3(e)(2), at 12.

71. See *id.* § 3(e)(4), at 13.

72. See *id.* § 3(e)(5), at 13.

73. See UPMIFA, *supra* note 9, at 2 (Prefatory Note).

74. See UPMIFA, *supra* note 9, §§ 3(a), 4(a), 5(a), at 11, 19, 29–30. “UPMIFA emphasizes the importance of donor intent in the way charities manage and spend their funds. UPMIFA provides more detailed guidance to charities than did UMIFA and reminds charities that donor intent remains paramount. Both the standard of conduct for managing and investing funds and the rule on spending from an endowment fund are subject to ‘the intent of a donor expressed in a gift instrument.’” Gary, *supra* note 12, at 1331 (quoting UPMIFA §§ 3(a), 4(a)). *But see* John H. Langbein, *Burn the Rembrandt? Trust Law’s Limits on the Settlor’s Power to Direct Investments*, 90 B.U. L. REV. 375 (2010) (discussing limits on the donor’s ability to restrict investment decisions) [hereinafter Langbein, *Limits on Settlor’s Power to Direct Investments*].

75. *Legislative Fact Sheet – Prudent Management of Institutional Funds Act*, UNIFORM L. COMMISSION, <http://uniformlaws.org/LegislativeFactSheet.aspx?title=Prudent%20Management%20of%20Institutional%20Funds%20Act> (last visited Apr. 9, 2014).

B. NYPMIFA

The economic downturn of 2008, which caused the endowments of many New York not-for-profit corporations to go “underwater,” precipitated cIcu’s decision to advocate for the adoption of UPMIFA in New York. An endowment fund is “underwater” when the fair market value of the endowment fund is less than the fund’s HDV. Under the rules of UMIFA, an institution then could only appropriate “income,”⁷⁶ but not appreciation,⁷⁷ from the fund. This often resulted in an endowment fund having insufficient current “income” to carry out its mission. Because of the large number of not-for-profit corporations in New York,⁷⁸ the economic downturn caused the impact of the HDV rule to be felt throughout the state⁷⁹—just at a time when charitable beneficiaries most needed more support, i.e., during the economic downturn, the HDV rule meant that many New York not-for-profit corporations did not have access to large portions of their endowments.

cIcu, representing many New York colleges and universities, led the push to adopt UPMIFA in New York, gathering input from its constituents, other not-for-profit organizations, lawyers who practice in the field of tax-exempt organizations, scholars whose work addresses the issues involved, and state not-for-profit regulators. Those providing input held a range of views on the necessity of adopting

76. The meaning of the term “income” in the endowment context is not well understood. It is generally thought of as including, among others, interest, dividends, rents, and royalties. For a discussion on the interpretation of the term “income,” see *infra* text accompanying notes 188–194. According to the Uniform Principal & Income Act, “income” is defined as “money or property that a fiduciary receives as current return from a principal asset.” UNIF. PRINCIPAL & INCOME ACT § 102(4), at 5 (2008), available at http://www.uniformlaws.org/shared/docs/principal%20and%20income/upia_final_08.pdf.

77. See UMIFA, *supra* note 11, § 2, at 7–8 (indicating that the governing board may appropriate for expenditure so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund *over the historic dollar value* of the fund as is prudent); see also Susan E. Budak & Susan B. Gary, *Legal and Accounting Challenges of Underwater Endowment Funds*, PROB. & PROP., Jan.–Feb. 2010, at 29, 30.

78. As of 2012, there were 94,108 registered non-profit organizations in New York. *Number of Registered Nonprofit Organizations by State, 2012*, NAT’L CENTER FOR CHARITABLE STAT., <http://nccsweb.urban.org/PubApps/reports.php?rid=2>. This reflects the number of nonprofit organizations registered with the IRS by state, from the Internal Revenue Service Business Master File.

79. See *supra* notes 1, 3, 4 and accompanying text; see also PATTERSON BELKNAP WEBB & TYLER, LLP, UNDERWATER ENDOWMENTS: UNDERSTANDING YOUR OPTIONS (2009), available at http://www.pbwt.com/files/Publication/8ed40d38-1f36-4c74-8686-016bd7871189/Presentation/PublicationAttachment/766da6cf-135f-4aef-9cc9-02f9c16cf967/EO_NL_UnderwaterEndowments_Mar2009.pdf.

UPMIFA in New York, the appropriate scope of the law, the validity of certain provisions, and the ways in which the New York version of UPMIFA should or should not differ from the uniform law.

As noted above, NYPMIFA contains certain provisions unique to New York. The authors of this article believe that the provisions of UPMIFA should have been enacted with as little change as possible in order to maintain uniformity with other states and to allow for legal interpretation, precedent, and comment to apply equally and uniformly to New York along with other states that have adopted UPMIFA. In addition, the authors believe that the decisions made by the ULC when drafting UPMIFA should have been accorded greater deference during the NYPMIFA drafting process given the length of time devoted to the drafting of UPMIFA, the robust debates held on each provision, and the high qualifications of those chosen to be on the UPMIFA Drafting Committee. A contrary view expressed during the NYPMIFA drafting process is that New York is unlike other states: it has a well-developed body of law applicable to its large number of not-for-profit corporations and it has an active regulatory agency, and therefore a uniform law drafted for all states is not appropriate in all respects for New York. NYPMIFA as enacted is the result of extensive input from parties holding each of these views.

Unlike UMIFA, which was incorporated piecemeal into various parts of the New York Not-For-Profit Corporation Law (N-PCL),⁸⁰ NYPMIFA was codified primarily in a new addition: Article 5-A.

III.

ANALYSIS OF NYPMIFA

This part contains a closer analysis of the individual provisions of the Act.

A. *Scope of NYPMIFA*

NYPMIFA applies only to funds considered to be “institutional funds” held by entities falling within the term of “institution” as defined by the Act. The following discussion illustrates the meanings of the terms “institution” and “institutional fund” and traces their evolution from prior law.

80. ELIOT P. GREEN, N.Y.C. BAR, REPORT IN SUPPORT OF NEW YORK'S ADOPTION OF THE UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT, WITH SUGGESTED MODIFICATIONS 1 (2008) (“New York enacted UMIFA in 1978, and it is codified in sections 102, 512, 513, 522 and 717 of the New York Not-for-Profit Corporation Law (the ‘N-PCL’).”).

1. *Applicability to “Institutions”*

Although the rules of UMIFA, UPMIFA, and NYPMIFA all apply to “institutions,” the term is defined differently in each statute. Under UMIFA, “institution” is defined as “an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of these purposes.”⁸¹

When New York adopted its version of UMIFA in 1978, it did not follow UMIFA’s definition of “institution.” Rather, New York’s version of UMIFA applied to a “corporation,” defined in the N-PCL as

a corporation (i) formed under [the N-PCL], or existing on its effective date and theretofore formed under any other general statute or by any special act of this state, exclusively for a purpose or purposes, not for pecuniary profit or financial gain, for which a corporation may be formed under [the N-PCL], and (ii) no part of the assets, income or profit of which is distributable to, or enures to the benefit of, its members, directors or officers except to the extent permitted under [the N-PCL].⁸²

This definition of “corporation” includes not-for-profit corporations that are governed by the N-PCL but which are not charitable, such as social welfare organizations and civic leagues.

Under UPMIFA, an “institution” is defined as a person,⁸³ other than an individual, organized and operated exclusively for charitable purposes;⁸⁴ a government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or a trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated.⁸⁵

81. UMIFA, *supra* note 11, § 1(1), at 5.

82. N.Y. NOT-FOR-PROFIT CORP. LAW § 102(a)(5) (McKinney 2005) [hereinafter N-PCL].

83. A “person” is defined in UPMIFA as “an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.” UPMIFA, *supra* note 9, § 2(6), at 7.

84. “Charitable purpose” is defined in UPMIFA as “the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community.” UPMIFA, *supra* note 9, § 2(1), at 6.

85. *Id.* § 2(4), at 6.

UPMIFA applies to a trust only if it is charitable and the trustee is a charity.⁸⁶ It does not apply to charitable trusts managed by individuals or corporate trustees.⁸⁷

Although the definition of “institution” in NYPMIFA is similar to that in UPMIFA, there are a few important differences. “Institution” is defined in NYPMIFA as “a person,⁸⁸ other than an individual, organized and operated exclusively for charitable purposes;⁸⁹ a trust that had both charitable and non-charitable interests, after all non-charitable interests have terminated; or any corporation described in section 102(a)(5) of the N-PCL.”⁹⁰ This includes corporations formed under the N-PCL and corporations in existence prior to the N-PCL’s enactment that were formed exclusively for a purpose allowable under the N-PCL and where no part of their assets, income or profit inures to the benefit of their members, directors or officers except as permitted under the N-PCL.⁹¹ As a consequence, the Act reaches beyond charitable organizations to include social welfare organizations and other entities incorporated under the N-PCL. The Act also governs educational institutions formed under the New York Education Law,⁹² and, with a few exceptions, institutions formed under the New York Relig-

86. *Id.* § 2(4) cmt., at 9.

87. *Id.*; *see also infra* text accompanying notes 97–114 (regarding the definition of “institutional fund”). “The exclusion of certain trusts comes through the definition of institutional funds and not through the definition of institution.” Gary, *supra* note 12, at 1292 n.93.

88. “Person” is defined in NYPMIFA as “an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, or any other legal entity.” N-PCL § 551(g) (McKinney Supp. 2014).

89. “Charitable purpose” is defined in NYPMIFA as “the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community including any purpose that is charitable under the laws of the state of New York.” *Id.* § 551(a). This expands on the UPMIFA definition by adding the language “any purpose that is charitable under the laws of the state of New York” in order to clarify that, notwithstanding the enactment of NYPMIFA, there is no change to the meaning of what is “charitable” under established New York law. According to New York Executive Law, a “charitable organization” is “[a]ny benevolent, philanthropic, patriotic, or eleemosynary person or one purporting to be such or law enforcement support organization as defined in subdivision eleven of this section.” N.Y. EXEC. LAW § 171-a(1) (McKinney 2010). Furthermore, as one treatise explains, the New York Estates, Powers and Trusts Law (EPTL), without explicitly providing a definition for the term, does include “religious, charitable, education or benevolent purposes” in the section titled “Disposition of property for charitable purposes.” 18 N.Y. JUR. 2D *Charities* § 2 (2011); *see* N.Y. EST. POWERS & TRUSTS LAW § 8-1.1(a) (McKinney 2002 & Supp. 2014) [hereinafter EPTL]; *see also* VICTORIA B. BJORKLUND ET AL., NEW YORK NONPROFIT LAW & PRACTICE 6–40 (2010).

90. N-PCL § 551(d).

91. *See id.* § 102(a)(5).

92. *See* N.Y. EDUC. LAW § 216-a (McKinney 2009).

ious Corporations Law.⁹³ As in UPMIFA, charitable trusts with an individual or corporate trustee are excluded from NYPMIFA's reach.

a. Legislative History

In early drafts, NYPMIFA applied only to funds held by institutions organized and operated exclusively for charitable purposes, and included governmental organizations that hold funds exclusively for charitable purposes. However, as a result of concerns raised by the Charities Bureau about the potential consequences of a lack of regulation of the management, investment, and appropriation of funds held by non-charitable corporations governed by the N-PCL, the definition was expanded as discussed above. This modification is consistent with prior law.

Concerns were also raised by the Act's sponsors in the Legislature as to whether governmental institutions should come within the scope of NYPMIFA. Governmental organizations were included in the UPMIFA definitions of "institution" and "person" because the UPMIFA drafters wanted UPMIFA to cover certain organizations created by government, such as public universities.⁹⁴ Consultations with New York lawyers specializing in the field of tax-exempt organizations confirmed that organizations with educational purposes funded by the state government of New York, such as the State University of New York and the City University of New York, would be covered by NYPMIFA even if the references to governmental organizations were removed from the definitions of "person" and "institution." Such institutions are considered "education corporations" under the New York Education Law, and the N-PCL applies to education corporations.⁹⁵ Therefore, NYPMIFA applies to these types of organizations despite the removal of government organizations from NYPMIFA's definition of "institution."⁹⁶ Although government-funded educational organizations are covered by NYPMIFA, other types of government-funded organizations may be excluded from its coverage.

93. See N.Y. RELIG. CORP. LAW § 2-b (McKinney 1990 & Supp. 2014).

94. Gary, *supra* note 12, at 1292-93; see also UPMIFA, *supra* note 9, § 2(4) cmt., at 9.

95. See N.Y. EDUC. LAW § 216-a.

96. This analysis may lead to a different result for governmental agencies/instrumentalities not included under the N-PCL and not governed by the Education Law. In addition, many educational institutions with government funding hold their endowments in separate foundations, formed under the N-PCL, which are governed by NYPMIFA.

2. Institutional Funds

a. Evolving Definition

UMIFA, UPMIFA, and NYPMIFA each govern the investment management and expenditure of “institutional funds.” However, just as with the definition of “institution,” the definition of “institutional fund” differs for each act. Under UMIFA, “institutional fund” was defined as “a fund held by an institution for its exclusive use, benefit, or purposes,” but did not include “(i) a fund held for an institution by a trustee that is not an institution or (ii) a fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purposes of the fund.”⁹⁷ New York’s version of UMIFA adopted a definition of “institutional fund” that was substantially the same as that in UMIFA with the exception that it specified that an institutional fund could be held on behalf of a corporation by a person or entity whose sole authority with respect to the fund was delegated by the corporation.⁹⁸

Under UPMIFA, “institutional fund” is defined as “a fund held by an institution exclusively for charitable purposes.”⁹⁹ The term does not include “(i) program-related assets; (ii) a fund held for an institution by a trustee that is not an institution; or (iii) 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.”¹⁰⁰ A “program-related asset” is defined as “an asset held by an

97. UMIFA, *supra* note 11, § 1(2), at 5.

98. N-PCL § 102(a)(17) (repealed 2010).

99. UPMIFA, *supra* note 9, § 2(5), at 7.

100. *Id.* Since NYPMIFA’s enactment, questions have arisen as to whether donations made to establish charitable gift annuities are subject to the Act. Since the definition of “institutional fund” explicitly excepts “funds in which a beneficiary that is not an institution has an interest,” the authors believe that so long as an individual is eligible to receive annuity payments, the charitable gift annuity amount held by the institution will not be governed by NYPMIFA. In addition, section 1110 of the New York State Insurance Law requires charitable gift annuity issuers to maintain actuarially-based reserves in support of their obligations. N.Y. INS. LAW § 1110 (McKinney 2006). The prudence standard applicable to investment of these reserves is found in section 11-2.3 of the New York Estates, Powers and Trusts Law, which contains the Prudent Investor Act to which the Insurance Law (at section 1110) cross-refers. EPTL § 11-2.3 (McKinney 2008). Funds donated by the donor that are in excess of these required reserves and are taken and managed by the institution become, at the time of their taking, institutional funds subject to NYPMIFA because there is no longer an individual beneficiary having an interest in those funds. Where the institution maintains more than the actuarially required amount as a reserve (e.g., maintains 100% of the gift amount as the reserve), the authors believe that the entire reserve would be excepted from NYPMIFA because the entire reserve is available to the individual beneficiaries. At such time as an amount is transferred out of the charitable gift annuity reserve fund into the institution’s general funds, it would become subject to

institution primarily to accomplish a charitable purpose and not for investment.”¹⁰¹

The comments say that UPMIFA, in contrast to UMIFA, “excludes from the prudent investor norms those assets that a charity uses to conduct its charitable activities, but does not exclude assets that have a tangential tie to the charitable purpose of the institution but are held primarily for investment purposes.”¹⁰² The comments provide an example: while a university’s purchase of land adjacent to its campus might not meet the prudent investor standards for commercial real estate, the purchase still may be appropriate because the university will use the land to build a needed dormitory.¹⁰³ In contrast, an endowment fund restricted to funding scholarships for a particular program would be an institutional fund, not a program-related asset.¹⁰⁴ If a program-related asset serves, in part, as an investment, the institution should identify categories for reporting such investments and establish investment criteria that are “reasonably related to achieving” the organization’s purposes.¹⁰⁵

NYPMIFA as an “institutional fund” because an individual beneficiary no longer has an interest in it. Since the Prudent Investor Act includes a prudence standard that is effectively the same as that in NYPMIFA, however, the same general standard of prudence applies under either statute.

101. UPMIFA, *supra* note 9, § 2(7), at 7. The UPMIFA Drafting Committee explained its views on program-related assets in a memorandum that states: “Most assets held by a charity will either be clearly program-related assets or investment assets. Nearly all funds held by a charity are governed by UPMIFA. The funds may be used for operating expenses, may serve as an endowment for scholarships, or may be a development fund to be used to pay for a new building. All of these funds are institutional funds under UPMIFA.” *Program-Related Assets Under UPMIFA*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/Shared/Docs/Prudent%20Mgt%20of%20Institutional%20Funds/UPMIFA%20Program%20Related%20Assets%20Article.pdf> (last visited Apr. 9, 2014). Susan Gary, Reporter of the UPMIFA Drafting Committee, has indicated her view that current operating funds, including cash, are institutional funds (not program-related assets excluded from UPMIFA), even if they are held only for a short-term period. See also David W. Lowden, *New York’s Nonuniform Prudent Management of Institutional Funds Act: What All New York Nonprofits (and Their Lawyers) Should Know*, 67 EXEMPT ORG. TAX REV. 233, 236–37 n.10 (2011).

102. UPMIFA, *supra* note 9, § 2(5) cmt., at 9–10.

103. *Id.*; see also Gary, *supra* note 12, at 1293–94 (describing example of Trinity College in Hartford, Connecticut).

104. Analogous, albeit not legally binding, authority for determining what is, and what isn’t, a “program-related asset” may perhaps be found in the regulations and rulings discussing “program-related investments” under I.R.C. § 4944(c) (2012). See, e.g., 26 C.F.R. § 53.4944-3 (2013) (especially the examples in § 53.4944-3(b)).

105. UPMIFA, *supra* note 9, § 2(7) cmt., at 10–11. An example of this would be a micro-lending program, providing below-market rate loans to businesses in an economically depressed neighborhood. The program’s purposes are “‘primarily to accomplish a charitable purpose of the institution’ but also can be considered, in part, an

Because of concerns raised by corporate trustees,¹⁰⁶ trusts where the trustee is not itself a charity were excluded from UPMIFA's ambit. Early drafts of UPMIFA applied to "all funds held by all charities,"¹⁰⁷ including "any fund for which the only beneficiary is a charity, regardless of whether a corporation rather than a charity acts as trustee"¹⁰⁸ because "the rules for the management, investment, and expenditure of charitable funds should not depend on the organizational form of the charity."¹⁰⁹ However, arguments put forward by the Association of American Bankers regarding potential confusion between applicability of trust law and UPMIFA convinced the drafters of UPMIFA to exclude funds managed by corporate (and individual) trustees from UPMIFA's reach.¹¹⁰ Therefore the final version of UPMIFA applies only to trusts where the trustee is itself an "institution" (i.e., a charity).¹¹¹

NYPMIFA includes the same definition for "institutional fund" as UPMIFA with the exception that, since NYPMIFA applies to more than just charitable organizations, it does not require the fund to be held exclusively for charitable purposes.¹¹² The definition of "program-related asset" in NYPMIFA adds clarifying language to the definition found in UPMIFA; NYPMIFA defines "program-related asset" as "an asset held by an institution not for investment under the terms of the gift instrument, but primarily to accomplish a programmatic purpose of the institution."¹¹³

investment. The institution should create reasonable credit standards and other guidelines for the program to increase the likelihood that the loans will be repaid." *Id.*

106. Some banks and trust companies, believing they were already closely regulated under other regulatory regimes, wished to avoid what they perceived as an unnecessary and burdensome additional layer of regulation.

107. Gary, *supra* note 12, at 1290; *see also Prudent Management of Institutional Funds: Committees*, UNIFORM L. COMMISSION, <http://uniformlaws.org/Committee.aspx?title=Prudent%20Management%20of%20Institutional%20Funds> (last visited April 20, 2014) (providing links to the previous drafts of the UPMIFA).

108. *See* Gary, *supra* note 12, at 1291.

109. *Id.* at 1290.

110. *See id.* at 1291–92.

111. *See* Johnny Rex Buckles, *Probing UPMIFA: The Mysteries of the Uniform Act in Light of Federal Tax and State Charity Laws and Concepts*, 46 REAL PROP., TR. & EST. L.J. 281, 285–91 (2011) (discussing the applicability of UPMIFA to a fund with one charitable and one individual or corporate trustee).

112. *See* N-PCL § 551(e) (McKinney Supp. 2014).

113. *Id.* § 551(h).

b. Legislative History

Because NYPMIFA applies to organizations other than charities, all references in UPMIFA to “charitable purposes” were removed from NYPMIFA.

UPMIFA defines “program-related asset” as one held “primarily to accomplish a charitable purpose of the institution.”¹¹⁴ NYPMIFA’s definition differs, due to concerns about lack of clarity in the UPMIFA definition. NYPMIFA refers to “programmatic purpose” rather than a “charitable purpose” because it was believed that it could be argued that all funds held by a charity are held for charitable purposes and thus that all funds might be inappropriately excepted from the definition of an “institutional fund.”

B. The Governing Board

New York law has historically placed on the governing board of the institution the obligation of compliance with rules regulating investment management. It continues to do so in NYPMIFA, although the language of NYPMIFA creates an unnecessary ambiguity.

1. Evolving Use

UMIFA defined “governing board” as the “body responsible for the management of an institution or of an institutional fund,”¹¹⁵ and New York adopted this definition in the N-PCL provisions codifying UMIFA.¹¹⁶ In contrast, UPMIFA does not utilize the term “governing board” nor does it explicitly place any obligation on a governing board. Instead, it places such obligations on the “institution.”

Although NYPMIFA adopts UPMIFA’s use of the term “institution,” it places specific obligations on an institution’s governing board, stating that “whenever any provision of [NYPMIFA] imposes any obligation on, or requires any action to be taken by, an institution, such obligation is imposed on, and such action shall be authorized by, the governing board of such institution.”¹¹⁷ This non-uniform provision seems both unwise and unnecessary, as discussed below.

114. UPMIFA, *supra* note 9, § 2(7), at 7.

115. UMIFA, *supra* note 11, § 1(4), at 5.

116. See N-PCL § 102(a)(15) (McKinney 2005); see also *id.* § 512 (repealed 2010); *id.* §§ 513, 514 (McKinney 2005 & Supp. 2014). Elsewhere in the N-PCL the terms “board” or “board of directors” are used. See, e.g., *id.* §§ 701, 702, 707.

117. N-PCL § 551(d).

2. *Legislative History*

The change of the focus from “governing boards” in UMIFA to “institutions” in UPMIFA raised concerns among those who thought that governing boards should bear explicit responsibility for decisions concerning investment management and appropriation of institutional funds, thus making it clear that the fiduciary duties applicable to governing boards specifically apply to such decisions. Others, including the authors of this article, believed this was unnecessary, because institutions may only act through their governing boards.¹¹⁸ Nevertheless, language was added to impose the obligations of the institution (under UPMIFA) on the governing board (under NYPMIFA). There are two unfortunate consequences to this drafting decision: (i) it might be understood as giving rise to a negative implication that, in other portions of the N-PCL outside of Article 5-A, the governing board does not have such responsibilities, and (ii) it might be understood as somehow increasing, for NYPMIFA purposes, the fiduciary obligations of governing boards beyond what they are in other areas. Both interpretations should be rejected. If rejected, it follows that the additional language in question is unnecessary surplusage that should be deleted.

C. *Standard of Conduct in Managing and Investing an Institutional Fund*

One of the most important contributions of UPMIFA is its expansion of the factors that must be considered when making prudent decisions regarding the management and investment of institutional funds.

1. *Prudence Standard*

a. *UMIFA Approach*

The UMIFA standard for investment management, appropriation, and delegation placed a general obligation on the governing board to invest prudently using ordinary business care.¹¹⁹ It states:

118. See N-PCL § 102(a)(15).

119. See UMIFA, *supra* note 11, § 6, at 10. UMIFA was strongly influenced by a study sponsored by the Ford Foundation and conducted by William L. Cary and Craig B. Bright. See WILLIAM L. CARY & CRAIG B. BRIGHT, *THE LAW AND THE LORE OF ENDOWMENT FUNDS* 66 (1969) [hereinafter CARY & BRIGHT, *LAW AND LORE OF ENDOWMENT FUNDS*]. See generally WILLIAM L. CARY & CRAIG B. BRIGHT, *THE DEVELOPING LAW OF ENDOWMENT FUNDS: “THE LAW AND THE LORE” REVISITED* (1974); WILLIAM L. CARY & CRAIG B. BRIGHT, *The Delegation of Investment Responsibility for Endowment Funds*, 74 COLUM. L. REV. 207 (1974); WILLIAM L. CARY & CRAIG B. BRIGHT, *The “Income” of Endowment Funds*, 69 COLUM. L. REV. 396 (1969).

[I]n the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. In so doing they shall consider the long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.¹²⁰

UMIFA also specifically authorized certain types of investments. In addition to investments otherwise permitted by law or the applicable gift instrument, the governing board could, subject to limitations in a gift instrument, (i) invest and reinvest in any real or personal property, whether or not it produced a current return,¹²¹ (ii) retain property contributed by a donor to an institutional fund for as long as the governing board deemed advisable, (iii) include all or any part of an institutional fund in any pooled or common fund maintained by the institution, and (iv) invest all or any part of an institutional fund in any other pooled or common fund available for investment in which such funds are commingled and investment determinations are made by persons other than the governing board.¹²² By granting this authority, UMIFA clarified that “a governing board is not restricted to investments authorized to trustees.”¹²³ This meant that a governing board could invest institutional funds in any manner as long as investment decisions were made with the appropriate standard of care and prudence.¹²⁴

Prior to UMIFA, there was no clear standard of conduct applicable to the investment management and expenditure of charitable assets.¹²⁵ In adopting a prudence standard, UMIFA provided a “corporate rather than a trust approach to the management of investment assets,”¹²⁶ but did not limit prudence to a simple business standard. Rather, the UMIFA standard was “cast in terms of the duties and

120. UMIFA, *supra* note 11, § 6, at 10.

121. This includes mortgages, stocks, bonds, debentures, and other securities, and shares in associations and partnerships. *Id.* § 4(1), at 9.

122. *Id.* § 4, at 9–10.

123. *Id.* § 4 cmt., at 10.

124. Prior to the adoption of the prudent man rule, trust law historically permitted investment only in enumerated classes of securities. *See* EPTL § 11-2.2(a)(1) (repealed 1970).

125. *See* Gary, *supra* note 12, at 1295; *see also* UMIFA, *supra* note 11, at 1, 4.

126. Gary, *supra* note 12, at 1296.

responsibilities of a manager of a nonprofit institution.”¹²⁷ In so doing, UMIFA made clear that prudence required taking into consideration “the fact that the organization is a charity and not a business.”¹²⁸ UMIFA rejected the older trust law which limited expenditure to income, and instead embraced the more modern concept of “total return.” Under this approach, the possibility of appreciation in value could be considered when determining whether to make an investment.

b. N-PCL Approach

With only minor linguistic changes, New York adopted UMIFA’s description of the factors to consider when making investment management, appropriation, and delegation decisions. For example, New York adopted UMIFA’s factors to consider when making investment management, appropriation, and delegation decisions, but did not incorporate the prudence standard exactly as articulated in UMIFA. At the time, section 717 of the N-PCL already provided a prudence standard for the conduct of directors and officers, requiring them to “discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.”¹²⁹

The N-PCL also adopted the more specific investment authority provisions of UMIFA. Institutional funds could be invested in common funds, where funds are commingled and investment determinations are made by persons other than the governing board.¹³⁰ As in UMIFA, the N-PCL stated that the governing board could retain property contributed by a donor to an institutional fund for as long as the

127. UMIFA, *supra* note 11, § 6 cmt., at 11–12.

128. Gary, *supra* note 12, at 1296.

129. N-PCL § 717(a) (McKinney 2005) (amended 2010). This was almost identical to the duty of care set forth in § 717(a) of the Business Corporation Law (BCL) when the N-PCL was enacted in 1969. The N-PCL was patterned after the BCL that was adopted in 1961 and took effect in 1963. In 1977, § 717(a) of the BCL was amended to eliminate the references to “diligence” and “skill.” This change was made to conform § 717(a) of the BCL to the formulation of the duty of care then articulated in the Model Business Corporation Act. *See* 2 WHITE, NEW YORK BUSINESS ENTITIES ¶ B717.01 (14th ed. 2010).

130. *See* N-PCL § 512 (repealed 2010). Though this provision was repealed by NYPMIFA, institutional funds may still be invested in common funds. *Compare* UPMIFA, *supra* note 9, § 3(e)(6) cmt., at 19 (stating that “Section 3(e)(3) of UPMIFA authorizes” investing in “pooled or common investment funds”), *with* N-PCL § 552(e)(3) (McKinney Supp. 2014) (repeating the relevant statutory language of UPMIFA § 3(e)(3)).

governing board deemed advisable.¹³¹ New York's version of the law thus clarified that a governing board could take into account requests by the donor to retain donated assets. Significantly, this meant that it could be considered prudent, in the hope of receiving future donations, to accept a gift that did not yield an optimum return and that the donor requested the institution to retain.

Even prior to its adoption of UMIFA, New York was among the first states¹³² to allow the board to include in "income" so much of the realized appreciation as the board deemed prudent,¹³³ thus permitting the potential for appreciation to be taken into account when determining whether to make an investment.

c. UPIA Approach

As discussed previously,¹³⁴ UPIA, promulgated in 1994, set forth rules on investing by trustees. UPIA requires diversification of trust assets unless the trust's purposes are better served by not diversifying.¹³⁵ UPIA also establishes a standard of care directing the trustee to adopt "an overall investment strategy having risk and return objectives reasonably suited to the trust," thus requiring the trustee to consider the context of the entire portfolio when making investments rather than making decisions on an asset-by-asset basis.¹³⁶ UPIA permits a trustee to delegate investment responsibilities. It also excuses the trustee from liability for any subsequent errors of the delegated party so long as the original delegation decision was made with "reasonable care, skill and caution."¹³⁷

UPIA enumerates a range of factors trustees must consider when making investment management decisions. These include the size of the portfolio, the nature and estimated duration of the fiduciary relationship, general economic conditions, liquidity and distribution re-

131. N-PCL § 512(2) (repealed 2010).

132. New York allowed not-for-profit corporations to consider realized appreciation a part of "income" starting in 1970, prior to the promulgation of UMIFA. *See* Act of May 26, 1969, ch. 1066, § 1, 1969 N.Y. Laws 2683, 2716 (codified at N-PCL § 513(d) (repealed 2010)).

133. N-PCL § 513(c) (repealed 2010).

134. *See supra* text accompanying notes 49–57.

135. UPIA, *supra* note 49, § 3, at 10.

136. *Id.* § 2(b), at 6; Gary, *supra* note 12, at 1298.

137. UPIA, *supra* note 49, § 9, at 17. Under prior trust law, a trustee could delegate only administrative functions, but not the ability to determine investments. Gary, *supra* note 12, at 1298; *see* RESTATEMENT (SECOND) OF TRUSTS § 171 cmt. H (1959) ("A trustee cannot properly delegate to another power to select investments."). Under UPIA, trust law caught up with not-for-profit corporation law, allowing for delegation of investment management and release of liability for prudent delegation.

quirements of the governing instrument, the possible effect of inflation or deflation, expected tax consequences, other resources of the beneficiaries, the role that each investment or course of action plays within the overall portfolio, and the expected total return of the portfolio.¹³⁸

UPIA also includes a requirement that fiduciaries incur only costs that are appropriate and reasonable in light of the purposes of the trust, the assets held, and skills of the trustee,¹³⁹ and places a duty on trust fiduciaries to investigate prior to making investment decisions (i.e., to verify relevant facts).¹⁴⁰ UPIA allows trustees to invest in any property or investment consistent with the standard of care and prudence.¹⁴¹

d. UPMIFA Approach

UPMIFA provides a more detailed prudence standard than that found in UMIFA, imposing responsibility for a broader range of duties as well as enumerating duties in greater detail.¹⁴² UPMIFA requires that those responsible for (i) managing and investing an institutional fund, (ii) making a determination to appropriate from or accumulate within an endowment fund, and (iii) delegating management and investment of an institutional fund to an external agent, act “in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.”¹⁴³ This standard “combines the approaches taken by UPIA and by the Revised Model Non-profit Corporation Act,”¹⁴⁴ reflecting the fact that “the standards for managing and investing institutional funds are and should be the same

138. UPIA, *supra* note 49, § 2(c), at 6.

139. *Id.* § 7, at 15.

140. *Id.* § 2(d), at 6. New York’s version of UPIA, codified at section 11-2.3 of New York’s EPTL, does not include the duty to investigate. EPTL § 11-2.3 (McKinney 2008).

141. UPIA, *supra* note 49, § 2(e), at 7 (conforming trust law with UMIFA); *see also* Jeffrey Haas, *When the Endowment Tanks: Some Lessons for Nonprofits*, *BUS. L. TODAY*, May–June 2003, at 19, available at <http://apps.americanbar.org/buslaw/blt/2003-05-06/haas.html> (discussing the enforcement of prudent conduct).

142. The general prudence obligation found in UPMIFA is not substantively different from that set forth in UMIFA, which required members of a governing board to exercise ordinary business care and prudence under the prevailing facts and circumstances. However, UPMIFA requires a number of factors to be taken into consideration when making decisions in order to ensure that such decisions are prudent. Though most if not all of these factors should have been taken into consideration when making decisions under UMIFA, their consideration is now explicitly required.

143. UPMIFA, *supra* note 9, §§ 3(b), 4(a), 5(a), at 11, 19, 29.

144. *Id.* at 1–2 (Prefatory Note); *see also* Harvey P. Dale, *Nonprofit Directors and Officers—Duties and Liabilities for Investment Decisions* (1993), in *NEW YORK UNIVERSITY TWENTY-SECOND CONFERENCE ON TAX PLANNING FOR 501(c)(3) ORGANIZATIONS 4-1* (1994). The third and latest edition of the Revised Model Nonprofit

regardless of whether a charitable organization is organized as a trust, a nonprofit corporation, or some other entity.”¹⁴⁵ This prudence standard focuses on process rather than outcome.¹⁴⁶

UPMIFA, like UPIA, enumerates factors that must be considered when making decisions regarding the management and investment of an institutional fund. It incorporates the factors set forth in UPIA with minor changes. Under UPMIFA, the following eight factors, if relevant, must be considered in managing and investing an institutional fund:

- (a) general economic conditions;
- (b) the possible effect of inflation or deflation;
- (c) the expected tax consequences, if any, of investment decisions or strategies;
- (d) the role that each investment or course of action plays within the overall investment portfolio of the fund;
- (e) the expected total return from income and appreciation of investments;
- (f) other resources of the institution;
- (g) the needs of the institution and the fund to make distributions and to preserve capital; and
- (h) an asset’s special relationship or special value, if any, to the charitable purposes of the institution.¹⁴⁷

In addition, like UPIA, UPMIFA imposes a duty to minimize costs. An institution “may incur only those costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution.”¹⁴⁸ UPMIFA does not provide guidance as to what might constitute “appropriate and reasonable” investment management costs. The commentary to UPMIFA notes that this provision, which tracks the language of section 7 of UPIA, allows an institution prudently to “incur costs by hiring an investment advisor, but the costs incurred should be appropriate under the circumstances.”¹⁴⁹

Corporation Act (RMNCA) was adopted in August 2008. MODEL NONPROFIT CORP. ACT (2009).

145. UPMIFA, *supra* note 9, at 1.

146. Under UPIA, fiduciaries must exercise “reasonable care, skill and caution.” This was changed to solely “care” in UPMIFA based on the formulation in the RMNCA. The comments to UPMIFA clarify that no difference was intended. *See id.* § 3 cmt., at 13–15.

147. UPMIFA, *supra* note 9, § 3(e)(1), at 11–12. For a discussion on UPMIFA’s support of mission-related investing, as evidenced by the requirement to consider an asset’s special relationship to the purposes of the institution, see Gary, *supra* note 12, at 1303–04.

148. UPMIFA, *supra* note 9, § 3(c)(1), at 11.

149. *Id.* § 3(c)(1) cmt., at 16.

UPMIFA also imposes a duty to investigate. An institution “must make a reasonable effort to verify facts relevant to the management and investment of the institutional fund.”¹⁵⁰ The drafters of UPMIFA note that this duty “requires persons who make investment and management decisions to investigate the accuracy of the information used in making such decisions.”¹⁵¹

e. NYPMIFA Approach

The Act applies the UPMIFA prudence standard, requiring that those responsible for managing and investing an institutional fund act in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.¹⁵² As was the case under prior law, NYPMIFA’s prudence standard focuses on the conduct of directors or their delegates in making investment decisions and not on the outcome of a particular investment.¹⁵³

The Act requires consideration of the same eight factors enumerated in UPMIFA in managing and investing an institutional fund.

In addition, consistent with UPMIFA and UPIA, NYPMIFA states that an institution may incur only those costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution, and must make a reasonable effort to verify facts relevant to the management and investment of the institutional fund.¹⁵⁴

Institutions may continue to invest their institutional funds in any kind of property or type of investment¹⁵⁵ and to pool two or more funds for investment and management purposes.¹⁵⁶ A donor, in the gift instrument, may limit the board’s freedom to invest the gift in any type of property or investment.¹⁵⁷

150. *Id.* § 3(c)(2), at 11.

151. *Id.* § 3(c)(2) cmt., at 16.

152. *See* N-PCL §§ 552(b), 553(a), 554(a) (McKinney Supp. 2014).

153. This means that as long as the decision-making process conforms to the standard of care and prudence required by the Act, the governing board will not be held responsible for the performance of chosen investments.

154. *See id.* § 552(c).

155. *Id.* § 552(e)(3).

156. *Id.* § 552(d).

157. *Id.* § 552(e). *But see* Langbein, *Limits on Settlor’s Power to Direct Investments*, *supra* note 74 (discussing limits on the donor’s ability to restrict investment decisions). Professor Langbein was the Reporter of the UPIA Drafting Committee. *See also infra* text accompanying note 170.

f. Legislative History

Under prior law, the prudence standard for investing was not set forth separately but rather was encapsulated within the general statutory provisions establishing fiduciary duty standards for directors and officers. NYPMIFA changes this by separately articulating, within the provisions of Article 5-A, the prudence standard for investing.¹⁵⁸

NYPMIFA also modifies the language used to describe of the prudence standard. The statement of the duty of care no longer employs the terms “diligence” and “skill” that were found in prior law; instead, NYPMIFA follows the linguistic formulation of the duty of care set forth in UPMIFA.¹⁵⁹ It is believed that elimination of those terms, however, was not intended to effect any substantive change to the duty of care.

2. Diversification

a. UMIFA and N-PCL: No Duty to Diversify

Neither UMIFA nor the N-PCL (prior to enactment of NYPMIFA) contained statutory language requiring diversification of assets. However, as modern portfolio theory evolved in practice, courts began to examine whether there was a duty to diversify as an element of prudence.¹⁶⁰

b. UPIA

In the 1990s, prudence norms were revised in response to further advances in modern portfolio theory.¹⁶¹ Modern portfolio theory posits that portfolio diversification reduces the risk inherent in any single investment.¹⁶² UPIA requires fiduciaries to diversify assets unless they reasonably determine that it is in the interest of the trust not to diversify.¹⁶³ The comments to UPIA explain that diversification is

158. See N-PCL §§ 552(b), 553(a), 554(a); see also *id.* § 717(a).

159. See N-PCL § 552(b).

160. See *In re Newhoff*, 486 N.Y.S.2d 956 (App. Div. 1985) (holding that investment of trust funds in a single security, with other elements of hazard, could be the basis for a finding of imprudence); *In re Estate of Janes*, 681 N.E.2d 332 (N.Y.1997) (holding that, although there is no “absolute rule” requiring diversification, it was imprudent not to diversify on the facts of the case). For further discussion of diversification and the “economics of social investing,” see John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 77–83 (1980).

161. See Langbein, *Limits on Settlor’s Power to Direct Investments*, *supra* note 74, at 387–91.

162. See Macey, *supra* note 12; see also UPIA, *supra* note 49, § 3 cmt., at 10–12.

163. See UPIA, *supra* note 49, § 3, at 10. The diversification requirement was adopted in New York with respect to trusts in § 11-2.3(b)(3)(C) of the New York

one of the fundamental elements of prudent investing, but that particular facts and circumstances may overcome the duty to diversify.¹⁶⁴ As an example, the comments to UPIA note that the wish to retain a family business may be a situation in which the purposes of the trust override the duty to diversify.¹⁶⁵ The comments also state that “‘there is no automatic rule for identifying how much diversification is enough’” though “broader diversification is usually to be preferred in trust investing” and “pooled investment vehicles ‘make thorough diversification practical for most trustees.’”¹⁶⁶

The market, however, only rewards what is sometimes called systemic, rather than specific, risk. For example, equities in general are more volatile than fixed-income securities, and over long time periods holders of a basket of equities can expect, with a high degree of confidence, to earn more than holders of bonds (This is sometimes referred to as the “equity premium.”). However, the market does not generally reward an investor who selects and holds only the stock of, for example, the Ford Motor Company rather than a diversified portfolio of stocks. Empirical studies have shown that security-specific risk is not compensated in the market. A prudent fiduciary would not expose a portfolio to risk without a commensurate expectation of reward.¹⁶⁷

Estates, Powers and Trusts Law. Passed in 2001, UPIA was effective in New York on January 1, 2002. EPTL § 11-2.3 Historical and Statutory Notes (McKinney Supp. 2014).

164. See UPIA, *supra* note 49, § 3 cmt., at 10–11.

165. *Id.* at 11.

166. *Id.* (quoting RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 general note on cmts. e–h (1992)).

167. As the comments to the UPIA express it:

Modern portfolio theory divides risk into the categories of “compensated” and “uncompensated” risk. The risk of owning shares in a mature and well managed company in a settled industry is less than the risk of owning shares in a start-up high-technology venture. The investor requires a higher expected return to induce the investor to bear the greater risk of disappointment associated with the start-up firm. This is compensated risk—the firm pays the investor for bearing the risk. By contrast, nobody pays the investor for owning too few stocks. The investor who owned only international oils in 1973 was running a risk that could have been reduced by having configured the portfolio differently—to include investments in different industries. This is uncompensated risk—nobody pays the investor for owning shares in too few industries and too few companies. Risk that can be eliminated by adding different stocks (or bonds) is uncompensated risk. The object of diversification is to minimize this uncompensated risk of having too few investments. “As long as stock prices do not move exactly together, the risk of a diversified portfolio will be less than the average risk of the separate holdings.”

UPIA, *supra* note 49, § 3 cmt., at 11 (quoting R.A. BREALEY, AN INTRODUCTION TO RISK AND RETURN FROM COMMON STOCKS 103 (2d ed. 1983)). This quotation is sub-

Thus, diversification is crucial because it avoids security-specific (and therefore uncompensated) risk while maintaining (and permitting calibration of) systemic (and therefore compensated) risk. Diversification involves holding securities that exhibit at least some degree of negative co-variance, that is, whose market values are not likely to fluctuate the same amount in the same direction at the same time.

c. *UPMIFA*

UPMIFA requires, except as otherwise provided in a gift instrument, that an institution “diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification.”¹⁶⁸ The comments to UPMIFA indicate that this provision derives directly from UPIA, in that it assumes that prudence requires diversification but allows an institution not to diversify under exceptional circumstances.¹⁶⁹ Furthermore, a decision not to diversify “must be based on the needs of the charity and not solely for the benefit of a donor.”¹⁷⁰ A decision to retain property “in the hope of obtaining additional contributions from the same donor may be

ject to some criticism, however, because the risk of owning shares either in a “mature and well managed company” or in “a start-up high-technology venture” would depend not only on the nature of the company but on the price being paid for the shares.

168. UPMIFA, *supra* note 9, § 3(e)(4), at 13.

169. *See id.* § 3(e)(4) cmt., at 17–18.

170. *Id.* This comment may contradict the statutory language indicating that the requirement to diversify is subject to the intent of the donor as expressed in the gift instrument. However, there is scholarly disagreement about whether a donor may require non-diversification, and some commentators argue that it is unclear whether a court would enforce a provision in a gift instrument that requires non-diversification. See the arguments and responses in the following series of articles: John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1113–14 (2004); Jeffrey A. Cooper, *Speak Clearly and Listen Well: Negating the Duty to Diversify Trust Investments*, 33 OHIO N.U. L. REV. 903 (2007); Jeffrey A. Cooper, *Empty Promises: Settlor’s Intent, the Uniform Trust Code, and the Future of Trust Investment Law*, 88 B.U. L. REV. 1165 (2008); Langbein, *Limits on Settlor’s Power to Direct Investments*, *supra* note 74; Jeffrey A. Cooper, *Shades of Gray: Applying the Benefit-the-Beneficiaries Rule to Trust Investment Directives*, 90 B.U. L. REV. 2383 (2010). The authors of this article believe that a direction in a gift instrument not to diversify would override the default rule in UPMIFA requiring diversification, except where such override is against public policy. *See also* Shelton v. Tamposi, No. 316-2007-EQ-2109, at *33 (N.H. Prob. Ct. Aug. 18, 2010), available at <http://www.courts.state.nh.us/caseinfo/pdf/civil/08182010tamposi.pdf> (holding that the trust instrument may “alter[] or eliminate[] provisions of the prudent investor rule that would otherwise disallow the investment in under-diversified assets”). *But see In re Estate of Janes*, 681 N.E.2d 332 (N.Y.1997) (holding that, although there is no “absolute rule” requiring diversification, it was imprudent not to diversify on the facts of the case).

considered made for the benefit of the charity, but the appropriateness of that decision will depend on the circumstances.”¹⁷¹

d. NYPMIFA

The Act adopts UPMIFA’s diversification language. However, the Act adds an additional non-uniform requirement that an institution “review a decision not to diversify an institutional fund as frequently as circumstances require, but at least annually.”¹⁷²

e. Legislative History

During the drafting of NYPMIFA the requirement to diversify was extensively discussed. Concerns were raised regarding the ability of an institution to determine prudently not to diversify, especially in light of then-current reports of the evisceration of institutional funds due to non-diversified investments in fraudulent investment schemes.¹⁷³ As a consequence, the statute was modified to require review, at least annually, of a decision not to diversify.¹⁷⁴ An additional drafting suggestion—for the addition of a provision requiring an institution to diversify investments unless it was “clearly prudent” not to do so—was rejected for two reasons: (1) a definition of the difference between “prudent” and “clearly prudent” would then have been required, and (2) there was no consensus about what such a definition would provide.

171. UPMIFA, *supra* note 9, § 3(e)(4) cmt., at 17–18.

172. N-PCL § 552(e)(4) (McKinney Supp. 2014).

173. The fraud committed by the investment firm Bernard L. Madoff Investment Securities severely impacted a number of not-for-profit corporations in New York, causing some to cease activities permanently due to a loss of virtually all of their assets. See Stephanie Strom, *Wall St. Fraud Leaves Charities Reeling*, N.Y. TIMES, Dec. 15, 2008, at A1. One past Assistant Attorney General of New York took the position that the adoption of UPMIFA might increase the risk of another Madoff-type Ponzi scheme. See William Josephson, Letter to the Editor, *State Law Rewards Profligate Charities*, CHRON. PHILANTHROPY, Nov. 12, 2009 [hereinafter Josephson, *State Law Rewards Profligate Charities*]. However, three other former Assistant Attorneys General of New York disagreed in a letter circulated widely to members of the New York State Legislature. Letter from Sean Delaney, Daniel L. Kurtz and Gerald A. Rosenberg to Members of the New York State Legislature (June 17, 2009) (on file with authors).

174. This non-uniform addition may be a signal that the standards for deciding not to diversify are more stringent in New York than in other states.

3. *Special Skills or Expertise*

a. *UMIFA and N-PCL*

If an individual who manages or invests institutional funds possesses special skills or expertise, UMIFA and the N-PCL (prior to enactment of NYPMIFA) imposed no explicit duty on the individual to use such skills or expertise. However, special skills or background of directors or officers could be relevant in evaluating compliance with the duty of care.¹⁷⁵ Section 717(b) of the NPCL (retained by NYPMIFA) allows directors and officers, when acting in good faith, to rely on information presented by officers or employees, external agents, or committees of the board.¹⁷⁶ However, directors and officers are “not considered to be acting in good faith if they have knowledge concerning the matter in question that would cause such reliance to be unwarranted.”¹⁷⁷

b. *UPIA*

Trust law has a long history of drawing distinctions between the expertise of amateur and professional trustees. The standard of conduct for professional trustees is deemed to be the standard of prudent professionals, while the standard of conduct for amateur trustees is the standard of prudent amateurs.¹⁷⁸ UPIA requires trust fiduciaries to use the special skills or expertise they have, or represent that they have, in carrying out their duties.¹⁷⁹

c. *UPMIFA*

UPMIFA’s rule, based on that found in UPIA,¹⁸⁰ requires a person possessing special skills or expertise, or one who has been selected in reliance on that person’s representation of possessing such skills or expertise, to use those skills or expertise in managing and investing institutional funds.¹⁸¹ The UPMIFA comments, quoting the comments set forth in the Revised Model Nonprofit Corporation Act,

175. See MODEL BUS. CORP. ACT § 8.30 cmt. (2005); MODEL NONPROFIT CORP. ACT § 8.30(b) cmt. (2009) (stating that the special background and qualifications of a particular director may be relevant in evaluating that director’s compliance with the duty of care).

176. See N-PCL § 717(b) (McKinney 2005). This provision was not amended by NYPMIFA.

177. *Id.*

178. See UPIA, *supra* note 49, § 2(f) cmt., at 9–10.

179. *Id.* § 2(f), at 7. This provision was codified in New York with respect to trusts in § 11-2.3(b)(6) of the New York Estates, Powers and Trusts Law.

180. UPMIFA, *supra* note 9, § 3(e)(6) cmt., at 18–19.

181. See *id.* § 3(e)(6), at 13.

indicate that the statement of director duties set forth therein relates “not only to the circumstances of the corporation but to the special background, qualifications, and management experience of the individual director and the role the director plays in the corporation.”¹⁸² Moreover, “the intent . . . is that a person managing or investing institutional funds must use the person’s own judgment and experience, including any particular skills or expertise, in carrying out the management and investment duties.”¹⁸³

d. NYPMIFA

NYPMIFA adopts exactly the same formulation as that in UPMIFA.

4. Investment Policy

Under NYPMIFA, not-for-profit corporations are required, for the first time, to adopt a written investment policy.¹⁸⁴ The Act specifies that the policy must reflect the requirements of the Act¹⁸⁵ and be taken into consideration when appropriating funds for expenditure from an endowment fund.¹⁸⁶

This new provision was proposed by the regulators at the Charities Bureau who believed that, since the Act requires governing boards to weigh the prudence factors, (1) it is fair to ask them to set forth in writing how they do so and (2) doing so could enhance regulators’ ability to enforce the statute. In contrast, the authors continue to believe that—since institutions are already required to consider the prudence factors and to document contemporaneously the consideration given to them when appropriating from an endowment fund—it is unclear what this provision adds, and it dramatically increases the likeli-

182. *Id.* (quoting MODEL NONPROFIT CORP. ACT § 8.30(a)(2) cmt. (2009)) (internal quotation marks deleted).

183. *Id.*

184. *See* N-PCL § 552(f) (McKinney Supp. 2014). There was no requirement to adopt a written investment policy in UMIFA, the N-PCL (prior to NYPMIFA’s enactment), or UPMIFA. The New York Attorney General’s Charities Bureau offered little specificity in its guidance on NYPMIFA regarding investment policies, stating simply “[t]here is no ‘one size fits all’ investment policy that applies to all institutions.” AG GUIDE, *supra* note 64, at 14. The AG Guide provides factors that should be considered in drafting the investment policy and ten examples of topics a policy might cover. *Id.* The AG Guide also notes that an organization’s “board should review the investment policy at regular intervals” and make necessary changes. *Id.* For further discussion, including direction that all institutions adopt an investment policy even if they do not have any investments, see Lowden, *supra* note 101, at 233.

185. *See* N-PCL § 552(f).

186. *See id.* § 553(a)(8).

hood of inadvertent non-compliance. As with many of the other non-uniform provisions enacted as part of NYPMIFA, the requirement to adopt a written investment policy will pose no meaningful burden for large, well-advised institutions but is likely to result in inadvertent non-compliance by a large number of smaller institutions. Thus, the provision, although perhaps intended to create a bright-line requirement, instead seems likely only to create an enforcement tool that can be wielded at the largely unfettered discretion of the Attorney General against small, uninformed institutions, or institutions maintaining only bank accounts (and not investments), that may inadvertently fail to comply.¹⁸⁷

*D. Appropriation for Expenditure or Accumulation
of Endowment Fund*

In general, the rules set forth in UMIFA, UPMIFA, and NYPMIFA apply to all institutional funds. However, special rules exist with respect to an institution's "endowment funds" (i.e., institutional funds not wholly expendable by the institution on a current basis under the specific terms of the applicable gift instrument).

1. Elimination of Historic Dollar Value

The following discussion traces the evolution of the concept of historic dollar value, from creation to extinction.

a. UMIFA

Institutional funds can include both restricted and unrestricted funds. Funds that are restricted by the donor such that they cannot be spent currently are called "endowment funds."¹⁸⁸ Under UMIFA, an institution was permitted to spend the "income" earned by an endowment fund (e.g., interest, dividends, rents, and royalties), and generally could spend the net appreciation, realized and unrealized; however the endowment fund's "historic dollar value" had to be preserved.¹⁸⁹ The authority of the institution to appropriate appreciation could be limited

187. See *supra* note 101 (noting that nearly all funds held by an institution are institutional funds subject to the Act). The authors believe that under the Act, all institutions are required to adopt a written investment policy.

188. UMIFA defined an "endowment fund" as "an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the specific terms of the applicable gift instrument." UMIFA, *supra* note 11, § 1(3), at 3. In common parlance, governing boards may designate funds as "endowment funds," but these funds do not constitute "endowment funds" under the acts.

189. See *id.* § 2, at 7–8. For further discussion on the effect of UMIFA's definition of "historic dollar value" and its effect on institutions, see Steven J. Riekes, *Is the Law*

by the applicable gift instrument.¹⁹⁰ This meant that institutions had to track three “buckets” of assets: income, realized and unrealized appreciation, and HDV.

Prior to the promulgation of UMIFA, the term “income” itself lacked a clear meaning, since generally corporate law included capital gains in income while trust law did not.¹⁹¹ Many institutions then applied trust accounting principles to appropriation decisions—for example, treating “income” as including interest and dividends but not capital gains (realized or unrealized), which were instead allocated to principal.¹⁹² Applying this trust-law definition of income to not-for-profit corporations limited such institutions’ ability to invest endowment assets effectively, because those responsible for managing and investing endowment funds had an incentive to invest for current “income” (as then narrowly defined) rather than for total return (which would include the long-term growth that would be more likely to enhance the endowment fund’s real purchasing power).¹⁹³

UMIFA addressed this issue by adopting an interpretation of “income” that included realized and unrealized appreciation,¹⁹⁴ and incidentally by creating the term “historic dollar value” to identify the original dollar value of all contributions to an endowment fund. UMIFA’s HDV rule used HDV as a floor, authorizing institutions to appropriate for expenditure as much of the value of the endowment fund above HDV as was prudent within the meaning of UMIFA. The HDV rule was intended to provide a safety mechanism against spending down an endowment fund so that the assets would be available

Causing Charities to Drown Because Their Endowment Funds are Now “Under Water”?, 43 CREIGHTON L. REV. 529, 530–32 (2010).

190. See UMIFA, *supra* note 11, § 3, at 8. Appropriation of income and appreciation could only be authorized if the proposed appropriation met the prudence standard set forth in UMIFA. If the value of an endowment fund fell “underwater,” or below its HDV, appreciation was no longer available for appropriation, and many believed that future appreciation, in accordance with prudence, had to be allocated to the endowment fund until it was returned to or above its HDV. See *id.* § 2, at 7–8; see also Budak & Gary, *supra* note 77; N.Y. DEP’T OF LAW, ADVICE FOR NOT-FOR-PROFIT CORPORATIONS ON THE APPROPRIATION OF ENDOWMENT FUND APPRECIATION (2009), available at <http://www.charitiesnys.com/pdfs/endowment.pdf>. For a discussion of what it means for an endowment fund to be “underwater,” see *supra* text accompanying notes 76–80.

191. See *infra* note 221 and accompanying text; see also Gary, *supra* note 12, at 1307–08; CARY & BRIGHT, LAW AND LORE OF ENDOWMENT FUNDS, *supra* note 119, at 27–30.

192. See Gary, *supra* note 12, at 1307–08.

193. See *id.*

194. For further discussion on the UMIFA rule of construction, see *infra* text accompanying notes 217–224.

over the life of the fund as presumably intended by the applicable gift instrument.

b. N-PCL

The N-PCL adopted the basic premise of appropriation set forth in UMIFA. Section 513(c) of the N-PCL (prior to enactment of NYPMIFA) permitted the governing board to appropriate for expenditure realized appreciation (with respect to all assets) and unrealized appreciation (with respect only to readily marketable assets) in the fair value of the assets of an endowment fund.¹⁹⁵ Section 102(a)(13) clarified that an “endowment fund” was governed by the specific terms of all applicable gift instruments.¹⁹⁶ “Historic dollar value” was defined in the same language as in UMIFA.¹⁹⁷

c. UPMIFA

One of UPMIFA’s most important changes is the elimination of the HDV rule. UPMIFA provides that an institution “may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines”—subject to the intent of the donor expressed in a gift instrument¹⁹⁸—“is prudent for the uses, benefits, purposes and duration for which the endowment fund is established.”¹⁹⁹

In making a decision to appropriate or accumulate, an institution must act in accordance with the prudence standard set forth in UPMIFA.²⁰⁰ UPMIFA requires consideration of the following seven factors, if relevant, in making a decision to appropriate or accumulate an endowment fund:

- (1) the duration and preservation of the endowment fund;
- (2) the purposes of the institution and the endowment fund;
- (3) general economic conditions;

195. See N-PCL § 513(c) (McKinney 2005) (repealed 2010). UMIFA allowed for appropriation of net appreciation, both realized and unrealized. The N-PCL limited this as stated in the text above.

196. See *id.* § 102(a)(13) (repealed 2010).

197. See *id.* § 102(a)(16).

198. UPMIFA defines “gift instrument” as “a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund.” UPMIFA, *supra* note 9, § 2(3), at 6. For this purpose, “‘record’ is an expansive concept and means a writing in any form, including electronic.” *Id.* § 2(3) cmt., at 8–9. Oral evidence, however, is not applicable to a determination of donor intent under UPMIFA.

199. *Id.* § 4(a), at 19.

200. *Id.* For discussion about spending policy under UPMIFA, see Cynthia Rowland, *UPMIFA, Three Years Later*, 18 A.B.A. SEC. BUS. L. 41 (2009), available at <http://apps.americanbar.org/buslaw/blt/2009-07-08/rowland.shtml>.

- (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; and
- (7) the investment policy of the institution.²⁰¹

These seven factors are considerably more detailed than those that were set forth in UMIFA. They emphasize the purpose of the fund in question, as designated by the donor, rather than the purpose of the institution as a whole, which was the case under UMIFA.²⁰² Furthermore, factors such as “the duration and preservation of the endowment fund” and “the purposes of the institution and the endowment fund” focus on the long-term nature of endowment funds and the need to consider maintaining purchasing power.²⁰³

Disincentives to prudent investing and appropriation that arose under UMIFA led to UPMIFA’s repeal of the HDV rule. Experience demonstrated that, in application, the HDV rule was an artificial and arbitrary distinction. Under UMIFA, once an endowment fund went underwater, appreciation could no longer be appropriated. This created an incentive for institutions with underwater endowments to invest for current income (such as in securities that pay high interest or dividends) rather than for appreciation. This sometimes resulted in a situation where the value of endowment funds so invested could not keep up with inflation. Conversely, the HDV rule had little application to institutions with significantly appreciated endowment funds where fair market value was far greater than HDV. For these organizations, UMIFA’s HDV rule did not provide much of a back-stop.

The UPMIFA drafting committee “concluded that a prudence standard coupled with more detailed guidance than is found in UMIFA would provide the best rule to govern endowment spending.”²⁰⁴ It was believed that “[t]he elimination of historic dollar value should not lead to overspending of endowment funds.”²⁰⁵

201. UPMIFA, *supra* note 9, § 4(a), at 19. The factors enumerated with respect to the appropriation authority set forth in UPMIFA are similar, but not identical, to those set forth in UPMIFA relating to the investment management of institutional funds. *See id.* § 3(e)(1), at 11–12.

202. *See* Rachel M. Williams, Note, *Transitioning from UMIFA to UPMIFA: How the Promulgation of the Uniform Prudent Management of Institutional Funds Act Will Affect Donor-Initiated Lawsuits Brought Against Colleges and Universities*, 37 J.C. & U.L. 201, 213 (2010).

203. *See* Gary, *supra* note 12, at 1310. Because UPMIFA repeals the HDV rule, maintenance of purchasing power is only a factor to consider rather than a mandate.

204. *Id.*

205. *Id. Contra* William Josephson, *Uniform ‘Imprudent’ Management of Institutional Funds Act*, N.Y. L.J., June 11, 2009, at 1 [hereinafter Josephson, *Uniform ‘Im-*

d. NYPMIFA

The Act codifies UPMIFA's elimination of the HDV rule and tracks UPMIFA's approach to appropriation decisions regarding endowment funds²⁰⁶ through a prudence standard combined with factors for consideration by the governing board (or a committee thereof).²⁰⁷ The Act requires, if relevant, consideration of eight factors, in contrast to UPMIFA's seven, in making decisions regarding appropriation or accumulation of an endowment fund.²⁰⁸ The additional factor unique to NYPMIFA requires consideration, "where appropriate and circumstances would otherwise warrant . . . [of] alternatives to [the] expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the institution."²⁰⁹ The Act also includes a non-uniform provision requiring an institution to keep a contemporaneous record describing the consideration given to each of the factors.²¹⁰ As in UPMIFA, all appropriation and accumulation decisions are subject to the intent of a donor expressed in a gift instrument.²¹¹

e. Legislative History

The elimination of the HDV rule was the subject of much debate during the drafting of NYPMIFA. Those in favor, including cIcu, its constituents, and the authors, noted the arbitrary nature of the distinc-

prudent' Management of Institutional Funds Act]. See generally Debra E. Blum, *New State Laws Give Charities More Wiggle Room on Endowment Spending*, CHRON. PHILANTHROPY, Sept. 17, 2009, at 10.

206. NYPMIFA defines "endowment fund" in substantially the same language as the term is defined in UPMIFA. As under UPMIFA, an "endowment fund" does not include assets that an institution itself designates as not expendable on a current basis. A restricted purpose or use fund (i.e., one that is limited by the gift instrument to a specific purpose or use, such as to support scholarships) is not an endowment fund unless the donor also intended and expressed the intention in a written gift instrument to restrict timing of the fund's expenditures as well as its purposes. See N-PCL § 551(b) (McKinney Supp. 2014).

207. New York allows a governing board to delegate investment, management and appropriation authority to its committees. For further discussion on internal delegation, see *infra* text accompanying notes 298–300.

208. See N-PCL § 553(a).

209. *Id.* § 553(a)(7).

210. See *id.* § 553(a). According to the Charities Bureau, "conclusory" statements are not enough; the "substance of the consideration" of each factor must be recorded. The *AG Guide* emphasizes that the "form of the record is less important than the substance," and that either board minutes or a specifically designed recording procedure will suffice. The records "should be maintained as permanent records of the institution" and should be available to the Charities Bureau upon request. See *AG GUIDE*, *supra* note 64, at 12–13.

211. See N-PCL § 553(a).

tion between HDV and “income” and argued that this distinction contradicts the donor’s overarching intent to provide resources for the institution’s beneficiaries, particularly in times of economic hardship. Those favoring retention of the HDV rule raised concerns about the donor’s possible intent to preserve original dollar value and about the potential for imprudent spending by an institution not subject to a spending limit.²¹² The debate focused on three issues: (i) possible alternatives to elimination of the HDV rule, (ii) the importance of minimizing invasion of HDV, and (iii) the need for documentation of appropriation decisions.

The Charities Bureau questioned whether there were other means available, outside of codifying UPMIFA in New York, whereby institutions could gain access to endowment funds that were “underwater.”²¹³ The regulators noted that an institution could petition the courts under a *cy pres* theory²¹⁴ to access endowment funds that were otherwise restricted. Supporters of the elimination of the HDV rule, including the authors, responded by identifying the substantial investments of time, effort, and expense that *cy pres* proceedings involve.

The Charities Bureau then proposed adding a factor to create an obligation to consider alternatives before making a decision to appropriate from HDV (e.g., cutting expenses, borrowing). They argued that invasion of HDV should be minimized and that an endowment is less likely to be spent down imprudently if its managers are required to focus on alternatives first.

The authors and others raised the concern that such a requirement would result in NYPMIFA’s retention of the concept of HDV when one of the most significant contributions of UPMIFA is its elimination. The authors argued that the premise of the prudence considerations and the concept of investing for total return demonstrate that HDV is irrelevant to the prudent maintenance of an endowment fund, and that it is not possible to go to a total-return approach while retaining the concept of HDV. Ultimately, a compromise resulted: the HDV rule was repealed but the non-uniform eighth factor was added to the Act.²¹⁵

212. See Josephson, *Uniform ‘Imprudent’ Management of Institutional Funds Act*, *supra* note 205, at 1.

213. For a discussion of what it means for an endowment fund to be “underwater,” see *supra* text accompanying notes 76–79. See also Budak & Gary, *supra* note 77.

214. For a discussion regarding *cy pres* proceedings, see *infra* text accompanying notes 308–40.

215. See *supra* text accompanying note 206–208. The language of the eighth factor reflects a balance, mandating that alternatives to expenditure be considered but limiting that mandate to appropriate circumstances. Furthermore, the institution may take

Finally, it was suggested that a record be kept of the consideration of each of the factors at the time of the appropriation decision. The regulators at the Charities Bureau initially suggested requiring an institution to keep a contemporaneous record describing the nature and extent of the consideration of each factor. Concerns were raised regarding the level of detail that this would involve. As adopted, NYPMIFA enacts a non-uniform provision that there be contemporaneous documentation of the consideration given to each of the prudence factors prior to appropriation from an endowment fund.²¹⁶ The authors believe, and guidance released by the Attorney General confirms, that the institution may consider the factors for, and appropriate from, multiple similarly-situated endowment funds simultaneously (e.g., by application of a spending rate). The authors believe that the documentation requirement may be met through a description in the minutes of the meeting of the consideration given to the factors. The record should also include the rationale for any determination that a factor was not relevant to the decision.

2. *Ability to Appropriate for Expenditure*

Due to the elimination of the HDV rule, UPMIFA also had to update the rules regarding interpretation of gift instruments.

a. *UMIFA*

While UMIFA allowed institutions to appropriate the net appreciation of an endowment fund, this ability to appropriate net appreciation was explicitly subject to the intent of the donor as expressed in the applicable gift instrument.²¹⁷ Because the donor's intent governed, UMIFA supplied a set of default rules governing those areas where a donor's intent was not expressed or was not clear.

into account the impact that the potential alternatives could have on the purposes of the institution. The authors believe this means that an institution should consider things like cost-cutting, program elimination, and staff reduction prior to appropriating from an endowment, but may determine that such measures would be imprudent due to their adverse impact. The New York Attorney General's Charities Bureau has explained that, in its view, inclusion of this factor "was intended to ensure that boards do not automatically decide to appropriate from endowment funds when circumstances warrant considering whether reasonable alternatives are available." AG GUIDE, *supra* note 64, at 12. Notably, the *AG Guide* illustrates this via the example of "an endowment fund [that] has diminished in value," stating that instead of continuing to spend the endowment, the board might alternatively want to consider cost-cutting measures and fund-raising efforts. *Id.*

216. N-PCL § 553(a) (McKinney Supp. 2014).

217. UMIFA, *supra* note 11, § 3, at 8.

The meaning of “income” in a gift instrument is often an example of an area where the donor’s intent is not clear. Legal boilerplate tends to use “income only” or similar language to describe an endowment gift. In part because lawyers rely on older forms and in part because investing for total return is still not widely understood, such anachronistic language is common. Seldom, however, does it represent a conscious choice of the donor.²¹⁸ At the time of the drafting of UMIFA, the term “income” had multiple meanings, some of which considered appreciation in value a part of income and some of which did not.²¹⁹ As a result, where a donor used terms like “endowment” or “income” or “keep the principal and spend income,” confusion existed as to what portion of the endowment fund an institution could prudently appropriate for expenditure.²²⁰ The reporter for UPMIFA explained that it was believed that, in general, the intent of the donor in establishing an endowment fund was to “create a fund that [would] generate sufficient total returns to be able to make ongoing distributions from the fund while at the same time preserving the purchasing power of the fund.”²²¹ UMIFA therefore included a rule of construction to effectuate this assumption regarding donor intent by deeming income to include a prudent amount of appreciation in value, both realized and unrealized.²²² UMIFA stated that a restriction on the expenditure of net appreciation “may not be implied from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only ‘income,’ ‘interest,’ ‘dividends,’ or ‘rents, issues or profits,’ or ‘to preserve the principal intact,’ or a direction which contains other words of similar import.”²²³ This UMIFA rule

218. Recognizing this, section 4(c) of UPMIFA “assumes that if a donor wants an institution to spend ‘only the income’ from a fund, the donor intends that the fund both support current expenditures and be preserved permanently. The donor is unlikely to be concerned about designation of particular returns as ‘income’ or ‘principal’ under accounting principles. Rather the donor is more likely to assume that the institution will use modern total-return investing techniques to generate enough funds to distribute while maintaining the long-term viability of the fund.” UPMIFA, *supra* note 9, § 4(c) cmt., 23–24.

219. Susan N. Gary, *The Problems with Donor Intent: Interpretation, Enforcement, and Doing the Right Thing*, 85 CHI.-KENT L. REV. 977, 1015–16 (2010).

220. In contrast, if a donor says, “‘hold this money as an endowment and use four percent from the endowment each year for your charitable purposes,’” the donor has given clear direction. Gary, *supra* note 12, at 1311.

221. *Id.* at 1311–12.

222. See UPMIFA, *supra* note 9, § 4 cmt., at 21.

223. UMIFA, *supra* note 11, § 3, at 8. For an example of application of the UMIFA rule of construction regarding the meaning of “income,” see *Robertson v. Princeton Univ.*, No. C-99-02, slip op. at 37 (N.J. Super. Ct. Ch. Div. 2007), available at http://www.princeton.edu/robertson/documents/docs/Article_11c_Summary_Judgment_Decision.pdf. The authors were involved, as counsel or expert witness, in the litigation in

applied retroactively as well as prospectively, i.e., it applied to gift instruments executed both before and after UMIFA's effective date.²²⁴

b. N-PCL

The N-PCL codified UMIFA's rule of construction without change.²²⁵

c. UPMIFA

UPMIFA, like UMIFA, requires donor intent to be respected when an institution makes decisions regarding accumulating or appropriating from its endowment funds. A donor may limit or totally prevent the application of UPMIFA's appropriation rules by specifically stating the limitation in the gift instrument.²²⁶

Comments to UPMIFA state that section 4(c) "provides rules of construction to assist institutions in interpreting donor's intent."²²⁷ If a donor expresses the desire for an institution to spend only income, section 4(c) interprets that to mean that the donor intends the fund to "support both current expenditures and be preserved permanently" as well as that the institution will take a "total-return" investment approach to generate sufficient funds to support activities while maintaining the long-term nature of the fund.²²⁸ The drafters identify section 4(c) as "an intent effectuating provision that provides default rules to construe donor's intent."²²⁹

Section 4(c) differs, then, from most of the other sections in NYPMIFA. The others set forth what may be thought of as substantive legal rules that will apply, by default, if the donor does not otherwise provide a statement of intent in the gift instrument. By contrast, section 4(c) sets forth a rule of interpretation that cannot be overcome by virtue of the donor expressing intent through the legal boilerplate term "income" or similar language. If the gift instrument's language on its face appears to limit expenditure to "income" or the like, that language will not be effective to create such a limitation. Instead, section 4(c) will interpret it as supporting a total-return approach under which not only "income" but also appreciation in value, both realized

question. The authors believe that the inclusion of "words of similar import" is intended to capture those words and phrases that, like "income," appear frequently in gift instruments but are really boilerplate language.

224. See UMIFA, *supra* note 11, § 3, at 8.

225. See N-PCL § 513(d) (McKinney 2005) (repealed 2010).

226. See UPMIFA, *supra* note 9, § 4(b), at 20.

227. *Id.* § 4(c) cmt., at 23.

228. *Id.*

229. *Id.*

and unrealized, may also be prudently expended. To overcome the section 4(c) interpretation rule, the gift instrument must contain other, more precise language that differs from or elaborates on the boilerplate language.²³⁰

Although under UPMIFA an institution may generally appropriate from an endowment fund without regard to HDV, it must comply with specific limitations set forth with sufficient clarity in a gift instrument. However, given section 4(c)'s rule of interpretation, specificity is now indispensable. UPMIFA's reporter has written that, for example, if a gift instrument provides for spending four percent of an endowment fund each year regardless of investment performance,²³¹ that would be sufficiently specific to control appropriation decisions.²³²

d. NYPMIFA

NYPMIFA generally follows UPMIFA's formulation word for word. However, concern for protecting presumed donor intent led to the adoption of additional language clarifying and softening UPMIFA's section 4(c) rule of interpretation. NYPMIFA states that terms in a gift instrument that set forth "a specific spending level, rate or amount," or that explicitly modify or override the appropriation rules of section 553(a), "will limit the authority of the institution to appropriate for expenditure or accumulate."²³³

e. Legislative History

During NYPMIFA's drafting, concerns were raised by former Assistant Attorney General in charge of the New York Charities Bureau, William Josephson, that the rule of construction in UPMIFA's Section 4(c) would override donor intent.²³⁴ Supporters of the rule of construction, including the authors, countered that the rule of con-

230. *Id.* Section 4(c) of UPMIFA lists several phrases that will be interpreted *not* as creating limitations on expenditure but rather as permitting total-return investing and expenditure. They are "'income,' 'interest,' 'dividends,' or 'rents, issues or profits,' or 'to preserve the principal intact,' or words of similar import." Such language, according to Section 4(c), "do[es] not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (a)." Compare this section to the RESTATEMENT (THIRD) OF TRUSTS ch. 23 (2012) (discussing "Accounting for Principal and Income").

231. This is a so-called unitrust spending standard.

232. See Gary, *supra* note 12, at 1311.

233. N-PCL § 553(b) (McKinney Supp. 2014).

234. See Josephson, *State Law Rewards Profligate Charities*, *supra* note 173; Josephson, *Uniform 'Imprudent' Management of Institutional Funds Act*, *supra* note 205, at 1.

struction actually works to effectuate donor intent. The rule of construction was enacted as part of NYPMIFA.

When a donor expresses intent clearly in a gift instrument, the Act requires the institution to adhere to the donor's instructions.²³⁵ If the donor's intent is unclear, the Act seeks to effectuate the donor's intent by directing the institution to spend an amount that is prudent, consistent with the purposes of the fund and relevant economic factors.²³⁶ This approach allows the institution to effectuate donor intent by protecting the endowment, promoting generational equity, and using the endowment to support the purposes for which the endowment was created.

f. Retroactive Application of the Rule of Construction

UMIFA applied the rule of construction retroactively, but applied it only to decisions made or actions taken after UMIFA's enactment.²³⁷ This meant that gift instruments in existence at the time of UMIFA's promulgation would thereafter be interpreted under the UMIFA rule of construction, but an institution's decisions made prior to UMIFA's drafting would not be examined under the UMIFA standard. When New Hampshire considered UMIFA, the New Hampshire Supreme Court rendered an advisory opinion stating that UMIFA's retroactive application of the rule of construction would not violate a provision of the state constitution prohibiting retrospective laws.²³⁸ New York's version of UMIFA also applied the rule of construction both retroactively and prospectively.²³⁹

UPMIFA's rule of construction also applies retroactively. Despite the precedent of retroactive application of UMIFA's rule of interpretation, concerns were raised anew during UPMIFA's drafting regarding the retroactive application of the rule of construction, both as to donor intent and constitutional issues. However, it was the opinion of the UPMIFA drafters that the rule of construction furthers rather than impedes donor intent. "UPMIFA seems as likely as UMIFA, [and hopefully] UPMIFA is more likely than UMIFA, to carry out the intent of donors who make gifts to endowments."²⁴⁰ Fur-

235. See *supra* note 234 and accompanying text.

236. See *supra* notes 207-209 and accompanying text.

237. See UMIFA, *supra* note 11, § 3, at 8.

238. See Opinion of the Justices, 306 A.2d 55, 57 (N.H. 1973), entered upon Request of the Senate No. 6667.

239. N-PCL § 513(d) (McKinney 2005) (repealed 2010).

240. Gary, *supra* note 12, at 1322 (providing an opinion as a drafter of UPMIFA).

ther, courts have held that retroactive application of constructional statutes do not raise constitutional concerns.²⁴¹

3. *Rebuttable Presumption of Imprudence*

UPMIFA includes an optional provision, neither contemplated by UMIFA nor prior law in New York, establishing a rebuttable presumption of imprudence for appropriating more than a specified portion of an endowment fund in any given year.²⁴² This provision states:

The appropriation for expenditure in any year of an amount greater than seven percent of the fair market value²⁴³ of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of not less than²⁴⁴ three years immediately preceding the year in which the appropriation for expenditure is made, creates a rebuttable presumption of imprudence.²⁴⁵

241. See *In re Estate of DeWitt*, 54 P. 3d 849 (Colo. 2002) (holding that retroactive application of a constructional statute did not violate the Contracts Clause); *In re Gardner's Trust*, 123 N.W. 2d 69, 75 (Minn. 1963) (finding no constitutional obstacles to retroactive application of a uniform act); see also Susan Gary, *Constitutional Issues and UPMIFA* (Feb. 16, 2009) (unpublished manuscript) (on file with authors).

242. A rebuttable presumption of imprudence did exist prior to the promulgation of UPMIFA in a small number of states, including Massachusetts, New Mexico and New Hampshire. Massachusetts enacted this rule in 1975 as part of its UMIFA statute. MASS. GEN. LAWS ch. 180A, § 2 (2004). New Mexico adopted the same presumption in 1978. N.M. STAT. ANN. § 46-9-2 (2004) (repealed 2009). New Hampshire had a similar provision. N.H. REV. STAT. ANN. § 292-B:6 (2009). It is interesting to note that the rule in Massachusetts, on which the UPMIFA optional provision was based, was repealed when Massachusetts enacted its version of UPMIFA. Compare 2009 Mass. Acts ch. 29 (repealing prior "chapter 180A" and inserting UMIFA), available at <http://www.malegislature.gov/Laws/SessionLaws/Acts/2009/Chapter29>, with 1975 Mass. Acts ch. 886 (enacting previous law). For a discussion of Massachusetts's enactment of UPMIFA, see Mintz Levin's Nonprofit Institutions Advisory, *Non-Profit Institutions Advisory: Massachusetts Enacts the Uniform Prudent Management of Institutional Funds Act*, MONDAQ, <http://www.mondaq.com/unitedstates/x/84214/Non-Profit+Institutions+Advisory+Massachusetts+Enacts+The+Uniform+Prudent+Management+Of+Institutional+Funds+Act> (last updated Aug. 5, 2009).

243. Amounts used to pay fund expenses do not have to be included in the computation of seven percent of the endowment fund's value. See Gary, *supra* note 12, at 1315.

244. The calculation for the rebuttable presumption is averaged over a period of not less than three years, which means that it could be more than three years. The institution's method for computing the presumption is determinative. See UPMIFA, *supra* note 9, § 4(d) cmt., at 26 ("The period that a charity uses to calculate the presumption (three or more years) and the frequency of valuation (at least quarterly) will be binding in any determination of whether the presumption applies.")

245. *Id.* § 4(d), at 20.

The nature of the presumption, and the standards for rebutting it, are discussed below.²⁴⁶

The presumption may be rebutted by the institution when circumstances in a particular year make expenditures above seven percent prudent.²⁴⁷ Appropriation otherwise permitted by law or under the terms of the gift instrument is exempt from the presumption.²⁴⁸ Appropriation of less than seven percent does not create a presumption of prudence.²⁴⁹

The UPMIFA Drafting Committee “debated at length whether to include a presumption of imprudence for spending above a fixed percentage of the value of the fund.”²⁵⁰ Those in favor of the seven percent rebuttable presumption of imprudence, as a bright-line rule for appropriate spending from an endowment fund, argued it could

curb the temptation . . . to spend endowment assets too rapidly. Although the presumption [is] rebuttable, and spending above the identified percentage might, in some years and for some [institutions], be prudent, institutions would likely be reluctant to authorize spending above seven percent. In addition, the presumption would give the attorney general a benchmark of sorts.²⁵¹

Those opposing the inclusion of the presumption believed that a “fixed percentage . . . might be perceived as a safe harbor that could lead institutions to spend more than is prudent.”²⁵² Additionally, they argued that recent economic conditions make identifying an appropriate number difficult because a spending rate of seven percent is typically too high but, in a period of high inflation, seven percent might be too low.²⁵³ Eventually, the UPMIFA Drafting Committee decided to include the presumption as an optional provision for states to consider.

a. NYPMIFA

New York adopted the optional seven percent rebuttable presumption, except that it chose a look-back of at least five years, rather

246. See *infra* text accompanying notes 260–65.

247. See UPMIFA, *supra* note 9, § 4(d) cmt., at 26.

248. See *id.*

249. See *id.*

250. *Id.* at 25.

251. *Id.*

252. *Id.*

253. *Id.* at 26. There may also be situations where an institution has an endowment fund of limited duration (e.g., where the donor has specified in the gift instrument that the entire gift should be spent within ten years). For such an endowment fund, a spending rate higher than seven percent is likely both necessary and prudent. See Gary, *supra* note 12, at 1306.

than UPMIFA's three years, for calculation purposes.²⁵⁴ In addition, NYPMIFA's presumption applies only to gift instruments executed on or after September 17, 2010.²⁵⁵ In codifying the rebuttable presumption of imprudence, New York joins a distinct minority (fifteen out of fifty as of March 2012) of the jurisdictions that have adopted UPMIFA.

b. Legislative History

The merits of the rebuttable presumption were debated throughout the process of drafting NYPMIFA. The regulators at the Charities Bureau supported including the presumption due to concerns regarding enforcement, suggesting that, without a bright-line rule, a regulator would not be able to know when an institution had appropriated imprudently.²⁵⁶

Those against including the optional rebuttable presumption, including the authors, argued that such a presumption might operate as a procrustean constraint on prudence. Anecdotal evidence suggests that mechanical limits on prudent spending are often inconsistent with donor intent.²⁵⁷ Another concern was disproportionate impact; for some institutions, the prior HDV rule was not a meaningful constraint because the HDV of their endowment funds was extremely low compared to current market value, so that the seven percent presumption imposes a more significant restriction than the HDV rule ever did.²⁵⁸ Furthermore, the presumption could be especially problematic in a

254. N-PCL § 553(d) (McKinney Supp. 2014).

255. *Id.* Thus, institutions may appropriate more than seven percent from endowment funds created prior to the enactment of NYPMIFA without triggering the presumption.

256. There was also discussion of enhanced disclosure on the annual reports most institutions must submit to state regulators (such as disclosure of the spending rate and how it was calculated), in order to facilitate oversight. With some exceptions (e.g., educational institutions not required to register with the Attorney General), not-for-profit corporations in New York must submit the CHAR500 annual report to the Attorney General. As of March 2014, it remains to be seen whether enhanced disclosure will be required.

257. When asked, donors have almost unanimously agreed that their gifts should be spent when needed, as determined prudently by the institution, rather than be constrained by the prior law's HDV rule. There is no reason to believe they would react differently if an institution were instead constrained by a 7% limitation.

258. Under UMIFA (as codified in prior section 513 of the N-PCL), an institution with an endowment fund established many years earlier often had significant appreciation that could be appropriated without concern as to the fund's HDV. Such an institution could appropriate, in accordance with UMIFA's prudence standard, more than seven percent of the endowment fund's fair market value. With a seven percent rebuttable presumption of imprudence, such an appropriation, even where it does not invade HDV, is presumptively imprudent.

high-inflation, high-interest environment. Finally, the limitation functions to favor tomorrow's beneficiaries at the expense of today's neediest.

There were extensive negotiations about whether the presumption should apply to endowments created prior to NYPMIFA's enactment. Some wanted the presumption to apply to all endowment gifts whenever created, while others argued that the presumption should not be included at all.²⁵⁹ The compromise was application of the rule only to gift instruments executed on or after September 17, 2010.

The practical burdens imposed on an institution by the seven percent presumption are somewhat unclear. According to UPMIFA's official commentary, the presumption of imprudence places only the burden of *production*—and explicitly not the burden of *persuasion*—on the institution “to demonstrate that its decision was prudent.”²⁶⁰ New York law is somewhat unclear on how much evidence must be produced in order to carry the burden of production and thus rebut the presumption. Some authorities appear to require that “substantial evidence” be adduced,²⁶¹ whereas others seem to require “clear and convincing” evidence.²⁶² Since the presumption only affects the burden of production, and not the burden of persuasion, it seems clear that an institution should not be required to produce a “preponderance” of the evidence for a successful rebuttal.

The presumption is triggered if the amount appropriated for expenditure exceeds 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

259. Initial drafts of NYPMIFA did not include the seven percent presumption of imprudence, and cIcu did not support inclusion of the presumption at any point during the process. However, others with input on the drafting of the Act were strongly in favor of including the presumption. After surveying its constituents and others in the not-for-profit community in New York, cIcu determined not to contest inclusion of the presumption in the final draft of the Act.

260. UPMIFA, *supra* note 9, § 4(d) cmt., at 26 (“The existence of the presumption does not shift the burden of persuasion to the charity.”)

261. *See* N.Y. WORKERS' COMP. LAW § 21 (McKinney 2010) (listing five presumptions rebuttable by substantial evidence); *Regency Realty Assocs., LLC v. Board of Assessment Review of Malta*, 905 N.Y.S.2d 710, 711 (App. Div. 2010) (presumption of tax assessment validity); *McDonald v. Rose*, 830 N.Y.S.2d 765, 783 (App. Div. 2007) (reading in standard of substantial evidence for permissive use of motor vehicles even though not explicit in statute); *City of New York v. 10-12 Cooper Square, Inc.*, 793 N.Y.S.2d 688, 690 (N.Y. Sup. Ct. 2004) (presuming regularity in official dealings); *Potter v. Kahler*, 219 N.Y.S.2d 522, 524 (N.Y. Sup. Ct. 1961) (stating as a general matter that “[t]he presumption growing out of a prima facie case, however, remains only so long as there is no substantial evidence to the contrary”).

262. *See, e.g., Drake v. Oslwyn*, 380 N.Y.S.2d 666, 666 (App. Div. 1976).

years”²⁶³ The choice of the frequency of valuation (at least quarterly) and length of time (not less than five years) is the institution’s and its decision on both is binding.²⁶⁴ The institution may use a different calculation for its other, customary expenditure decisions. For example, an educational institution may decide that it will usually spend 4.8% of the value of its endowment averaged over a three-year period. The Attorney General of New York appears to have confirmed that such a rule is acceptable for purposes other than for the statutory presumption of imprudence, but has stated that “[i]f necessary, institutions must perform a separate calculation, averaging the fund’s fair market value of at least the preceding five years, in order to determine whether a proposed appropriation would be presumptively imprudent.”²⁶⁵

4. Notice

For gift instruments executed by the donor before September 17, 2010, an institution must provide 90 days advance notice to the donor,²⁶⁶ if available,²⁶⁷ before appropriating from the applicable endowment fund for the first time.²⁶⁸ This is a requirement that appears only in NYPMIFA, and not in UMIFA, UPMIFA, or prior law.

The Act specifies that notification should be substantially in the form of statutorily prescribed boxes that the donor may check providing either that (a) the institution may spend as much of the endowment fund as is prudent, or (b) the institution may not spend below the original dollar value of the endowment gift.²⁶⁹ If the donor does not re-

263. N-PCL § 553(d) (McKinney Supp. 2014).

264. UPMIFA, *supra* note 9, § 4(d) cmt., at 26.

265. *See* AG GUIDE, *supra* note 64, at 13.

266. “Donor” means 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, transferees, or distributees. *See* N-PCL § 551(a-1). This definition is not found in UPMIFA. The Act does not specify whether notice needs to be given to “subsequent” donors who did not sign the original gift instrument but who later contributed to an existing endowment fund, and this issue was not discussed during the drafting of the Act.

267. “A donor is ‘available’ if such donor (a) is living, or if the donor is not a natural person, is in existence and conducting activities; and (b) can be identified and located with reasonable efforts.” *See id.* § 551(j). The definition of “available” is not included in UPMIFA. The Act does not elaborate on the meaning of “reasonable efforts,” but it is believed that this would include conducting Internet searches and contacting known associates of the donor. The New York Attorney General has issued guidance on this issue for institutions governed by NYPMIFA. *See* AG GUIDE, *supra* note 64, at 13.

268. *See* N-PCL § 553(e)(1).

269. *See id.* The phrase “original dollar value,” although linguistically different than ‘historic dollar value,’ should be interpreted to be the same as HDV. The New York

spond within ninety days from the date notice was given, the institution will not be subject to the original dollar value limitation.²⁷⁰ If the donor does respond, the institution must follow the donor's direction.²⁷¹

Notice is not required where (a) the gift instrument permits appropriation without regard to original dollar value, (b) the gift instrument limits the institution's ability to appropriate in accordance with the necessary limiting language (e.g., a specific spending rate), or (c) the gift was received as the result of an institutional solicitation and was not accompanied by a separate statement from the donor expressing a limitation on the use of the funds.²⁷²

The Act requires that an institution keep a record of all notice activities.²⁷³ Institutions should document search-and-notice activities even where unsuccessful.

a. Legislative History

As a result of concerns that donors would not understand the change to an institution's ability to appropriate from an endowment fund under NYPMIFA, the regulators at the Charities Bureau suggested allowing donors to "opt-out" of the new rules. They proposed requiring institutions to notify both new and existing donors that, with enactment of NYPMIFA, institutions would be permitted to appropriate from the original dollar value of an endowment gift. Although this obligation places a significant burden on institutions, the regulators pointed out that institutions had already dealt with similar burdens under release provisions found in prior law,²⁷⁴ and so NYPMIFA should similarly require institutions to make an attempt to locate the donor prior to appropriating for the first time from an endowment fund under the Act's new rules.

There was significant discussion between those holding opposing views on inclusion of a donor-notice provision in the Act, with the regulators arguing for required notification with respect to all endowment gifts (not just those pre-dating the effective date of the Act), and

Attorney General's Guide confirms this stating that the term "original dollar value" is "a plain-English equivalent" of historic dollar value. AG GUIDE, *supra* note 64, at 10. 270. See N-PCL § 553(e)(1).

271. See *id.*

272. See *id.* § 553(e)(2).

273. See *id.* § 553(f).

274. For a discussion regarding the provisions on release and modification of a donor-restriction, see *infra* text accompanying notes 308–42.

other parties, including the authors, claiming that donor notice should be unnecessary.²⁷⁵

After extensive debate, the notice provision was added to the Act. The provision is limited to endowment gifts in existence prior to the effective date of the Act, and the definitions of “donor” and “donor availability” are drawn narrowly.²⁷⁶ The Act also specifies when a donor is considered “available,” allowing an institution to apply the appropriation provisions of NYPMIFA to existing gifts if the donor cannot be found with reasonable efforts.²⁷⁷

E. Delegation of Management and Investment Functions

The ability of a governing board to delegate management and investment functions has evolved significantly from the rules set forth in early trust law.

1. UMIFA

Prior to UMIFA, institutions often applied the trust law principle of non-delegation, which forbade delegation to others of non-ministerial functions.²⁷⁸ UMIFA clarified that both internal and external delegation of investment management authority was permissible, though subject to donor intent as expressed in a gift instrument.²⁷⁹ The comments to UMIFA emphasized that responsibility for an investment

275. Some participants in the legislative drafting processes tried to insert a requirement for institutional consent before a donor could, via the notification procedure, amend the gift instrument. The effort was based on the notion that a donor should not be able unilaterally to modify a gift instrument. The effort was unsuccessful.

276. The Attorney General has provided guidance that notice must be provided prior to appropriation both for funds where value exceeds HDV and when a fund is underwater. Furthermore, in the opinion of the Attorney General, appropriations *can* be made during the 90-day notice period, but they must be limited to income and appreciation. See AG GUIDE, *supra* note 64, at 8–9.

277. To determine whether a donor is “available” for purposes of notice, an institution should make reasonable efforts to locate the donor, including conducting Internet searches and contacting known associates of the donor. Records should document the search even if it is unsuccessful. See *id.* at 10.

278. See UMIFA, *supra* note 11, § 5 cmt., at 11; see also UPIA, *supra* note 49, § 9 cmt., at 18.

279. UMIFA provided, “Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may (1) delegate to its committees, officers or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds, (2) contract with independent investment advisors, investment counsel or managers, banks, or trust companies, so to act, and (3) authorize the payment of compensation for investment advisory or management services.” UMIFA, *supra* note 11, § 5, at 10.

policy and selection of competent agents remained with the governing board.²⁸⁰

2. *N-PCL*

UMIFA's approach to delegation was codified in the N-PCL.²⁸¹ However, New York added three provisions not found in UMIFA that clarified the responsibilities of a governing board with respect to delegation: (i) each contract pursuant to which authority was delegated had to be subject to termination by the governing board at any time, without penalty, on no more than sixty days' notice;²⁸² (ii) the governing board had a specific fiduciary duty to exercise the standard of care in the process of delegation;²⁸³ and (iii) appropriate exercise of the duty of care in delegation released the governing board from liability for the acts and omissions of persons to whom authority was so delegated.²⁸⁴

3. *UPIA*

UPIA followed the lead of UMIFA and reversed the prior trust rule of non-delegation. UPIA permits the delegation of investment management authority to investment advisors or managers and other delegates, provided that the trust fiduciary exercises care, skill, and caution in selecting the delegate, establishes the scope and terms of the delegate's duties, and periodically reviews the delegate's performance.²⁸⁵ The UPIA provision, like the provisions on delegation in the N-PCL, specifies that appropriate delegation serves to relieve trustees of liability for the decisions or actions of the agent to whom the function was delegated.²⁸⁶ In performing delegated functions, an agent is also governed by UPIA and is required to act with reasonable care to comply with the scope and terms of the delegation.²⁸⁷

280. *Id.* For a discussion of the wisdom of this shift, see Harvey P. Dale & Michael Gwinnell, *Time for Change: Charity Investment and Modern Portfolio Theory*, 3 CHARITY L. & PRAC. REV. 65, 80–81 (1995).

281. See N-PCL § 514 (McKinney 2005) (amended 2010). The N-PCL provision did not include the UMIFA reference to governmental institutions or funds.

282. *Id.* § 514(a).

283. *Id.* § 514(b).

284. *Id.*

285. See UPIA, *supra* note 49, § 9, at 17.

286. *Id.* § 9(c).

287. *Id.* § 9(b).

4. UPMIFA

UPMIFA incorporates UPIA's provision on external delegation. Under UPMIFA, those responsible for managing institutional funds may delegate authority for investment decisions to external investment advisors or managers.²⁸⁸ An institution must act in good faith, with the care that an ordinarily prudent person in a like position would exercise, under similar circumstances, in selecting an agent, establishing the scope and terms of the delegation (consistent with the purposes of the institution and the institutional fund), and periodically reviewing the agent's actions.²⁸⁹ An agent owes a duty to the institution to exercise reasonable care to comply with the delegation.²⁹⁰ As with other UPMIFA provisions, this is a default rule, subject to any specific contrary terms in the applicable gift instrument.²⁹¹

UMIFA addressed internal delegation in addition to external delegation, "due to a concern at that time that trust law concepts might [otherwise] govern internal delegation in nonprofit corporations."²⁹² The UPMIFA drafters indicated that in light of widespread adoption of nonprofit corporation statutes since UMIFA's drafting, directors may now look to nonprofit corporation laws for internal delegation rules and for rules regarding release of liability following appropriate delegation.²⁹³ Therefore, while UPMIFA provides for delegation to external agents, it does not specifically authorize internal delegation to committees, officers, or employees. The absence of such a provision is not intended to suggest that boards cannot delegate investment authority internally.²⁹⁴

5. NYPMIFA

a. Delegation to External Agents

The Act's provision on external delegation elaborates on the corresponding provision in UPMIFA. An institution governed by the Act must act in good faith with the care that an ordinarily prudent person in a like position would exercise in (i) selecting, continuing, or termi-

288. See UPMIFA, *supra* note 9, § 5, at 29–30. The comments to UPMIFA note that only management and investment functions can be delegated; decisions concerning expenditure cannot be delegated. *Id.* § 5 cmt., at 30–31.

289. See *id.* § 5(a), at 29.

290. See *id.* § 5(b), at 30.

291. See *id.* § 5(a), at 29.

292. See *id.* § 5 cmt., at 31.

293. See *id.*

294. See *id.* § 5 cmt., at 30–31.

nating an external agent,²⁹⁵ and assessing the agent's independence, (ii) establishing the scope and terms of the delegation, including payment of compensation, and (iii) monitoring the external agent's performance and compliance with the scope and terms of the delegation.²⁹⁶ In addition, the Act provides that (i) an agent owes a duty to act with reasonable care, skill, and caution in performing delegated functions (and submits to the jurisdiction of the New York courts), (ii) a governing board that complies with the standard of care in delegation is relieved of liability for the decisions or actions of the external agent, and (iii) each contract pursuant to which authority is delegated must provide that it may be terminated by the institution at any time, without penalty, on not more than sixty days' notice.²⁹⁷

b. Internal Delegation

Internal delegation of investment management functions is governed by section 514 of the N-PCL, as amended by NYPMIFA. This provision permits an institution's governing board to delegate to the institution's committees, officers, or employees the authority to act in place of the governing board in investing and reinvesting institutional funds.²⁹⁸ The governing board must discharge its duties, as well as select committees, officers, or employees to whom investment management authority is delegated or with whom contracts delegating such authority are made, and in continuing or terminating such delegation or contracts, in good faith and "with the care an ordinarily prudent person in a like position would exercise under similar circumstances"²⁹⁹

295. NYPMIFA defines "external agent" as "an independent investment advisor, investment counsel or manager, bank, or trust company." N-PCL § 551(k) (McKinney Supp. 2014). This definition is not in UPMIFA. The authors believe this definition was added to ensure continuity with prior law as to external delegation, including the requirement that an external agent be independent. *See id.* § 514(a)(2) (McKinney 2005) (amended 2010).

296. *See id.* § 554(a) (McKinney Supp. 2014).

297. *See id.* §§ 554(b), (c), (d), (e).

298. *See* NYPMIFA, ch. 490, § 6, 2010 N.Y. Laws 1334, 1340–41 (amending N-PCL § 514(a)).

299. *See* N-PCL § 514(b). In delegating investment management authority to internal agents, the governing board also must consider, if relevant, the eight factors that the board is required to consider when making investment decisions pursuant to section 552 of the N-PCL. *See* NYPMIFA § 7, 2010 N.Y. Laws at 1341 (amending N-PCL § 717(a)). As these factors seem irrelevant to internal delegation and do not even appear in relation to external delegation, the authors believe that this requirement was an inadvertent drafting error. For further discussion of technical errors the authors believe are in need of correction, see *infra* text accompanying notes 402–08.

Both the external and internal delegation provisions of the Act are default rules, and a donor, in the gift instrument, may limit the board's power to delegate investment management authority.³⁰⁰

6. *Legislative History*

Those drafting the Act decided to adopt UPMIFA's general formulation for delegation to external agents, and largely keep the prior law regarding internal delegation to committees, officers, and employees. Therefore, the delegation provisions now found in the N-PCL are distributed between section 514 (internal) and section 554 (external).

The review of the UPMIFA external delegation provision generated substantial discussion. Some concerns addressed then-current financial frauds committed by certain external agents.³⁰¹ Concerns were raised regarding the sufficiency of the periodic review of external agents' actions as set forth in UPMIFA, and it was suggested that the Act clarify that an institution has a continuing obligation to monitor an external agent's performance. In response, the "periodical review" required by UPMIFA was deleted; instead the Act indicates an institution's duty to monitor an external agent's performance and compliance with the delegation but without setting forth the timing for such reviews.³⁰² In addition, the NYPMIFA provision regarding external delegation elaborates on that set forth in UPMIFA, indicating that external agents owe a duty to the institution to exercise reasonable skill and caution, in addition to reasonable care, in performing their duties.³⁰³

The Charities Bureau also suggested that the Act require a governing board to consider an external agent's independence when making delegation decisions. In response, such language was added; it requires scrutiny of any conflicts of interest the agent has. The Attorney General's guidance indicates that a governing board should select external agents based on competence, experience, past performance,

300. See N-PCL § 554(a). Section 514 of the N-PCL does not apply to religious corporations. See N.Y. RELIG. CORP. LAW § 2-b(1)(c) (McKinney 1990 & Supp. 2014). However, prior to the enactment of NYPMIFA, section 514 of the N-PCL provided for both internal and external delegation. It now provides only for internal delegation, with external delegation addressed in the new section 554 enacted by NYPMIFA. Section 554 is not excepted from applicability to religious corporations under section 2-b(1)(c) of the Religious Corporation Law. The authors believe that this was an error in the drafting of NYPMIFA.

301. See *supra* note 173 and accompanying text.

302. In contrast decisions not to diversify are to be reviewed as frequently as circumstances require, and at least annually. See N-PCL § 552(e)(4).

303. This is the same standard as that found in UPIA. See UPIA, *supra* note 49, § 9, at 17.

and proposed compensation, rather than on any business or personal relationships between members of the institution's governing board and the agent.³⁰⁴ The Attorney General's guidance to NYPMIFA now recommends that the governing board should adopt and follow a conflict-of-interest policy that requires the institution to determine if any of its officers or directors are officers or directors of the external agent or have a substantial financial interest in the external agent.³⁰⁵

NYPMIFA retains section 514 of the N-PCL requiring institutions to insert in their engagement contracts the ability to terminate agent delegations on sixty days' notice without penalty.³⁰⁶ Early drafts of NYPMIFA had eliminated this provision. Regulators at the Charities Bureau, however, believed that this provision is helpful to institutions and can serve as an enforcement tool for regulators. However, this requirement is likely to cause inadvertent noncompliance and prevent sophisticated institutions from reducing management fees by accepting longer termination-notice provisions, i.e., illiquidity, in exchange for fee reductions.³⁰⁷

F. Release or Modification of Restrictions on Management, Investment, or Purpose

A donor may place a restriction on a gift, whether as to purpose (e.g., that it be used solely for scholarships), or as to time (e.g., that it not be spent currently), with the best of intentions, yet the restriction, over time, may no longer make sense, or compliance with the restriction may become impossible or impracticable.³⁰⁸ Under longstanding

304. See AG GUIDE, *supra* note 64, at 14. The Attorney General has explained that the 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." *Id.* In addition, the board must query "whether the retention of outside agents who have business or personal relationships with board members or other insiders might prevent the board from receiving independent advice on investment strategy and risk." *Id.*

305. See *id.* at 15. The Attorney General has written that "it is this Office's view that institutions are well-advised to adopt policies that require full disclosure of relationships with outside agents and implement practices that ensure objective oversight by the board." *Id.*

306. N-PCL § 554(e).

307. The authors believe that this provision should not prohibit an institution from investing in alternative investment vehicles, including ones with lock-ups of more than sixty days. While perhaps a fine distinction, an alternative investment involves the purchase of an asset—e.g., a limited partnership interest, LLC membership interest, or shares in a company—as opposed to the delegation of management within the meaning of NYPMIFA.

308. An example would be where a donor restricts a gift so that it may be used only to care for individuals suffering from a specific disease, and the disease is later eradicated. See *In re Scott's Will*, 171 N.E.2d 326 (N.Y. 1960) (modifying restriction as to

trust law, the doctrine of *cy pres* “permits a court to modify a restriction imposed on the *purpose or use* of the trust.”³⁰⁹ *Cy pres* can be applied, “but only if the restriction has become unlawful, impossible, or impracticable, or, under a modern articulation of *cy pres*, wasteful.”³¹⁰ In order to modify or release a restriction on *management* of the trust imposed by the settlor, trust law applies the doctrine of equitable deviation, which “enables a court to modify a restriction on the *administration* of a charitable trust.”³¹¹

1. UMIFA

Although an institution can apply for relief from a restriction through a *cy pres* proceeding, the UMIFA drafting committee believed that institutions needed additional ways to address the release and modification of restrictions, since “*cy pres* . . . is reluctantly applied in some states.”³¹² Under UMIFA, an institution could release a restriction with the authorization of the donor.³¹³ Where the donor was dead, disabled, unavailable, or impossible to identify, the institution, on prior notice to the Attorney General, could seek court release if the restriction was obsolete, inappropriate, or impracticable.³¹⁴ The Attorney General was also given the opportunity to be heard.³¹⁵ UMIFA provided only for release; it did not specifically address modification of restrictions.³¹⁶ UMIFA’s release route was not exclusive: despite it,

purpose of tuberculosis treatment); *In re Hastings Estate*, 217 N.Y.S.2d 810 (Sup. Ct. 1961) (modifying restriction as to purpose of tuberculosis treatment). Another example would be where a donor indicates that the gift assets should be invested solely in specified securities and those securities are unable to generate a return sufficient to keep up with inflation. See *In re Application of the Trs. of Estate & Prop. of Diocesan Convention of New York*, 484 N.Y.S.2d 406 (Sup. Ct. 1984) (granting trustee authority to invest in all instruments allowed under N.Y. EST. POWERS & TRUSTS § 11-2.2(a)(7) (McKinney 2014) even though grant specified that investments should be made only in federal and municipal government stocks and bonds, “first mortgage railway bonds” and New York City “improved real estate”).

309. Gary, *supra* note 12, at 1324 (emphasis added); see RESTATEMENT (THIRD) OF TRUSTS § 67 (2003); RESTATEMENT (SECOND) OF TRUSTS § 399 (1959).

310. Gary, *supra* note 12, at 1324.

311. *Id.* (emphasis added); see UPMIFA, *supra* note 9, § 6(b) cmt., 33–34; see also MARION FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS 438 (2004); Gary, *supra* note 12, at 1324–25.

312. UMIFA, *supra* note 11, § 7 cmt., at 12; see also Gary, *supra* note 12, at 1325.

313. See UMIFA, *supra* note 11, § 7(a), at 12. A donor could therefore lift a restriction on either the use or purpose of the institutional fund, or a restriction on the management of the institutional fund. Even though the donor can lift the restriction, the donor has no property interest in an institutional fund after the gift has been made. *Id.* § 7 cmt., at 12–13.

314. See *id.* § 7(b), at 12.

315. *Id.*

316. See Gary, *supra* note 12, at 1326–28.

an institution could continue to seek *cy pres* relief under trust laws. Only *cy pres* relief could transform an endowment fund into a non-endowment fund (e.g., lift a restriction as to the timing of spending) without donor consent.³¹⁷ New York adopted the UMIFA release rules.³¹⁸

2. UPMIFA

UPMIFA updates the release provisions to permit more efficient management of institutional funds. UPMIFA continues to allow for donor consent to a modification or release of a restriction.³¹⁹ In addition, under UPMIFA an institution may seek court release or modification of a restriction, regarding either the *management* or *investment* of an institutional fund, even if the donor is available but does not consent, 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.³²⁰ An institution may also seek court release or modification of a restriction regarding the *purpose* of an institutional fund, even if the donor is available, if the purpose becomes impossible, impracticable, unlawful, or wasteful.³²¹ When seeking court release, an institution must provide notice to the Attorney General, and the Attorney General has the opportunity to be heard.³²²

UPMIFA adds a provision not found in prior law dealing with old small funds. It allows an institution to apply the doctrine of *cy pres* or equitable deviation on its own, without application to court, but after giving notice to the Attorney General.³²³ UPMIFA brackets a value of \$25,000 as small and twenty years since establishment as old,³²⁴ but the comments indicate that the enacting jurisdiction should adjust

317. The interaction between UMIFA and *cy pres* was often unclear. Courts have held that *cy pres* requires consideration of donor intent, but that release under UMIFA did not. *See* Yale Univ. v. Blumenthal, 621 A.2d 1304, 1309–10 (Conn. 1993). UMIFA's release provision required that the funds continue to be used for the purposes of the institution. *See* UMIFA, *supra* note 11, § 7(c), at 12.

318. *See* N-PCL § 522 (McKinney 2005) (repealed 2010).

319. *See* UPMIFA, *supra* note 9, § 6(a), at 31. The donor may consent to release or modification of either a restriction on the management or investment of an institutional fund or on the purpose of an institutional fund. *Id.*

320. *Id.* § 6(b), at 32.

321. *Id.* § 6(c).

322. *Id.* § 6(b)–(c).

323. *See id.* § 6(d).

324. *Id.* The UPMIFA comments note that the twenty-year period begins from the date the institutional fund was established, and not from the date of each gift to the institutional fund. *See id.* § 6(d) cmt., at 34.

these numbers as appropriate.³²⁵ The institution must use the property in a manner consistent with the purposes expressed in the gift instrument,³²⁶ and the Attorney General has sixty days to object to such a modification or release.³²⁷

Therefore UPMIFA, unlike UMIFA, allows for modification as well as release of a restriction. UPMIFA distinguishes between two types of modification and release: one dealing with a restriction on the *management* or *investment* of a fund and other dealing with the *purpose* of a fund. Any modification of management or investment must be “in accordance with the donor’s probable intention,”³²⁸ and any modification of purpose must be made “in a manner consistent with the charitable purposes expressed in the gift instrument.”³²⁹

By including the power to “modify,” in addition to the power to release, a restriction on the administration of an institutional fund, UPMIFA took “an approach that favors modification over release to protect donor intent.”³³⁰ According to UPMIFA Reporter Susan Gary,

A donor commonly has a predominating purpose for a gift and, secondarily, an intent that the charity carry out the purpose in a particular manner. Deviation is intent effectuating because the doctrine permits a modification that will enable the charity to carry out the purposes of the fund more effectively.³³¹

UPMIFA’s modification and release rules preserve the historic position of the Attorney General as the overseers of charities. Under UPMIFA, as under trust law, the court will determine whether and how to apply *cy pres* or deviation; the Attorney General will receive notice and have the opportunity to participate in the proceeding. A significant addition to existing law under UPMIFA allows an institution the authority to modify a restriction on a fund that is both old and small. For these funds, the expense of applying to court for release will often be prohibitive. By permitting an institution to make an appropriate modification, money is saved for the institution’s activities in support of its beneficiaries. Even with respect to small, old funds, however, the institution must notify the Attorney General of the institution’s intended action. The Attorney General can review the institution’s plan for modification or release and, if necessary, request changes. As with court relief from a restriction, an institution must

325. *Id.* § 6(d) cmt.

326. *Id.* § 6(d)(3), at 32.

327. *Id.* § 6(d).

328. *Id.* § 6(b).

329. *Id.* § 6(c).

330. Gary, *supra* note 12, at 1328.

331. *Id.* at 1328–29.

change a restriction in a manner in keeping with the donor's intent and the purpose of the institutional fund.

The drafters of UPMIFA decided not to require notification of donors prior to the modification or release of a restriction because the trust law rules of equitable deviation and *cy pres* do not require donor notice and instead rely on the court and Attorney General to protect donor intent. The drafters believed that locating a donor who contributed to a small fund created more than twenty years earlier could be difficult and expensive, and concluded that an institution's concern regarding donor relations would be sufficient incentive to notify donors of release or modification where warranted.³³²

3. NYPMIFA

NYPMIFA enacted the release and modification provisions of UPMIFA with one substantive difference.³³³ Under the Act, when seeking court release, an institution must provide notice to the donor, in addition to the Attorney General, and both the Attorney General and donor have the opportunity to be heard.³³⁴ NYPMIFA confirms that it does not limit or change application of the common law doctrine of *cy pres*.³³⁵

NYPMIFA adopted UPMIFA's provision relating to institutional release of small, old funds, but established its own thresholds for small

332. *Id.* at 1331–32.

333. See N-PCL §§ 555(a)–(c) (McKinney Supp. 2014).

334. The *AG Guide* “urges institutions and their counsel to submit a draft petition” before filing with the court to obtain release or modification because “[a]dvance review by the Charities Bureau can help to identify and resolve potential issues, thus simplifying the proceeding and saving time.” *AG GUIDE*, *supra* note 64, at 15. The authors do not believe that giving notice to the donor or allowing the donor to be heard substantially impacts donor standing. One scholar has explained that “nearly all the modern American authorities . . . deny a donor standing to enforce a restricted gift to public charity absent” an explicit agreement otherwise. See Iris J. Goodwin, *Donor Standing to Enforce Charitable Gifts: Civil Society & Donor Empowerment*, 58 *VAND. L. REV.* 1093, 1145 (2005). The concept is an extension of the common law treatment of “right of reverter.” *Id.* at 1444–47. “Today, we do not recognize the property given by a donor to charity remains in any sense ‘his own.’” *Id.* at 1148. The authors do not believe that the requirement to give donors notice prior to release or modification of a restriction on an institutional fund changes the historical denial of standing to a donor after a gift is made.

335. See N-PCL § 555(f); see also UPMIFA, *supra* note 9, § 6 cmt., at 33. In New York, the *cy pres* doctrine is also embodied in section 8-1.1(c)(1) of the New York Estates, Powers and Trusts Law. Under the EPTL, if the donor of a gift is living, the donor must consent to the *cy pres* relief granted by the court in order for it to be effective. While § 555(c) of the Act specifies that a donor must be given notice and the opportunity to be heard, it does not require donor consent to the relief fashioned by the court.

and old.³³⁶ Under the Act, if an institution determines that a restriction is unlawful, impracticable, impossible to achieve, or wasteful, after ninety days' notice³³⁷ to the Attorney General and the donor (if the donor is available), the institution may release or modify a restriction if (i) the fund has a total value of less than \$100,000; (ii) more than twenty 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. The Act, unlike UPMIFA, provides the form that notice to the Attorney General should take, including (A) an explanation of (i) the institution's determination that the restriction meets the requirements set forth in the Act and (ii) the proposed release or modification; (B) a copy of the institution's approval of the release or modification; and (C) a statement of the proposed use of the fund after such release or modification.³³⁸

4. *Legislative History*

Under section 522 of the N-PCL (repealed by NYPMIFA), donor consent was required to lift a restriction unless consent could not be obtained due to death, disability, unavailability, or impossibility of identification. NYPMIFA now allows an institution to request court release even if a donor is available. Regulators at the Charities Bureau were concerned that this provision might override donor intent, and suggested that NYPMIFA require institutions to give notice and an opportunity to be heard to an available donor prior to any release or modification. Others, including the authors, preferred the view of the UPMIFA Drafting Committee, which decided not to include donor notification for two reasons: (i) the burden it would place on institutions, and (ii) the impracticality of notifying donors of older funds. Trust law does not require notification of donors for application of equitable deviation or *cy pres*; thus, in this matter, UPMIFA follows trust law.

After debate, a donor notice requirement was added. The required notice is narrowly drawn: notice is only required to be given to a donor deemed "available," i.e., the donor must be (i) capable of being identified and located with reasonable efforts, and (ii) must be living or, if not a natural person, in existence and conducting activities. Do-

336. See N-PCL § 555(d).

337. UPMIFA requires only 60 days notice to the Attorney General. See UPMIFA, *supra* note 9, § 6(d), at 32.

338. N-PCL § 555(d)(2). The Attorney General has taken the position that an institution may not move forward with a release or modification of a restriction, even on a small, old fund, without receiving consent from the Charities Bureau. See AG GUIDE, *supra* note 64, at 15–16. The authors disagree. See *infra* text accompanying note 414.

nor notification for release or modification of a small, old fund was added for the same reasons and subject to the same limitations.

The thresholds for institutional release or modification of a restriction on small, old funds were discussed at length by the Act's drafters. Early versions of the legislation set a \$250,000 maximum value and a ten-year existence requirement for an institution to release or modify a restriction without court approval.³³⁹ The dollar value was later reduced to \$100,000. A suggestion that this number should be indexed for inflation was rejected as too complicated.

NYPMIFA adds a list of materials that should be submitted with the notice to the Attorney General on modification of a small, old fund. This list was drafted by the regulators at the Attorney General's Charities Bureau and reflects the considerations they believed necessary to determine whether a modification or release is in the best interests of the institution and its beneficiaries.³⁴⁰

Section 555 of the Act specifies the court to which an application for modification or release should be made.³⁴¹ This language derives directly from prior section 522 of the N-PCL, which has now been repealed.³⁴²

IV.

NYPMIFA'S IMPACT ON OTHER NEW YORK LAWS

The enactment of NYPMIFA required certain changes to be made to other New York laws. These are considered below.

A. *Changes to Other Parts of the N-PCL*

Cross-references to definitions in NYPMIFA were added where terms defined in NYPMIFA are used elsewhere in the N-PCL or other New York laws.³⁴³ For the sake of uniformity and for ease of use, the drafters decided to retain the NYPMIFA definitions within Article 5-A

339. The ULC comments note the maximum value of an institutional fund that an institution should be able to release or modify without court approval should reflect the cost of a judicial proceeding to obtain a modification, and so the number may be higher in some states and lower in others. The ULC comments also note that an enacting jurisdiction may wish to designate a higher or lower minimum number of years that must have elapsed since the establishment of an institutional fund which an institution may release without court approval. This minimum is intended to be a further safeguard for fidelity to donor intent.

340. See N-PCL § 555(d)(2); see also AG GUIDE, *supra* note 64, at 15–16.

341. N-PCL § 555(e).

342. N-PCL § 522 (McKinney 2005) (repealed 2010).

343. See, e.g., NYPMIFA, ch. 490, §§ 4–7, 2010 N.Y. Laws 1334, 1340–41 (amending N-PCL §§ 406, 513, 514(a), 717(a)).

rather than putting them into the general definitions provision of section 102 of the N-PCL. Overlapping definitions were deleted.³⁴⁴

There was discussion regarding section 513(b) of the N-PCL requiring the treasurer's report on assets received for a specific purpose.³⁴⁵ That report only covers assets restricted by purpose—not endowments. It was determined to leave this requirement as is. The governing board, of course, may request reports on endowment funds in addition to the required treasurer's report.

Under prior law and also under NYPMIFA, a governing board that complies with the standard of care in delegation is relieved of liability for the actions of its delegate. Under prior law, section 514 provided such relief with respect to both internal and external delegations.³⁴⁶ As amended by the Act, 514 continues to provide such relief with respect to internal delegation,³⁴⁷ while new section 554(c) provides relief for external delegation.³⁴⁸ Though there are some minor linguistic differences between those two sections, there is no intended difference in outcome.

Section 717 of the N-PCL was amended to mirror the new prudence language found in section 552(b) of NYPMIFA (though this was not intended to be a substantive change) and to indicate that the prudence factors must be taken into consideration when making internal delegations.³⁴⁹

344. *See id.* § 2, 2010 N.Y. Laws at 1340; *see also* N-PCL § 102(a)(13), (14), (17) (McKinney 2005) (repealed 2010).

345. *See* NYPMIFA § 5, 2010 N.Y. Laws at 1340.

346. *See* N-PCL § 514.

347. *See id.* § 514(b).

348. *See* N-PCL § 554(c) (McKinney Supp. 2014).

349. NYPMIFA also makes the following conforming changes to the N-PCL: (i) section 513(a) of the N-PCL was retained, providing that a charitable corporation under the N-PCL has full ownership rights in assets given to it and is not a trustee of an express trust of such assets; (ii) section 513(c) of the N-PCL was eliminated, overridden by the new appropriation provisions of NYPMIFA; (iii) section 514(a) of the N-PCL was amended, retaining the ability to delegate investment management to internal committees and officers, and adding a cross-reference to the external delegation rules in section 554 of NYPMIFA; and (iv) section 406(b) of the N-PCL was amended by NYPMIFA only to cross-reference the new definition of the term "gift instrument" with no impact to the private foundation adjustment provisions. NYPMIFA does not override or conflict with this section of the N-PCL, nor the corresponding section 8-1.8 et. seq. of the New York Estates, Powers and Trusts Law. *See* NYPMIFA §§ 3-4, 2010 N.Y. Laws at 1340; *see also* N-PCL § 406; EPTL § 8-1.8 (McKinney 2002 & Supp. 2014).

B. Executive Law

The Act amends section 174(b)(2) of Article 7-A of the New York Executive Law to require that institutional solicitations for an endowment fund include a statement that, unless otherwise restricted by the gift instrument, the institution may expend so much of an endowment fund as it deems prudent after considering the factors required by the Act.³⁵⁰ Though the authors believed it to be unnecessary, this provision was added due to concerns raised by the Charities Bureau regarding the application of NYPMIFA to mass solicitations.

Under section 172-a of Article 7-A of the Executive Law, Article 7-A does not apply to (i) corporations organized under the religious corporations law, (ii) other religious agencies and organizations, and (iii) charities, agencies, and organizations operated, supervised, or controlled by or in connection with a religious organization.³⁵¹ Therefore, such organizations do not need to include the NYPMIFA disclosure statement in their solicitations.

Education corporations are required to include the NYPMIFA disclosure statement in institutional solicitations for endowment funds. Though many education corporations are exempt from the requirement to register with the Attorney General under section 172-a(2) of Article 7-A of the New York Executive Law, the NYPMIFA disclosure language was added to section 174-b(2), which is not limited to registered corporations.

C. Education Law

The New York Education Law provides in section 216-A that the N-PCL applies to educational organizations unless the Education Law specifically states otherwise.³⁵²

There is nothing in the Education Law that would prevent application of NYPMIFA to educational organizations, and prior law reflecting UMIFA did apply to educational organizations.³⁵³ The Act does not specifically amend any provision of the Education Law.

350. NYPMIFA § 14, 2010 N.Y. Laws at 1342.

351. N.Y. EXEC. LAW § 172-a (McKinney 2010).

352. See N.Y. EDUC. LAW § 216-A (McKinney 2009).

353. *Id.*

D. Religious Corporation Law

NYPMIFA applies to religious corporations through section 2-b(1)(c) of the New York Religious Corporation Law (RCL).³⁵⁴ Changes were made to sections 2-b(1)(c) and (e) of the RCL to indicate limitations on the applicability of the modification and release provisions of NYPMIFA on religious organizations.³⁵⁵ Prior to the enactment of NYPMIFA, section 2-b(1)(c) of the RCL referenced section 522 of the N-PCL (Release of restrictions), and stated that religious corporations did not have to give notice to the Attorney General when releasing a restriction on an institutional fund. Following the enactment of NYPMIFA, this was changed to reference section 555 of NYPMIFA (Release or modification of restrictions), and provides that religious corporations do not need to give notice to either the Attorney General or the donor when releasing a restriction on an institutional fund, and neither the Attorney General nor the donor has the opportunity to be heard.³⁵⁶ Cross-references were also updated in section 2-b(1)(e) of the RCL.³⁵⁷

E. Miscellaneous

Changes were made to sections 8-1.1(e) and 8-1.1(j) of the New York Estates, Powers and Trusts Law to make clear that trusts governed by NYPMIFA may utilize the release and modification provisions of NYPMIFA.³⁵⁸ The existing special rules for cemetery corporations continue to apply.³⁵⁹

V.

INTERNAL AFFAIRS DOCTRINE

Does NYPMIFA apply to institutions organized under the law of a different state but carrying on some quantum of activity within New York? Analyzing this question requires considering New York's choice of law rules, among which two are principally significant: the "internal affairs" doctrine³⁶⁰ and the "interest analysis" approach. The former would select the substantive law of the jurisdiction in which the institution is organized to govern all matters within the scope of the doctrine, thus applying foreign rather New York law even if the

354. N.Y. RELIG. CORP. LAW § 2-b(1)(c) (McKinney 1990 & Supp. 2014).

355. NYPMIFA § 8, 2010 N.Y. Laws at 1341.

356. *Id.*

357. *Id.*

358. *Id.* at § 9–10.

359. *See* N-PCL § 1507 (McKinney 2005).

360. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

institution is carrying on activities within New York. The latter would select either New York law or the law of the institution's formation, but would rest the choice of law selection on an analysis of the competing policy interests of each of the two jurisdictions in having its law apply.³⁶¹

Even if the internal affairs doctrine is accepted by a court for this purpose, there remains the question of whether investment management decisions, i.e., those that would be governed by NYPMIFA if New York law applied, are within the scope of that doctrine. As one leading treatise puts it, “[i]t is not always clear . . . whether a matter qualifies as an internal corporate matter or as another type of matter calling for a different choice of law rule.”³⁶² The authors have found only one court decision squarely involving a charitable institution—organized in state A but conducting extensive activities in state B—that was a defendant in litigation in state B challenging the propriety of its management of its investment portfolio. In that case, the state B (activity state) court applied the internal affairs doctrine and selected state A's law, i.e., the formation state's law, to govern the issues.³⁶³ In analogous cases, involving for-profit organizations rather than chari-

361. For ease of reference, the jurisdiction in which an institution is incorporated is sometimes referred to herein as the “formation state” and a jurisdiction in which an institution is carrying on some quantum of activities is sometimes referred to as an “activity state.” Of course, not only states but also counties and municipalities may decide to regulate institutions that conduct activities within their borders; as appropriate, then, “activity state” will also be taken to include subdivisions of states. The possibility of state-subdivision regulation is far from fanciful: the first of the U.S. Supreme Court's decisions on the constitutionality of activity-state regulation of charitable fundraising involved a municipal (rather than a state) ordinance, *Schaumburg v. Citizens for a Better Environment*, 444 U.S. 20 (1980), and it was an ordinance adopted by Pinellas County, in Florida, that led, *inter alia*, to the adoption by the National Association of State Charity Law Officials of the so-called Charleston Principles suggesting limits on when activity states should attempt to regulate internet fundraising. See BRUCE R. HOPKINS, *THE LAW OF FUNDRAISING* § 4.13(b) (4th ed. 2009); Catherine E. Livingston, *Tax-Exempt Organizations and the Internet: Tax and Other Legal Issues*, 31 EXEMPT ORG. TAX REV. 419 (2001).

362. 9 FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPS. § 4223.50 (2010); see also Theresa Gabaldon, *The Story of Pinocchio: Now I'm a Real Boy*, 45 B.C. L. REV. 829, 840–41 (2004); Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (1985).

363. *Robertson v. Princeton Univ.*, No. C-99-02, slip op. at 37 (N.J. Super. Ct. Ch. Div. 2007) (granting partial summary judgment on Article 11(c) and holding that the Delaware version of UMIFA applied). Because the litigation was later settled, the lower court's holding was never considered by any appellate court. The authors were involved, as counsel or expert witness, in the litigation in question.

ties, other courts have held that the internal affairs doctrine does apply to investment management decisions.³⁶⁴

The New York Court of Appeals, in dicta, has rejected “any automatic application of the so-called ‘internal affairs’ choice of law rule”³⁶⁵ In that case, it did, nevertheless, apply the law of the foreign formation state, and noted that there were

theoretical advantages which would appear to flow from a conclusion that the rights of all shareholders of this real estate investment trust in comparable situations should be determined on a trust-wide basis rather than in consequence of the litigants’ choice of forum or the assessment by several courts as to which State it is where the investment trust may be said to be present.³⁶⁶

Courts following and citing to that decision have generally selected the law of the formation state; thus, courts conclude with a choice of law selection that would be dictated by the internal affairs doctrine even when reciting the interest-analysis approach.³⁶⁷ In part this may be a result of recognizing, as did the U.S. Supreme Court, that “[t]he internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation’s internal affairs . . . because otherwise a corporation could be faced with conflicting demands.”³⁶⁸ It may also recognize in part that the formation state has an interest superior to that of any

364. *See, e.g.,* Seidl v. Am. Century Co., 713 F. Supp. 2d 249, 255–56 (S.D.N.Y. 2010) (applying Maryland law under internal affairs doctrine to decide the question of shareholder standing). It appears possible that a cause of action alleging improper conduct in managing an institution’s investments might be cast as a breach-of-contract or breach-of-fiduciary-conduct claim. Most such claims fall outside of the boundaries of the internal affairs doctrine so this possibility adds further confusion to the scope of the doctrine. Nevertheless, some courts have used the internal affairs doctrine to choose formation-state law in such cases. *See, e.g., In re Charles Schwab Corp. Securities Litigation*, 257 F.R.D. 534, 554 (N.D. Cal. 2009) (“As both sides recognize, because the fund is a Massachusetts trust, plaintiffs’ fiduciary-duty claim should be analyzed under Massachusetts law.”); *Druck Corp. v. Macro Fund (U.S.) Ltd.*, No. 02 Civ. 6164(RO), 2007 WL 258177, at *1 (S.D.N.Y. 2007) (internal affairs doctrine utilized by court in breach-of-contract and breach-of-fiduciary-duty case), *aff’d on other grounds*, 290 Fed. Appx. 441(2d Cir. 2008); *Hart v. General Motors Corp.*, 517 N.Y.S.2d 490, 491–92 (App. Div. 1987); *Yusufzai v. Owners Transport Communication, Inc.*, 856 N.Y.S.2d 504 (Sup. Ct. 2008).

365. *Greenspun v. Lindley*, 330 N.E.2d 79, 81 (N.Y. 1975).

366. *Id.* at 80–81.

367. *E.g.,* *Medical Self Care v. Nat’l Broadcasting Co.*, 2203 WL 1622181 (S.D.N.Y. 2003); *Schonfeld v. Hilliard*, 62 F. Supp. 2d 1062 (S.D.N.Y. 1999); *BBS Norwalk One v. Raccolta*, 60 F. Supp. 2d 123 (S.D.N.Y. 1999); *Aramony v. United Way of America*, 28 F. Supp. 2d 147 (S.D.N.Y. 1998); *Hart*, 517 N.Y.S.2d at 491–92; *Yusufzai*, 856 N.Y.S.2d 504.

368. *Atherton v. Federal Deposit Ins. Corp.*, 519 U.S. 213, 223–24 (1997) (citing *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982)).

activity state in regulating the directors' conduct of the internal affairs of the corporation. As New York's First Department Appellate Division has stated:

[I]t is Delaware, not New York, which has an interest superior to that of all other States in deciding issues concerning directors' conduct of the internal affairs of corporations chartered under Delaware law. While many States other than Delaware may claim some interest in this transaction, none of them . . . are [sic] in a position to overcome the presumption in favor of the law of the State of incorporation.³⁶⁹

Thus, whether by application of the internal affairs doctrine or via an interest analysis that heavily weights the policy concerns of the formation state, courts virtually always select the law of the formation state to govern investment management matters.

In the case of New York State, this conclusion is strengthened by two additional statutory considerations. First, although NYPMIFA is in certain respects non-uniform, it nevertheless very largely follows UPMIFA word for word. UPMIFA has already been adopted by 51 jurisdictions. As a result, the few unique and relatively minor New-York-specific rules would not seem to be able to support a claim of any New York State policy interest powerful enough to overcome the interest of the foreign formation state.

Second, the N-PCL by its own terms does apply certain of its provisions to foreign charities carrying on activities in New York State. There are two such statutory provisions, and they must be interpreted by reference to two separate legal doctrines. The first—and the more general—statutory provision is N-PCL § 103(a) which reads in part: “this chapter applies to every . . . foreign corporation . . . which is authorized to conduct or which conducts any activities in this state.”³⁷⁰ The second—and the more specific—provision is N-PCL § 1320 which reads in part:

[T]he following provisions, to the extent provided therein, shall apply to a foreign corporation conducting activities in this state, its directors, officers and members:

- (1) Section 623 (Members' derivative action brought in the right of the corporation to procure a judgment in its favor).
- (2) Sections 721 (Exclusivity of statutory provisions for indemnification of directors and officers) through 727 (Insurance for indemnification of directors and officers), inclusive.

369. *Hart*, 517 N.Y.S.2d at 491–92.

370. For this purpose, a “foreign corporation” is “a corporation formed under laws other than the statutes of this state,” N-PCL § 102(7) (McKinney 2005).

(3) Section 906 (Merger or consolidation of domestic and foreign corporations).

The first relevant doctrine of statutory interpretation is that a more specific statutory provision prevails over a more general one.³⁷¹ The leading treatise on statutory construction confirms that this is the dominant view.³⁷² Some New York courts appear to have modified this doctrine by adding a second test: that the more specific provision will prevail only if it is adopted at a later time than the more general provision.³⁷³ Because both of the above statutory provisions were enacted at the same time,³⁷⁴ the second test does not appear to be relevant and the more specific provisions of section 1320 should prevail over the more general provisions of section 103.

The second doctrine of statutory interpretation is that an enumeration of certain items should be understood to intend the exclusion of others that are not enumerated. The doctrine—sometimes referred to in Latin as *expressio unius est exclusio alterius*—is generally applied in New York. A leading treatise states that “there is an inference that all omissions should be understood as exclusions.”³⁷⁵ New York has enacted a strong statutory version of this rule, providing that “where a law expressly describes a particular act, thing or person to which it shall apply, an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded.”³⁷⁶ The New York Court of Appeals has called this a “basic principle” of statutory construction.³⁷⁷ Because N-PCL § 1320 refers only to N-PCL §§ 623, 721-27, and 906, section 1320 should be understood as in-

371. As enunciated by the U.S. Supreme Court, “it is a commonplace of statutory construction that the specific governs the general . . .” *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992) (citation omitted); *accord* *Erie Cnty. Water Auth. v. Kramer*, 167 N.Y.S.2d 557, 562 (App. Div. 1957).

372. 2B SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 51:5 (7th ed. 2010).

373. *See, e.g.*, *Dutchess Cnty. Dep’t of Social Svcs. ex. rel. Day v. Day*, 749 N.E.2d 733, 736 (N.Y. 2001) (citations omitted). The prevailing view is to the contrary, holding that a more specific provision prevails over a more general provision even if the latter is enacted at a later time. 2B SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 51:5 (7th ed. 2010).

374. Both provisions were enacted in 1969. N-PCL § 103. A later amendment to N-PCL § 103 is not relevant here. In 1973, § 103 was amended to make the chapter applicable to all corporations “formed not for profit” under any chapter of New York laws except the consolidated laws. *Id.* On its face, this amendment applied only to corporations formed in New York.

375. 2A SUTHERLAND STATUTORY CONSTRUCTION § 47:23 (7th ed. 2010).

376. N.Y. STAT. LAW § 240 (McKinney 1981).

377. *Arons v. Jutkowitz*, 880 N.E.2d 831, 844 (N.Y. 2007) (Pigott, J., dissenting); *accord* *Morales v. Cnty. of Nassau*, 724 N.E.2d 756, 759 (N.Y. 1999) (referring to “the standard canon of construction of *expressio unius est exclusio alterius*”).

tending to exclude the provisions of NYPMIFA because the provisions of NYPMIFA appear elsewhere (at sections 550–58) in the N-PCL.³⁷⁸

Furthermore, if New York State, as an activity state, attempts to impose its unique, non-uniform NYPMIFA provisions on a foreign institution, the formation state is likely to reject that result, therefore producing a true conflict of laws leaving the institution's fiduciaries subject to uncertain and perhaps even conflicting legal obligations. This situation has arisen under a California statute that applies to closely-held for-profit corporations. The statute provides that a corporation incorporated outside of California will be subject to California's corporate law in certain circumstances.³⁷⁹ The rule only applies, however, to corporations carrying on a majority of their business within California, as measured by a three-factor formula focused on the corporation's revenue, assets, and payroll within and outside of that state.³⁸⁰ At least one California court has applied section 2115 to a foreign corporation, thus declining to choose the law of its formation state, when a majority of its business was conducted in California.³⁸¹ A Delaware decision, however, strenuously declined to follow that result, holding that:

the internal affairs doctrine is not merely a principle of conflicts law. It is also one of serious constitutional proportions—under due process, the commerce clause and the full faith and credit clause—so that the law of one state governs . . . in matters of internal corporate governance. The alternatives present almost intolerable consequences to the corporate enterprise and its managers.³⁸²

Later Delaware decisions have agreed, reiterating the view that application of formation state law is required not only by prudential but also by constitutional considerations.³⁸³ And a more recent California case, citing the Delaware decision approvingly, chose to apply formation state law rather than applying section 2115 to select California law.³⁸⁴

378. See N-PCL § 1320.

379. CAL. CORP. CODE § 2115 (West 1990 & Supp. 2014).

380. *Id.* The statute does not apply to publicly-held or nonprofit corporations.

381. *Wilson v. Louisiana-Pacific Resources, Inc.*, 187 Cal. Rptr. 852, 863 (Ct. App. 1983) (discussing but rejecting various constitutional arguments against the application of activity-state law).

382. *McDermott Inc. v. Lewis*, 531 A.2d 206, 216 (Del. 1987).

383. *E.g.*, *Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1115 (Del. 2005).

384. *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 8 Cal. Rptr. 3d 56, 65 (Ct. App. 2003). The cases are discussed in Matt Stevens, Note, *Internal Affairs Doctrine*:

The threshold for applying California's section 2155 is high: according to its terms, a majority of a foreign corporation's business must occur in California before activity-state law may be applied. By contrast, the threshold under the New York State statutes in question³⁸⁵ is much lower: carrying on any activities within New York State is sufficient. That raises the specter of many activity states³⁸⁶ simultaneously attempting to apply their perhaps-differing rules to the same corporation, thus magnifying the risk of multiple inconsistent legal regimes and the resultant confusion about applicable fiduciary and prudence standards to which investment managers and corporate directors might be subject.

Because charities must have large and "open" (i.e., public) classes of beneficiaries, their beneficiaries may reside in many jurisdictions both within and outside of the United States. Furthermore, because beneficiaries are mobile and new beneficiaries may be identified in yet other jurisdictions, the laws that might be relevant are subject to continuous change. Beneficiaries might be in jurisdictions that, for example, do not permit portfolio investments in common stock, or in interest-bearing securities, or in securities of companies deemed to be acting contrary to local public policy. In at least one insurance-claims case, the New York Court of Appeals was willing to permit application of the "grouping of contacts" analysis to multiple foreign states under a claim-by-claim approach.³⁸⁷ But even if such an approach is acceptable, *ex post*, when insurance claims are involved, it would be impossible to manage a charity's portfolio if the charity's fiduciaries, *ex ante*, could not ascertain which law—of which domestic or foreign jurisdiction—would govern their investment decisions. To guide and regulate the decision-making of portfolio fiduciaries, a simple, stable, and predictable choice of law rule is essential, and the relevant legal principles must be ascertainable at the time decisions are made rather than later when claims may arise.

It follows that—whether by application of the internal affairs doctrine or the interests analysis approach—the law of the formation state, rather than NYPMIFA, should govern the investment management functions for foreign institutions with activities or beneficiaries within New York State.

California Versus Delaware in a Fight for the Right to Regulate Foreign Corporations, 48 B.C. L. REV. 1047 (2007) (favoring application of activity-state law).

385. See *supra* text accompanying notes 370–71.

386. It is relevant to recall that "activity state" is not limited to States but may include sub-divisions of States, and indeed foreign countries and their subdivisions, thus dramatically multiplying these risks. See *supra* note 361.

387. *In re Liquidation of Midland Ins. Co.*, 947 N.E.2d 1147, 1178–79 (N.Y. 2011).

VI.

UNIFORMITY OF INTERPRETATION

As its name implies, the ULC desires to foster uniformity in interpretation of its so-called uniform laws. Section 1.2 of the ULC Constitution provides that “[i]t is the purpose of the Conference to promote uniformity in the law among the several States on subjects as to which uniformity is desirable and practicable.”³⁸⁸ It is standard ULC practice to include explicit uniformity language in its uniform laws. Thus, section 10 of UPMIFA states that “[i]n applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.”³⁸⁹ In the enactment of NYPMIFA, however, section 10 of UPMIFA was omitted. Does that lead to a negative implication, i.e., that New York courts and regulators should *not* look to other States’ interpretations of UPMIFA in deciding issues arising under NYPMIFA? The answer to that question is no: no such implication should arise; New York courts and regulators should, as appropriate, refer to and follow UPMIFA decisions in other States.

NYPMIFA does contain some unique provisions not found in any other State’s version of UPMIFA. In interpreting those provisions, New York regulators and courts obviously will be on their own. NYPMIFA also contains some provisions that, while not unique to New York, were adopted only by a minority of other States, e.g., the seven percent presumption-of-imprudence rule. Relevant decisions and interpretations from those other minority States should inform New York interpretations of that rule.

There are two reasons why no negative implication should arise from New York’s failure to enact section 10 of UPMIFA. The first stems from consideration of the legislative history of NYPMIFA’s enactment and the second from other New York State case law precedent.

Otto von Bismarck is often credited with saying, “If you like laws and sausages, you should never watch either one being made.”³⁹⁰ NYPMIFA’s enactment process was certainly chaotic and messy enough to justify that quotation. Among the people who were deeply involved in it, none can recall any mention whatsoever of any con-

388. UNIFORM LAW COMMISSION Constitution § 1.2, *available at* <http://www.uniformlaws.org/Narrative.aspx?title=Constitution> (last visited Apr. 11, 2014).

389. UPMIFA § 10.

390. The attributed quotation cannot be verified, however.

scious reasoning about omitting UPMIFA's section 10.³⁹¹ It seems clearly to have fallen out of the final form of NYPMFA for no particular purpose. There is, therefore, no reason to believe that the omission should be understood as having been intentional rather than accidental.

At least seventeen other uniform laws have been adopted by New York State with uniformity provisions intact.³⁹² In at least one prior case, however, New York adopted a uniform law without enacting its uniformity provision: although the Uniform Determination of Death Act contains a uniformity provision,³⁹³ the provision is omitted from the uniform law as enacted in New York State.³⁹⁴ Notwithstanding that omission, New York Courts have referred to relevant court decisions in other States in determining how to interpret that law.³⁹⁵ This seems entirely correct and provides additional precedential authority for allowing New York courts and regulators to inform their judgment in interpreting NYPMIFA by reference to decisions in other States.

391. Telephone Interview by Harvey P. Dale with Abe Lackman, former President, cIcu (Aug. 11, 2011); Telephone Interview by Harvey P. Dale with Laura Anglin, President, cIcu (Aug. 15, 2011). None of the authors can recall any discussion of any reason for omitting that provision.

392. N.Y. GEN. BUS. LAW § 899-p (McKinney 2012) (Uniform Athlete Agents Act); N.Y. CRIM. PROC. LAW § 640.10(5) (McKinney 2006) (Uniform Act to Secure the Attendance of Witnesses from Without a State in Criminal Proceedings); N.Y. DOM. REL. LAW § 78 (McKinney 2010) (Uniform Child Custody Jurisdiction and Enforcement Act); EPTL § 6-6.6 (McKinney 2002) (Uniform Disposition of Community Property Rights at Death Act); N.Y. C.P.L.R. § 5407 (McKinney 1997) (Uniform Enforcement of Foreign Judgments Act); N.Y. C.P.L.R. § 5308 (McKinney 1997) (Uniform Foreign Money-Judgments Recognition Act); N.Y. C.P.L.R. § 3119(f) (McKinney 2005 & Supp. 2014) (Uniform Interstate Depositions and Discovery Act); EPTL § 11-A-6.1 (McKinney 2008) (Uniform Principal and Income Act); EPTL § 13-4.11 (McKinney 2008) (Transfer-on-Death Security Registration Act); EPTL § 7-6.24 (McKinney 2002) (Uniform Transfers to Minors Act); N.Y. GEN. OBLIG. LAW § 5-1311(2) (McKinney 2012) (Uniform Vendor and Purchaser Risk Act); N.Y. U.C.C. § 1-102 (McKinney 2002) (Uniform Commercial Code).

393. UNIF. DETERMINATION OF DEATH ACT § 2, 12A U.L.A. 784 (2008).

394. N.Y. COMP. CODES R. & REGS. tit. 10, § 400.16 (2011) (Determination of Death). The uniform law was adopted in New York as a regulation rather than as a statute.

395. See Alvarado by Alvarado v. New York City Health and Hospitals Corp., 547 N.Y.S. 2d 190, 196 (Sup. Ct. 1989) (citing *In re Welfare of Bowman*, 617 P.2d 731 (Wash. 1980) and *Dority v. Superior Court of San Bernadino*, 193 Cal. Rptr. 288 (Ct. App. 1983)).

VII.
ACCOUNTING CHANGES DUE TO ENACTMENT
OF UPMIFA—FASB 117-1

In addition to its impact on the N-PCL and other New York laws, NYPMIFA's enactment impacted certain accounting principles and financial reporting requirements.

In general, institutional balance sheets reflect three classes of net assets: permanently restricted, temporarily restricted, and unrestricted. Unrestricted assets are free of donor restrictions. Temporarily restricted assets are assets subject to restrictions that can be fulfilled either by the passage of time or through actions taken by the institution. Permanently restricted assets are subject to donor restrictions that do not expire with time or through actions taken by the institution.³⁹⁶ Under UMIFA, it was clear that the HDV of endowment funds was to be categorized as permanently restricted.

With UPMIFA and the elimination of the HDV rule, it is less clear how to determine what portion of an institution's net assets to classify as permanently restricted. Nevertheless, the accounting standards continue to require classification of net assets into the three historic categories.

New guidelines issued by the Financial Accounting Standard Board (FASB) for institutions subject to UPMIFA require that a portion of an endowment fund of perpetual duration be classified as permanently restricted, and, in the absence of specific donor guidance as to what portion should be so classified, the governing board must determine that portion.³⁹⁷ The financial statements must include a disclosure regarding the governing board's rationale for the classification.

396. Budak & Gary, *supra* note 77, at 3.

397. FIN. ACCOUNTING STANDARDS BD., FASB STAFF POSITION NO. FAS 117-1: ENDOWMENTS OF NOT-FOR-PROFIT ORGANIZATIONS 3 (2008) [hereinafter FAS 117-1], available at http://www.fasb.org/pdf/fsp_fas117-1.pdf. According to the FASB website, this Staff Position, and all previous guidance, have technically been superseded by FIN. ACCOUNTING STANDARDS BD., ACCOUNTING STANDARDS UPDATE: TOPIC 105—GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (2009), available at <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819710691&blobheader=application%2Fpdf>. *Pre-Codification Standards*, FIN. ACCOUNTING STANDARDS BD., <http://www.fasb.org/jsp/FASB/Page/PreCodSectionPage&cid=1218220137031#fsp> (last visited April 21, 2014). In addition, FASB has issued a pronouncement regarding launching a project to reexamine existing standards for financial statement presentation by not-for-profit entities. *Project Update*, FIN. ACCOUNTING STANDARDS BD., http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176159286112 (last updated Mar. 19, 2014).

The repeal of the HDV rule means that many institutions, previously bound in perpetuity not to appropriate for expenditure assets below the HDV level, are now free of that restriction, but are subject to a standard of prudence imposed by NYPMIFA. The accounting rules, however, continue to require that some portion of endowment assets be classified as permanently restricted. This creates a disconnect (or at least a lack of clarity) between the accounting and the legal rules.

Susan Gary, the reporter for the UPMIFA Drafting Committee, interprets the FASB 117-1 directive as giving governing boards three options for determining the amount of an endowment fund that boards can classify as permanently restricted. These options include: (i) the HDV of the fund; (ii) an amount indexed for inflation in a manner that preserves purchasing power of the original gift; or (iii) an amount less than the value of the original gift but which is a floor below which the governing board determines it is imprudent to appropriate.³⁹⁸ Anecdotal evidence, however, suggests that many accountants recommend the first option, which means that institutions would have to continue to track HDV for accounting purposes but not for legal purposes.

In addition to standards relating to permanently restricted net assets, FASB 117-1 requires all earnings on endowment funds to be classified as temporarily restricted until appropriated. Previously, such earnings were classified as “unrestricted” unless the donor also specified the use of the returns by used for a limited purpose.³⁹⁹ In some instances, such reclassifications may impact debt covenants that key off of the portion of an institution’s assets that are unrestricted,⁴⁰⁰ and have other implications.

Moody’s, a credit rating agency, indicated that it does not expect financial reporting changes resulting from adoption of UPMIFA to impact credit quality. Moody’s states, “UPMIFA may improve the availability of funds as the governing Board uses its discretion when making spending decisions and can authorize spending even from a fund that is considered ‘underwater.’”⁴⁰¹

398. Budak & Gary, *supra* note 77 at 3.

399. FAS 117-1, *supra* note 397.

400. It may be prudent for a governing board to resolve, under NYPMIFA, to appropriate temporarily restricted funds and thereby reclassify them as “unrestricted” in order to avoid defaulting on a bond covenant. The governing board would not be required to expend these funds, but would merely “appropriate” them for expenditure for purposes of satisfying a bond covenant.

401. MOODY’S INVESTORS SERVICE, UPMIFA IMPLEMENTATION BY ENDOWED ORGANIZATIONS WILL NOT ALTER CREDIT EVALUATION FOLLOWING CHANGED ACCOUNTING TREATMENT 1 (2009).

VIII.

CALL TO CLEAN UP PROBLEMS

Due to the pressures of advancing the legislation and the disparate views of the stakeholders, the Act was adopted with a number of technical errors as well as certain provisions that the authors believe are unnecessary or untenable for donors, institutions, and institutional beneficiaries. The authors of this article call on all of the stakeholders of NYPMIFA to advocate for changes to be made to the Act itself and for interpretation that would lessen the burdens of institutions so that they may most efficiently continue to provide for their beneficiaries. The authors believe that there are three main avenues for correction: (i) chapter amendments (through which technical corrections can be made), (ii) chapter amendments (through which substantive changes can be made), and (iii) further advice from the Attorney General that would interpret the non-uniform NYPMIFA provisions in a manner that makes compliance feasible and that sets forth guidance for directors striving for improved fiduciary conduct and legal compliance.

A. Technical Corrections

There are a number of technical drafting errors that the authors advocate changing through chapter amendments. First, drafting errors appear in section 558 (Electronic Signatures Act), where certain subparagraph references appear to have been dropped and the reference to section “7001(a)” should instead refer to “7001(c).”⁴⁰² Second, in section 555(d)(4), relating to the type of funds for which notice is not required to be given to the donor prior to modification or release of a restriction, the authors believe that the reference should be to clause (C) of subparagraph two of section 553(e) (Received as a Result of an Institutional Solicitation) instead of clause (B) (Gift Instrument Limits Institution’s Authority to Appropriate).⁴⁰³ Third, section 555(a) uses the term “charitable” in limiting the uses of a released or modified fund. Since the Act applies to more than just charitable institutions, this word should be dropped.⁴⁰⁴

Fourth, prior to NYPMIFA, section 2-b(1)(c) (Applicability of not-for-profit corporation law) of the Religious Corporation Law indicated that section 514 of the N-PCL (Delegation of investment management) did not apply to religious corporations.⁴⁰⁵ This has not

402. See N-PCL § 558 (McKinney Supp. 2014).

403. See *id.* § 555(d)(4).

404. See *id.* § 555(a).

405. *Id.* § 514 (McKinney 2005) (repealed 2010).

changed with the enactment of NYPMIFA. However, prior to the enactment of NYPMIFA, section 514 provided for both internal and external delegation. It now provides only for internal delegation, with external delegation addressed in the new section 554 enacted by NYPMIFA.⁴⁰⁶ Section 554 is not excepted from applicability to religious corporations under section 2-b(1)(c) of the RCL. The authors believe this to be a drafting error, and suggest that section 2-b(1)(c) of the Religious Corporation Law also indicate that the external delegation provision found in section 554 of the Act does not apply to religious corporations.⁴⁰⁷ Finally, in delegating investment management authority to internal agents, the governing board also must consider, if relevant, the eight factors that the board is required to consider when making investment decisions pursuant to section 552 of the Act.⁴⁰⁸ As these factors seem irrelevant to internal delegation and do not even appear in relation to external delegation, the authors believe that this requirement was an inadvertent drafting error and should be deleted.

B. Substantive Amendments

The authors believe that certain provisions enacted as part of the Act are inappropriate and have a negative impact on donors, institutions, and charitable beneficiaries. These provisions include the requirement that all institutions adopt and maintain a written investment policy (even where an institution has no investments),⁴⁰⁹ the seven percent rebuttable presumption of imprudence,⁴¹⁰ and the requirement to notify donors of existing endowments prior to appropriating, even for appropriations of income and appreciation.⁴¹¹ The authors believe that each of these provisions should be eliminated or further limited in applicability.

C. Regulatory Advice

The *AG Guide*, which sets forth its views on the Act, is helpful.⁴¹² The *AG Guide*, however, contains certain interpretations of the Act with which the authors disagree, and which the authors believe are contrary to the intention of the drafters and detrimental to those the

406. *Id.* § 554 (McKinney Supp. 2014).

407. *See* discussion *supra* note 300.

408. *See* NYPMIFA, ch. 490, § 7, 2010 N.Y. Laws 1334, 1341 (amending N-PCL § 717(a)).

409. N-PCL § 552(f).

410. *Id.* § 553(d).

411. *Id.* § 553(e).

412. *See* AG GUIDE, *supra* note 64 at 12–13.

Act attempts to protect. These include the instruction that an institution should ensure that any decision to appropriate from multiple similarly-situated endowment funds simultaneously is justified by applying the factors to each fund individually prior to the appropriation. The *AG Guide* does not clarify how to comply with this instruction, and if all such funds are indeed similarly situated it is difficult to understand what additional steps would be required in a fund-by-fund decision-making process. The Charities Bureau should clarify that, following a prudent decision with respect to similarly-situated funds, fund-by-fund analysis is generally not required unless it appears that there are differences among some of the funds in question that would be material to one or more the factors.

In addition, the *AG Guide* does not appropriately address the drafting error set forth in section 555(d)(4) of the Act,⁴¹³ which indicates that notice need not be given to the donor for release or modification of a restriction on a small, old fund if a limitation on appropriation is already set forth in the gift instrument. As noted above, this should instead indicate that notice need not be given to a donor for release or modification of a restriction on a small, old fund if the gift was made as the result of an institutional solicitation. Rather than indicating it would interpret this provision in its intended manner in the *AG Guide*, the Charities Bureau takes the position that, absent clarification from the New York State Legislature, notice pursuant to the release and modification provision on small, old funds should be given to any donor that is available.

Finally, the *AG Guide* indicates the Charities Bureau's position that an institution should not release or modify a restriction on a small, old fund if it does not have the consent of the Charities Bureau. The *AG Guide* does not indicate what recourse, if any, an institution may have if the Charities Bureau does not give its consent. The Act does not require that an institution receive the Attorney General's consent prior to such release or modification—the Act only provides for notice to the Attorney General. The authors believe that where an institution does not receive the consent of the Attorney General's Charities Bureau, it may release or modify the restriction, and the Attorney General will need to bring a court proceeding to overturn the release or modification.⁴¹⁴ The authors believe that the Attorney General's Char-

413. See N-PCL § 555(d)(4).

414. Of course, an institution might, at the urging of the Attorney General, agree to delay its release or modification in exchange for the Attorney General agreeing to postpone initiating a court proceeding for some period of time.

ities Bureau should issue additional guidance regarding NYPMIFA addressing these issues.

CONCLUSION

In general, the enactment of NYPMIFA has greatly enhanced the ability of institutions to provide needed services for its beneficiaries, while protecting donor intent. It is unlikely that institutions with endowment funds will face the same tough choices during the next economic downturn as they faced during the 2008 financial crisis. However, the Act is not without flaws. The authors hope that all stakeholders in the nonprofit sector, including institutions, regulators, lawmakers, and donors, can work together to make the changes necessary to increase the effectiveness of this law for all interested parties.

APPENDIX A

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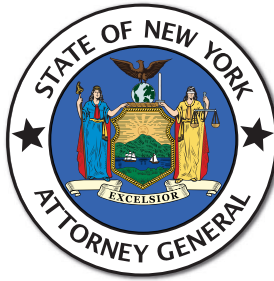
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APPENDIX B

**A PRACTICAL GUIDE TO THE
NEW YORK PRUDENT MANAGEMENT
OF INSTITUTIONAL FUNDS ACT**

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**A PRACTICAL GUIDE TO THE
NEW YORK PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT**

**Office of the Attorney General
Charities Bureau**

The Charities Bureau of the New York State Attorney General's Office offers this guide on the New York Prudent Management of Institutional Funds ("NYPMIFA" or "the Act"), which took effect on September 17, 2010. This guide provides an overview of the Act and includes practical guidance that is intended to assist charities and other institutions in complying with the Act's new requirements. This guide contains general information and is not a substitute for legal advice from an attorney.

BACKGROUND

NYPMIFA – New York's version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") – governs the management and investment of funds held by not-for-profit corporations and other institutions. It replaces and updates key provisions of the Uniform Management of Institutional Funds Act ("UMIFA"), which was adopted in New York in 1978.

NYPMIFA makes important changes to the rules governing the spending of endowment funds – funds that are not wholly expendable on a current basis due to donor-imposed restrictions on spending. In particular, and unlike prior law, it allows institutions to spend endowment funds below their original dollar amount ("historic dollar value") without court approval or Attorney General review, if the institution's board of directors concludes that such spending is prudent. NYPMIFA also provides standards for the prudent management and investment of institutional funds, the delegation of management and investment functions to outside advisors, and procedures for lifting or modifying donor-imposed restrictions on the management, expenditure or use of institutional funds.

Recognizing that the proposed uniform legislation (UPMIFA) gives boards of directors broader authority to spend donor-restricted endowment funds than they had under prior law, New York's version of the legislation built in additional requirements for institutions and their boards and additional protections for donors – provisions unique among the 47 states that had thus far adopted UPMIFA. Among other things, NYPMIFA requires that boards determine whether it is appropriate to consider alternatives before deciding whether to authorize expenditure of an endowment fund. It also requires that a notice be given to available donors of endowment funds who executed the gift instrument before September 17, 2010, allowing these donors to opt out of the new rule permitting institutions to spend below the historic dollar value of endowment funds. In addition, the Act includes several provisions that strengthen corporate governance with respect to oversight of institutional funds and delegation of management and investment functions. These additional provisions are designed to encourage and assist boards to exercise their broader spending powers responsibly.

The text of the Act is on the Charities Bureau website at www.charitiesNYS.com.

OVERVIEW OF THE ACT

The Act adds a new Article, 5-A (§§ 550-558), to New York's Not-for-Profit Corporation Law (N-PCL),¹ which addresses four principal areas:

- Standards of conduct for prudently managing and investing institutional funds (new N-PCL § 552);
- Rules that boards must follow in deciding whether to appropriate from or accumulate endowment funds (new N-PCL § 553);
- Standards for delegating management and investment functions to outside agents (new N-PCL § 554); and
- Rules pertaining to the lifting or modification of donor restrictions on management and investment of institutional funds, and on donor restrictions on use of such funds (new N-PCL § 555).

The Act applies to all entities defined as “institutions” under the Act, including all New York not-for-profit corporations, corporations formed under the Religious Corporations Law and education corporations as defined in Education Law § 216-a.² Under the Act, whenever an action is required to be taken by an institution, such action must be authorized by the institution's governing board. N-PCL § 551(d).

Standard of Conduct in Managing and Investing Institutional Funds (N-PCL § 552)

The Act provides that each person responsible for managing and investing an institutional fund “shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” N-PCL § 552(b). The Act sets forth basic requirements for satisfying the standard of prudence, including a requirement that an institution make a reasonable effort to verify facts relevant to the management and investment of the fund, and that an institution only incur costs that are reasonable and appropriate.

The Act also requires that the following factors, if relevant, be considered in managing and investing an institutional fund:

- (1) general economic conditions;
- (2) the possible effect of inflation or deflation;
- (3) the expected tax consequences, if any, of investment decisions or strategies;
- (4) the role that each investment or course of action plays within the overall investment portfolio of the fund;
- (5) the expected total return from income and the appreciation of investments;

¹ The Act also amends portions of N-PCL Article 5 and N-PCL § 717, as well as sections of the Religious Corporations Law, the Estates Powers and Trusts Law, the Surrogate's Court Procedure Act, and the Executive Law. L.2010 ch.490 §§ 2-14. The existing special rules for cemetery corporations continue to apply. *See* N-PCL § 1507.

² N-PCL § 551(d) defines “institution” as: “(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; or (3) any corporation described in subparagraph five of paragraph (a) of section 102 (Definitions).”

- (6) other resources of the institution;
- (7) the needs of the institution and the 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.

N-PCL § 552(e)(1).

Additionally, the Act requires that investments of an institutional fund be diversified “unless the institution prudently determines that, because of special circumstances, the purposes of the fund are better served without diversification.” N-PCL § 552(e)(4). A decision not to diversify must be reviewed as frequently as circumstances require, but at least annually.

The Act also requires every institution to adopt a written investment policy setting forth guidelines on investments and delegation of management and investment functions. N-PCL § 552(f).

Expenditure of Endowment Funds (N-PCL § 553)

Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets (*i.e.*, may not be spent) until they are “appropriated for expenditure” by the institution. N-PCL § 553(a). Although this term is not defined in the Act, an appropriation is generally understood to mean a decision by the governing board to release a portion of an endowment fund from the donor-imposed restriction on spending, thus authorizing it to be spent in accordance with the terms of the gift instrument. Funds appropriated for expenditure need not be spent immediately; such funds may be appropriated on one date and spent at a later date or over a period of time. Effective September 17, 2010, decisions to appropriate from endowment funds are governed by N-PCL § 553.

Under prior law, an institution could appropriate for expenditure so much of the net appreciation as its governing board determined was prudent; however, the institution could not appropriate below the historic dollar value of an endowment fund without court approval unless the gift instrument permitted such appropriation. *See* former N-PCL § 513(c). The Act removes the prohibition on appropriations below the historic dollar value of endowment funds; however, the donor of an endowment fund established before September 17, 2010 who is “available” as defined in the Act may opt to retain the historic dollar value limit with respect to that fund by responding to a notice sent by the institution (see below). Furthermore, as under prior law, the donor of an endowment fund may include an explicit spending limitation in the gift instrument. The Act continues to require that decisions to appropriate for expenditure from endowment funds be made prudently, but adds specific criteria for determining when this standard is met.

In deciding whether to appropriate from an endowment fund, the institution must act “in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances,” and must consider, if 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.

N-PCL § 553(a)(1)-(8).

The seventh factor, requiring an institution to consider alternatives to expenditure, is unique to New York and is discussed further in the Guidance below.

Contemporaneous Records

An institution must make a contemporaneous record of the consideration it gave to each of the factors in deciding to appropriate. If the institution decides to accumulate rather than appropriate from an endowment fund, it must also keep a record of such action. N-PCL § 553(a), (f).

Presumption of Imprudence

For endowment gifts made after September 17, 2010, the Act creates a rebuttable presumption of imprudence if an institution appropriates more than 7% of the fund's fair market value (averaged over a period of not less than the preceding five years) in any year. The presumption of imprudence does not apply to appropriations permitted by law or by the gift instrument. An appropriation of 7% or less of an endowment fund's value in any year is not presumptively prudent. N-PCL § 553(d)(1), (2).

Notice to Donors of Endowment Funds

The Act allows "available" donors of endowment gifts made pursuant to gift instruments executed before September 17, 2010 to opt out of the new rule permitting institutions to appropriate below the historic dollar value of endowment funds. A donor is considered available if the donor can be found with reasonable efforts and is living (if an individual) or conducting activities (if an entity). The institution must send each available donor a written notice describing the donor's two options, which contains language substantially as follows:

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.

N-PCL § 553(e)(1).

If the donor does not respond within 90 days from the date notice was given, or if the donor returns the notice within 90 days and checks Box #1, NYPMIFA's new spending rules will apply to the donor's endowment gift. If the donor checks Box #2, the institution may not appropriate for expenditure below the historic dollar value of the endowment gift but may spend the income and appropriate the appreciation over historic dollar value if it is prudent to do so, unless otherwise prohibited by the gift instrument. Institutions must keep a record of all notices sent to donors. *See* N-PCL § 553(f).

Donor notice is not required in three circumstances:

- The gift instrument already permits spending below historic dollar value;
- The gift instrument expressly limits spending in the manner set forth in § 553(b) of the Act; or
- The donor made the gift in response to an institutional solicitation but did not include a separate statement restricting use of the funds.

N-PCL § 553(e)(2).

Delegation of Management and Investment Functions to Outside Agents (N-PCL § 554)

NYPMIFA sets forth legal standards that govern the delegation of management and investment functions by boards of directors to agents outside of the institution (external agents). The Act requires that boards use prudence in selecting, continuing or terminating an agent, and that they consider, among other things, the agent's independence including any conflicts of interest that such agent has or may have.

Standard of Care for Delegation

The Act provides that, subject to any specific limitation set forth in a gift instrument or another law, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that such a delegation is prudent under the circumstances. In order to delegate prudently, an institution must act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances in:

- (1) selecting, continuing or terminating an agent, including assessing the agent's independence including any conflicts of interest such agent has or may have;
- (2) establishing the scope and terms of the delegation, including the payment of compensation, consistent with the purposes of the institution and the institutional fund; and

- (3) monitoring the agent's performance and compliance with the scope and terms of the delegation.

N-PCL § 554(a)(1)-(3).

Standard of Care for External Agent Performing Delegated Duties

In performing a delegated function, an external agent owes a duty to the institution to exercise reasonable care, skill and caution to comply with the scope and terms of the delegation. N-PCL § 554(b). The Act continues to require that any contract that delegates a management or investment function to an external agent must provide that the contract may be terminated at any time, without penalty, with up to 60 days prior notice. N-PCL § 554(e).

Release of Donor-Imposed Restrictions on Management, Investment, or Purpose of an Institutional Fund (N-PCL § 555)

The Act modifies the standards for releasing donor-imposed restrictions on institutional funds, including restrictions on the management and investment of funds, the expenditure of funds (endowment restrictions), and the purposes for which a fund may be used. It also sets forth procedures for seeking court release of restrictions, and a new procedure for releasing restrictions on funds valued at less than \$100,000 that have been in existence for more than 20 years.

As under prior law, an institution may obtain the donor's written consent to release or modify a restriction on management or investment. If the donor is available and withholds such consent, or if the donor is not available, an institution may seek court approval to release or modify a restriction regarding the management or investment of an institutional 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. To the extent practicable, any modification must be made in accordance with the donor's probable intention. N-PCL § 555(a), (b).

Similarly, an institution may obtain the donor's written consent to release or modify a use restriction. If the donor is available and withholds such consent, or if the donor is not available, an institution may also seek court approval to release a donor's restriction on the use of a fund if the restriction becomes impossible, impracticable, unlawful or wasteful. N-PCL § 555(c).

A key difference from prior law is that under NYPMIFA an institution may seek court release from a restriction if the donor does not consent to the release. Notice of the court proceeding must be provided to the donor and to the Attorney General, both of whom will have an opportunity to be heard. N-PCL § 555(b), (c). However, under the Act, the executors or heirs of a deceased donor are not included in the definition of "donor" and thus are not entitled to notice.

In addition, the Act provides a new procedure whereby an institution may lift or modify a donor-imposed restriction on the management, investment, or purpose of an institutional fund if the fund is less than \$100,000 in value and has been in existence for more than 20 years. If an institution determines that such a restriction is unlawful, impracticable, impossible to achieve, or wasteful, the institution may release or modify the restriction, in whole or part, without court

approval, after giving written notice to the Attorney General, unless the Attorney General objects to the release or modification within 90 days. If the Attorney General does not notify the institution within 90 days, the institution may proceed with the release or modification. N-PCL § 555(d).

The institution's written notice to the Attorney General must contain the following:

- An explanation of (i) the institution's determination that the restriction is unlawful, impracticable, impossible to achieve, or wasteful, and (ii) the proposed release or modification;
- A copy of a record of the institution approving the release or modification; and
- A statement of the proposed use of the institutional fund after such release or modification.

N-PCL § 555(d)(2), (3).

The notice must also be given to the donor, if available.³

After releasing or modifying the restriction, the institution must use the property in a manner consistent with the purposes expressed in the gift instrument. N-PCL § 555(d)(1)(C).

Solicitations for Endowment Funds (Executive Law § 174-b[2])

The Act also amends Executive Law § 174-b[2] to require a disclosure when institutions solicit for endowment funds. Under the new provision, the solicitation must include a statement that, unless otherwise restricted by the gift instrument pursuant to N-PCL § 553(b), the institution may expend so much of the endowment fund as it deems prudent after considering the factors set forth N-PCL § 553(a).⁴

³ Although the Act provides that notice to the donor need not be given for funds described in N-PCL § 553(e)(2)(B), this appears to be a drafting error. The intended reference may have been to § 553(e)(2)(C), where the gift consists of funds received as a result of an institutional solicitation without a separate statement by the donor expressing a restriction on the use of funds. Absent clarification by the Legislature, it is the view of this Office that notice pursuant to N-PCL § 555(d) should be given to any donor that is available.

⁴ L.2010 ch.490 §14 (amending Executive Law § 174-b[2]).

GUIDANCE

In the following sections, we provide practical guidance for institutions on key topics covered by the Act. This guidance is subject to change and may be supplemented from time to time. The views expressed here are those of the Attorney General's Charities Bureau; the meaning and effect of the provisions of the Act are ultimately matters for determination by the Courts of this State.

Notice to Donors of Endowment Funds

Is notice to donors required?

The Act states that unless an exception applies, an institution "must" provide 90 days notice to available endowment donors who executed gift instruments prior to September 17, 2010 before applying the new endowment spending rules in N-PCL § 553(a) for the first time. The notice requirement as written is not optional; the institution must send the notice before appropriating from the endowment fund. (The three exceptions to the notice requirement are described on page 5 above.)

It is possible that in the interim between September 17, 2010 and the issuance of this guidance some institutions, acting in good faith, may have appropriated from endowment funds before sending notice to the donors as required by N-PCL § 553(e)(1). In this case, the institution should promptly send the notice to donors if it has not already done so. If the donor responds by checking Box #2 on the notice, it is the view of this Office that the institution must restore the fund to its historic dollar value if any pre-notice appropriation reduced the fund below that level. (The rules that apply when the donor checks Box #2 are discussed below.)

Questions have been asked about whether notice is required if the endowment fund is above historic dollar value and the institution has no present intention to appropriate below historic dollar value. It is the view of this Office that notice is required. The Act makes no distinction between funds that are above historic dollar value or below; the notice is required in either case. If notice were not required while the fund is above historic dollar value, institutions could delay sending the notice, perhaps indefinitely, which is not, in our view, what the Legislature intended.

Read in the context of N-PCL § 553 as a whole, the notice serves two related but distinct policy objectives: (1) to provide the donor with *information* about the change in law with regard to an institution's authority to appropriate for expenditure below the historic dollar value of endowment funds, and (2) to give the donor an *opportunity to clarify or amend* the terms of the donor's gift with regard to such appropriations. The informational purpose of the notice is not served if the notice is not given. Furthermore, although a particular endowment fund may be "above water" now, the fund may drop below historic dollar value at some point in the future when the donor may no longer be available to clarify or amend the terms of the gift. Delaying the notice or withholding it altogether 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. For these reasons, it is this Office's 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.

May an institution appropriate from an endowment fund during the 90-day period after notice is sent?

Although not expressly addressed in the Act, it is this Office's view that the Legislature did not intend the notice requirement to harm organizations by prohibiting any appropriation of endowment funds before the notice process is completed. A reasoned interpretation of the notice requirement is that, after notice is sent, an institution may appropriate the income and the net appreciation over historic dollar value of an endowment fund during the 90-day notice period, if it is prudent to do so in accordance with N-PCL § 553(a). Expenditures above historic dollar value after giving notice to the donor would not prejudice donors who may check Box #2 because principal would remain preserved during the 90-day notice period. An institution may not, however, appropriate for expenditure below the historic dollar value of an endowment fund until the 90-day notice period ends, unless the donor has returned the notice and checked Box #1.

What rules apply to the endowment fund if the donor checks Box #1 on the notice?

If the donor checks Box #1, all decisions to appropriate and spend endowment funds, as well as decisions to accumulate and not spend those funds, are governed by N-PCL § 553(a). The historic dollar value limitation on endowment appropriations that existed under prior law no longer applies.

What rules apply to the endowment fund if the donor checks Box #2 on the notice?

If the donor checks Box #2, the institution may not appropriate below the historic dollar value of the endowment fund without first obtaining court approval on notice to the Attorney General and the donor, if available. The institution may spend the income and appropriate the appreciation over the historic dollar value of the fund if it is prudent to do so. As under prior law, the historic dollar value of a "Box #2" endowment fund and the amount, if any, of appreciation of the fund that is available for appropriation is determined on a fund-by-fund basis, not by simply aggregating the asset values of multiple endowment funds. Also, as under prior law, if an institution appropriates below the historic dollar value of such an endowment fund (for example, as a result of applying a spending policy), it is the view of this Office that the institution has a duty under N-PCL §§ 553(e)(1) and 717 to restore the endowment fund to its historic dollar value.

Questions have been raised about the effect of language in the notice stating that if Box #2 is checked "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." When read in the context of the overall notice provision, it is apparent that this language was intended to clarify that the statutory criteria permitting expenditures below historic dollar value do not apply when Box #2 is checked. It is this Office's view that, other than the historic dollar value limitation, Article 5-A continues to apply to these endowment funds. Thus, for example, if the donor checks Box #2, the governing board must still determine that any appropriation from the endowment fund is prudent after considering the factors enumerated in § 553(a), and the board must make a contemporaneous record of each determination to

appropriate from the fund. To conclude otherwise would take “Box #2” endowment funds out of the Act entirely, with no statutory standard governing appropriation and accumulation of funds, which is a result the Legislature could not have intended.

While the Act requires that the notice to donors contain language substantially as set forth in N-PCL § 553(e)(1), institutions may wish to add an assurance to donors that if Box #2 is checked, all decisions to appropriate from the endowment fund must still be prudent under the Act and that the endowment fund will remain subject to other provisions of the Act.

Does the term “original dollar value” in the required notice have the same meaning as “historic dollar value”?

The Act does not define “original dollar value”; however, when read in the context of the statutory notice set forth in N-PCL § 553(e)(1), it is this Office’s view that this term is intended to be a plain-English equivalent of “historic dollar value” as defined in N-PCL § 102(a)(16). That section defines “historic dollar value” as “the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund.” That section goes on to state that “[t]he determination of historic dollar value made in good faith by the corporation is conclusive.”

What steps should an institution take to determine whether a donor is “available” such that notice is required?

A donor who is an individual is “available” if the donor is living and can be identified and located with reasonable efforts. If the donor of a particular fund is not known, the institution should make reasonable efforts to identify the donor. For donors whose current address is unknown, the institution should make reasonable efforts to locate the donor, including Internet searches and contacting known associates of the donor, such as an attorney who represented the donor when the gift was made. The statute requires institutions that send the N-PCL § 553(e)(1) notice to keep a record. N-PCL § 553(f). The record should document the institution’s efforts to locate donors even if those efforts ultimately did not succeed.

Expenditure of Endowment Funds

How does the Act modify previous concepts of endowment spending?

Traditional endowment concepts focused on preserving “principal” and spending “income.” In the 1970s, UMIFA expanded permissible spending to include a prudent amount of the appreciation of the endowment fund; this remained the law until September 17, 2010. The Act takes a different approach, reflecting the view that a prudent investment strategy requires institutions to invest their endowments and other institutional funds for “total return,” which may result in increases (or decreases) in principal, income or both. The Act thus requires institutions to determine spending based on the total assets of the endowment fund. As the drafters of UPMIFA have noted:

Although the Act does not require that a specific amount be set aside as “principal,” the Act assumes that the institution will act to preserve “principal” (i.e., to maintain the purchasing power of the amounts contributed to the fund) while spending “income” (i.e. making a distribution each year that represents a reasonable spending rate, given investment performance and general economic conditions). Thus, an institution should monitor principal in an accounting sense, identifying the original value of the fund (the historic dollar value) and the increases in value necessary to maintain the purchasing power of the fund.⁵

Must the board consider all eight factors for every endowment fund appropriation?

The Act states that the board must consider the eight factors “if relevant,” so at a minimum the board must consider each factor to determine whether or not it is relevant. As discussed below under “Contemporaneous Records,” if the board determines that any factor is not relevant, it should document how it reached that conclusion.

If a factor is relevant, the board should go on to consider to what extent the factor affects the decision whether or not to appropriate or how much to appropriate. Although the factors should be considered individually, the board should also look at the “big picture” and consider how the factors, considered together and weighted appropriately, affect the decision at hand. The nature and extent of the board’s consideration of the factors may vary from institution to institution, depending on the institution’s size, purposes, programs, financial condition and other circumstances.

May an institution make a single appropriation decision for multiple endowment funds?

In this Office’s view, the Act contemplates that decisions to appropriate from endowment funds will ordinarily be made on a fund-by-fund basis and documented in a separate contemporaneous record for each endowment fund.⁶ A question has arisen as to whether there are circumstances in which the Act would permit an institution to make a single decision to appropriate from multiple endowment funds and document that decision in a single contemporaneous record. The question is of particular interest to larger institutions holding numerous endowment funds, for example, a community fund with numerous endowment donors or an educational institution with hundreds or even thousands of endowment funds for scholarships, endowed chairs and other purposes.

In this Office’s view, the governing board of an institution may make a single decision to appropriate from multiple endowment funds, and this decision may be documented in a single contemporaneous record, provided that the endowment funds are similarly situated. The

⁵ National Conference of Commissioners on Uniform State Laws, Uniform Prudent Management of Institutional Funds Act (2006), available at http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf (“UPMIFA”) § 4, Comment at p. 21.

⁶ This is evidenced by N-PCL § 553’s consistent use of the defined terms “donor,” “endowment fund” and “gift instrument,” each of which is phrased in the singular. See also the definitions of these terms in N-PCL § 551(a-1), (b) and (c).

governing board should develop written procedures for determining when a group of funds is similarly situated for this purpose. Such a determination may be based on factors including the purposes of the funds as stated in the gift instruments, the spending restrictions imposed in the gift instruments, the durations of the funds, the financial condition of the funds, whether the funds are invested similarly, and such other factors as may be relevant under the circumstances.

A decision to treat a group of endowment funds as similarly situated group should be made with care to ensure that any decision to appropriate from the funds collectively would be justified if the factors in N-PCL § 553(a) were applied to each fund individually.

What is meant by “alternatives to expenditure of the endowment fund,” and how should institutions give consideration to that factor?

As noted above, N-PCL § 553(a) requires that, in making a determination to appropriate or accumulate from an endowment fund, the board must consider, if relevant, eight factors, including “(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.” In this Office’s view, the inclusion of this factor, which is unique among all states that have adopted UPMIFA, was intended to ensure that boards do not automatically decide to appropriate from endowment funds when circumstances warrant considering whether reasonable alternatives are available. For example, if an endowment fund has diminished in value, the board may determine that it is appropriate to take steps to avoid or reduce further spending of the fund. Such steps might include, where appropriate, fund-raising efforts, expense reductions, sale of non-essential assets, or reductions in non-essential staff. The board might also consider whether certain expenditures can prudently be deferred. The board should identify the particular alternatives that might be appropriate in the circumstances and discuss to what extent these steps are feasible as an alternative to endowment spending, including what impact such alternatives would have on the institution’s operations and programs. The consideration of alternatives should be appropriately documented (see “Contemporaneous Records,” below).

Contemporaneous Records of the Determination to Appropriate

What should the contemporaneous record address?

The contemporaneous record of the determination to appropriate should address each of the eight factors included in N-PCL § 553(a) and discuss the consideration that the board gave to each factor. In this Office’s view, it is not sufficient to state in a conclusory fashion that the board considered a particular factor; rather, the record should describe the substance of the consideration given to each factor. If any factor was deemed not relevant to the board’s decision, the record should explain why.

As stated above, if the governing board of an institution makes a single decision to appropriate from multiple endowment funds that are similarly situated, it is this Office’s view that the decision may be documented in one contemporaneous record.

How should the contemporaneous records be documented?

The form of the record is less important than the substance. The record may be made in the board's minutes; alternatively, boards may wish to develop a record especially for the purpose of documenting their decisions to appropriate endowment funds for expenditure. Contemporaneous records of decisions to appropriate from endowment funds should be maintained as part of the permanent records of the institution. The Charities Bureau may request production of these records in the exercise of the Attorney General's supervisory authority over institutions.

When should contemporaneous records be prepared?

To be contemporaneous, the record should be prepared at the time the board makes a decision to appropriate from an endowment or immediately thereafter. If the board relies on advice and information from professionals (such as lawyers, accountants or investment advisors) when it decides to appropriate endowment funds for expenditure, it may (but is not required to) incorporate all or part of such written advice in its contemporaneous record, to the extent such advice is not privileged, confidential or proprietary.

Presumption of Imprudence***Does the presumption of imprudence mean that an institution can safely appropriate up to 7% of the value of its endowment funds each year?***

The Act makes it clear that an appropriation of 7% or less of the value of an endowment fund in any year does not create a presumption of prudence. The level of appropriation for each endowment fund held by an institution must be determined in accordance with the prudence standard in N-PCL § 553(a) of the Act, after consideration of the enumerated factors.

Does an endowment spending policy of 7% or less per year in itself ensure that the presumption of imprudence will not be triggered?

No. The Act's 7% standard is based on the endowment fund's fair market value averaged over at least *five years* immediately preceding the year in which the appropriation for expenditure is made (or over the life of the fund if the fund has been in existence less than five years). If, for example, an institution's spending policy is based on fair market value averaged over a shorter period, the spending policy may result in appropriations that are presumptively imprudent under the Act. All spending policies should be reviewed to determine how they interact with the presumption of imprudence. If necessary, institutions must perform a separate calculation, averaging the fund's fair market value over at least the preceding five years, in order to determine whether a proposed appropriation would be presumptively imprudent.

Managing and Investing Institutional Funds***What topics should the investment policy address?***

There is no “one size fits all” investment policy that applies to all institutions. The contents of the investment 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 nature and scope of the institution’s activities or programs. Examples of the subjects an investment policy may include:

- (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) processes for reviewing investment policies and strategies; and
- (10) proxy voting.

The board should review the investment policy at regular intervals and whenever a change in the institution’s financial condition or other circumstances so require.

Delegation of Management and Investment Functions to Outside Agents***What steps should a board take to assess an outside investment agent’s independence?***

Governing boards should be diligent in assessing the independence of outside investment agents – both before and after retaining them. Outside investment agents should be selected based on the agent’s competence, experience, past performance, and proposed compensation, and not on any business or personal relationships between the agent and board members or other insiders. It is essential that board members are capable of objectively assessing and monitoring investment performance and risk without regard to those relationships.

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. For example, assume a chairman of the board asks the board to transfer management of institutional funds to his private investment firm. The board must decide whether it is prudent to do so under the circumstances, and whether it feels it can objectively oversee and monitor the agent’s performance going forward. The governing board should also consider whether the retention of outside agents who have business or personal relationships with board members or other insiders might prevent the board from receiving independent advice on investment strategy and risk. For example, assume the board chair wishes to switch investments to his firm, in part to invest in derivative products developed by his firm. Can the board of directors, based on advice it receives from investment advisors employed by the board chair’s firm,

objectively determine in good faith that such an investment strategy is in the best interests of the organization?

To avoid these situations and alleviate the pressure that board members may experience, some boards may determine that the best course of action is to adopt a policy requiring that all outside agents be independent. Although not required by the Act, it is this Office's view that institutions are well-advised to adopt policies that require full disclosure of relationships with outside agents and implement practices that ensure objective oversight by the board. At a minimum, an institution should have a conflict of interest policy and follow the policy in selecting, continuing or terminating the agent. Such a policy would generally include procedures for determining whether any of the institution's officers or directors have a financial interest in the agent or have any other material business or personal relationship with the agent. If so, the policy should provide for reporting such relationships or interests to the board and should address abstention or recusal of the director or officer in question.

**Release of Donor-Imposed Restrictions on
Management, Investment, or Purpose of an Institutional Fund**

What should an institution do before seeking court release of a donor-imposed restriction on an institutional fund?

Because a court proceeding can be expensive and time-consuming, an institution may first wish to inquire whether the donor is available and willing to consent in writing to the proposed release or modification in accordance with N-PCL § 555(a). The donor's written consent would obviate the need for court approval.

If it is necessary to seek court release or modification of a donor-imposed restriction, when should the institution contact the Attorney General's Office?

Although not required by law, the Attorney General's Charities Bureau urges institutions and their counsel to submit a draft petition to the Charities Bureau for review and discussion before filing the petition with the court. A copy of the gift instrument and other relevant documentation should also be submitted in advance. Advance review by the Charities Bureau can help to identify and resolve potential issues, thus simplifying the proceeding and saving time. Petitions should be submitted to the Charities Bureau at the earliest possible time to allow sufficient time for review. Please confirm that the Charities Bureau's review has been completed before commencing a proceeding in court.

Release of Restrictions on "Small, Old" Funds

What procedures apply when submitting a notice to the Attorney General under N-PCL § 555(d) to release or modify a restriction on a "small, old" fund?

The institution should first determine whether the donor, if available, will consent to the release, thus avoiding the need to submit a notice to the Attorney General. If the donor is not

available or is unwilling to consent, then the institution must comply with § 555(d) in order to release the restriction. First, the institution must make a record (typically, a resolution of the board) approving the release or modification of the restriction. A copy of this record must be submitted to the Attorney General's Charities Bureau together with a written notice of the institution's intention to release the restriction and explaining why the restriction has become unlawful, impracticable, impossible to achieve, or wasteful. The notice must also describe the proposed use of the fund if the restriction is released.

In addition to meeting the above statutory requirements, the notice to the Attorney General's Charities Bureau should include a copy of the gift instrument and other documentary evidence sufficient to show that the fund's total value is less than \$100,000 and that more than 20 years have elapsed since the fund was established. Additionally, if the donor is available, and particularly if the donor has withheld consent, the notice should include copies of any correspondence between the institution and the donor with regard to the proposed release or modification. If the donor has been notified pursuant to N-PCL § 555(d)(4), a copy of this notice should be included in the notice sent to the Attorney General.

Notices to the Attorney General pursuant to N-PCL § 555(d) should be sent as follows:

If sent by e-mail with PDF attachment (preferred method), to:
section555.notice@ag.ny.gov

If sent by regular mail, to:
Attorney General of the State of New York
Attention: Chief, Charities Bureau
120 Broadway, 3rd Floor
New York, NY 10271

What procedures apply after the § 555(d) notice is submitted to the Charities Bureau?

If the Charities Bureau has questions or requires further information, or if the Charities Bureau objects to the proposed release or modification, the Charities Bureau will notify the institution in writing within 90 days. If such notice is received, the institution should not release or modify the restriction unless and until it receives a further written notice from the Charities Bureau stating that any questions or objections have been resolved to the satisfaction of the Attorney General. We anticipate that many such issues will be resolved after discussions with the institution or its counsel.

CONCLUSION

For further information, please contact the Attorney General's Charities Bureau at the address shown above.

This and other Charities Bureau booklets, forms and instructions are available on the Attorney General's website at <http://www.charitiesnys.com>.

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