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**REPORT IN SUPPORT OF NEW YORK'S ADOPTION OF THE
UNIFORM PRUDENT MANAGEMENT
OF INSTITUTIONAL FUNDS ACT,
WITH SUGGESTED MODIFICATIONS**

The Committee on Non-Profit Organizations (the "Committee") of the New York City Bar Association (the "Association") recommends enactment of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") in New York, subject to the modifications set forth below. The Committee members are lawyers in the New York City area with an interest in legal issues affecting non-profit organizations. Committee members include attorneys in private practice, attorneys who serve as "in-house" counsel to non-profit organizations, current and former regulators, and prominent academics. A list of committee members is attached to this report. The Committee believes the collective professional experience of its members provides a perspective that is pertinent to consideration of UPMIFA in New York State. However, the views expressed in this letter reflect the views only of the Committee, not necessarily the views of any law firms, governmental agencies or non-profit organizations with which members of the Committee are affiliated or whom they represent.

BACKGROUND

UPMIFA was approved and recommended for enactment in all states by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in July 2006. Where enacted, it would replace the Uniform Management of Institutional Funds Act ("UMIFA") in states where UMIFA is current law. UMIFA was approved by NCCUSL in 1972 and has been enacted in 48 jurisdictions. 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").

UMIFA was novel in that, as enacted in New York, it, among other things: (i) permits charitable corporations to use modern investment techniques such as total-return investing when managing/investing their funds; (ii) provides endowment spending rules that do not depend on trust accounting principles of income and principal; and (iii)

permits the release of restrictions on the use/management of funds under certain circumstances.

Many, including this Committee, see certain portions of UMIFA as out-of-date. Per the prefatory note to UPMIFA, UPMIFA is an attempt to: (i) provide modern articulation of the prudence standards for the management and investment of charitable funds and for endowment spending; and (ii) incorporate certain recent revisions with respect to charitable trusts, as set forth in the Uniform Prudent Investor Act (“UPIA”), promulgated in 1994 and enacted in 46 jurisdictions (including New York), into the law governing charitable corporations, such that standards for managing and investing institutional funds are the same regardless of whether a charitable organization is organized as a trust, corporation or some other entity. (UPMIFA Prefatory Note, p. 1)

After careful review, the Committee believes that UMIFA (as codified in the N-PCL) warrants revisions due to the fact that certain provisions are out-of-date.

COMMITTEE’S RECOMMENDATIONS

UPMIFA is comprised of twelve sections. The Committee’s specific comments to certain sections of UPMIFA are set forth immediately below. Unless specifically discussed below, the Committee recommends adoption of a section without comment.

1. Short Title (UPMIFA Section 1)

Section 1 states that the act may be cited as the Uniform Prudent Management of Institutional Funds Act.

If it is decided to move forward with enactment of UPMIFA in New York, the Committee recommends that careful consideration be given to how to integrate UPMIFA into the law it affects. That is, the Committee recommends careful consideration of whether UPMIFA should be fully integrated into either the N-PCL or the Estates, Powers, & Trusts Law (“EPTL”) with a cross-reference to the other statute, or enacted as a stand-alone act crossreferenced in both the N-PCL and the EPTL. The Committee notes that, as drafted, UPMIFA (unlike UMIFA, which, as currently codified in the N-PCL, applies only to charitable corporations) would apply to all charitable “institutions,” including all charitable corporations, as well as, generally, those charitable trusts of which a charitable “institution” or a governmental agency is the trustee. (Charitable trusts with exclusively individual, corporate and other fiduciaries that are not charitable “institutions” are excluded from both UPMIFA and UMIFA, as currently codified in the N-PCL).

2. Appropriation for Expenditure or Accumulation of Endowment Fund; Rules of Construction (UPMIFA Section 4)

A. General Provisions

Under the Uniform Management of Institutional Funds Act (“UMIFA”), as enacted in New York, a charitable organization can only spend amounts [of an endowment fund] above "historic dollar value" that it determines to be prudent, where historic dollar value is defined as all contributions to an endowment fund valued at the time of contribution. UPMIFA eliminates the historic dollar value limitation on

endowment fund spending. Under UPMIFA, subject to the intent of a donor expressed in a gift instrument, a charitable organization may spend any amount that is prudent, consistent with the purposes of the fund, relevant economic factors and the donor's intent that the fund continue in perpetuity (or for a period specified in the gift instrument). The proposed elimination of the historic dollar value limitation is motivated by the view that a donor's intent to create a fund of long duration that preserves its value is not always best served by a strict adherence to maintaining historic dollar value and, under certain circumstances, dipping below historic dollar value can, in the long run, better serve such donor intent.

Subsection (c) of Section 4 provides rules of construction to assist charitable organizations in interpreting donor intent. It states that terms in a gift instrument designating a gift as an endowment, or a direction/authorization in the gift instrument to use only “income,” “interest,” “dividends” or “rents, issues or profits,” or “to preserve the principal intact,” or similar words create an endowment fund of permanent duration (unless there is additional language limiting duration) but do not otherwise limit spending authority. Under UPMIFA, these rules of construction will be applied retroactively to funds already in existence.

In an August 2007 report, the Committee supported elimination of the historic dollar value limitation on spending *on a prospective-only basis*. For the following reasons, the Committee has now decided to withdraw its previous objection to UPMIFA’s *retroactive* elimination of the historic dollar value limitation on spending.

i. *Relevant Economic Factors*

As the philanthropic climate deteriorates in the current global markets crisis and the endowments of many charities are “underwater,” *i.e.* worth less than their “historic dollar value,” these charities, particularly those who have received funds for an endowment in the last five to seven years, are struggling to finance the accomplishment of their basic charitable missions, *e.g.*, providing food and shelter for the homeless or scholarships to needy students. Since many charities are now strapped for dollars, their ability to tap into the principal of their endowments may be the only source for operating funds.

Pursuant to UPMIFA, charities would be able to “prudently” spend funds in their endowments below the “historic dollar value.” Previously, the Committee supported *prospective - only* application of the historic dollar value provisions of UPMIFA because the Committee did not want to negatively impact donors who may have relied on the pre-UPMIFA endowment spending limitations of UMIFA.¹ However, since many charities are now unable to fund their charitable missions (some are shutting their doors), the economic crisis arguably supports adopting UPMIFA on a retroactive basis and allowing charities to spend a reasonable amount of the principal of their current endowments.

¹ Many UPMIFA advocates believe that most donors probably were not aware of the historic dollar value spending limitations contained in UMIFA when they established endowments, and therefore, they could not have “relied” on these limitations.

ii. *UPMIFA Supports “Donative Intent”*

The Committee believes UPMIFA may actually support “donative intent” better than UMIFA, the current law. Most donors would presumably want their donees to be able to spend some principal if the donees find their economic well-being threatened without the use of such funds. Accordingly, allowing retroactive application of the elimination of the historic dollar value spending limitation may reflect greater respect of donative intent. As noted, UMIFA, the current law, prohibits *any* invasion of the historic dollar value of the principal of an endowment, whereas UPMIFA supports it within reason.

iii. *Other States’ Treatment of UPMIFA*

To date, thirty-two states have adopted UPMIFA. A brief review of the legislation indicates that the thirty-two states have unanimously adopted UPMIFA to apply to previously-created funds, including the elimination of the historic dollar value spending limitation. This legislative trend has helped convince the Committee that it may be appropriate and more feasible to enact UPMIFA with the retroactive application of the removal of the historic dollar value spending limitation.

iv. *Retroactive Application of UMIFA*

There is precedent for the retroactive application of the proposed UPMIFA statute based on the retroactive application of the current law. UMIFA has been adopted in 48 jurisdictions and was adopted in New York in 1978. UMIFA is now codified in certain sections of the New York Not-for-Profit Corporation Law. UMIFA, when adopted by New York and the other 47 states, was adopted to be applied to existing endowments. Consequently, there is legislative precedent which indicates that retroactive application of UPMIFA would be proper.

B. Optional Presumption of Imprudence

UPMIFA includes as an optional provision (to be included at the enacting jurisdiction’s option) a presumption of imprudence if a charitable organization spends more than 7% of an endowment fund in any one year. The presumption is meant to protect against spending an endowment too quickly.

While the Committee does not have a recommendation as to whether or not New York State’s version of UPMIFA should include the optional provision, if such a provision is included, the Committee strongly recommends that the provision be made more flexible in some manner (e.g., that the percentage be adjusted for fluctuations in current market interest rates and the rate of inflation/deflation and that the presumption discriminate based on type of spending, such as permitting exceptions for multi-year capital campaigns).

C. Optional Provision regarding Small Funds Invading Historic Dollar Value

The comments to Section 4 of UPMIFA include as an optional provision (to be included at the enacting jurisdiction’s option) a provision requiring notice to the Attorney General (the “AG”) for small charitable organizations invading historic dollar value. The provision is meant to curb imprudent spending by small, unsophisticated charitable organizations. In particular, the provision would:

- apply only to charitable organizations with endowment funds valued, in the aggregate, at less than [\$2 million] (or another amount established by the enacting jurisdiction); and
- require such organizations to notify the AG (but not obtain its consent) before spending below historic dollar value. The AG would then have the opportunity to review the organization and its spending decision, educate the organization on prudent decision-making for endowment funds, and intervene if the AG determines the spending would be imprudent.

The Committee recommends consideration of adoption of this section, both as a regulatory matter and as a possible source of comfort to donors.

D. Accounting Issues

Under UMIFA, a fund's historic dollar value is shown as permanently restricted from an accounting perspective. The comments to Section 4 of UPMIFA maintain that endowment funds, notwithstanding the repeal of the historic dollar value limitation, will still be considered legally restricted because there are some limitations on current spending (albeit flexible). The comments assert this to be true regardless of the treatment from an accounting perspective. [Comments to UPMIFA Section 4, p. 23] The Committee understands that discussions are ongoing within the accounting profession regarding the effects of the elimination of the historic dollar value limitation on the accounting treatment of endowment funds. The Committee thinks that consideration of this issue is extremely important, not only with respect to charitable organizations understanding how to present their financial statements accurately, but also in terms of current and prospective donors digesting those statements.

3. Release or Modification of Restrictions on Management, Investment, or Purpose (UPMIFA Section 6)

Generally, the provisions set forth in Section 6 are the same as, or clarify, UMIFA's provisions relating to release/modification of institutional fund restrictions with donor or court consent. In particular, UPMIFA clarifies that the doctrines of *cy pres* and deviation apply to funds held by charitable corporations as well as to funds held by charitable trusts.

However, Section 6 also contains a new provision, not included in UMIFA, that would permit a charitable organization to modify a restriction on its own (i.e. without court approval) for small funds [less than \$25,000] (or another amount as determined by the enacting jurisdiction) that have existed for a substantial period of time [20 years] (or another time period as determined by the enacting jurisdiction), after giving notice [60 days] (or another notice period as determined by the enacting jurisdiction) to the AG. The AG may then take action if the proposed modification appears inappropriate. The provision is meant to permit a charitable organization to lift a restriction that may no longer make sense where the cost of a judicial *cy pres* proceeding would be so great as to be prohibitive.

The Committee generally recommends inclusion of such a provision, but proposes that the provision be revised to permit a charitable organization to modify a restriction without court approval only so long as it notifies the AG and obtains AG consent to such modification (either as originally proposed in the notice or with the AG's suggested changes). If, however, the AG

does not provide its consent, if the charitable organization desires to pursue the modification, it must then proceed with a typical court proceeding.

* * *

For the above reasons, the Committee recommends enactment of UPMIFA in New York, with the noted suggested modifications. Please do not hesitate to contact me with any questions, or if you would like to discuss any of the Committee's recommendations.

Very truly yours,

Eliot P. Green
Chair

April 23, 2009

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