Tax-Exempt Organizations

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Underwater Endowments: Understanding Your Options

With world financial markets down dramatically, and losses magnified by far-reaching financial fraud, many charities are facing difficult questions about what they can and must do with endowment funds that are underwater. We have been receiving many questions from our clients on this subject, and it is our sense that charities might find it helpful to better understand the law in this area and the options available to them.

Identifying Endowment Funds. Under New York law, the term "endowment fund" refers to each particular fund in an organization's investment portfolio that is not "wholly expendable . . . on a current basis" due to donor restrictions. Usually the term refers to a fund set up by a particular gift instrument, though at times it could refer to a specific fund set up by the organization that is funded by multiple gifts from different individuals. An organization's endowment funds are usually part of a larger investment portfolio, and charities should remember that the unrestricted assets in the portfolio are not subject to the rules addressed in this article.

Identifying Underwater Endowment Funds. Generally speaking, an endowment fund is said to be "underwater" when its value is less than at the time of original funding. In New York, that original value is known as the fund's "historic dollar value" (sometimes referred to in this article with the shorthand "HDV").

Tracking Underwater Endowment Funds. Each endowment fund has its own HDV and its own unique financial and legal history. Even though charities rarely segregate one endowment fund from another or invest one endowment fund differently from another, charities are required *as an internal accounting matter* to track and report on each endowment fund separately.[1] Although it is possible for an organization's entire endowment portfolio to be underwater, it is more commonly the case that some funds are underwater (often the more recent ones, with the highest HDV) and that other funds (particularly older ones with a low HDV) remain at or above the so-called waterline.

Part I of this article outlines options that may be available to New York not-for-profit corporations when an endowment fund is underwater.[2] For readers who would like a fuller understanding of New York endowment law, Part II explains the current rules governing the use of endowment funds by New York not-for-profit corporations. Part III provides a glimpse of changes to the law that may be on the horizon, namely, the possible adoption of the Uniform Prudent Management of Institutional Funds Act (or "UPMIFA"), which would change aspects of New York endowment law that, in the eyes of many, do not reflect the realities of today's investment landscape or advance the wishes of donors.

The general guidance in this article is no substitute for a thorough analysis of the restrictions on particular endowment funds or advice concerning the proper handling of those funds. After a legal analysis of the gift instrument that governs a particular endowment fund and the way the endowment fund has been spent or not spent, charities commonly discover that they have either more or less flexibility than they had thought.

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I. Options Available When an Endowment Fund Is Underwater

New York law sets forth rules governing how charities must account for and report on their endowment funds as well as the circumstances under which net appreciation of an endowment fund may be spent. However, the law provides little guidance on what can be done when a particular endowment fund is underwater. The following are four options that may be available to charities that find themselves in that situation.

Option 1 – Expend Fund Income (and Only Income)

When the Endowment is Underwater Due to Asset Depreciation. As explained further in Part II, a charity may not apply its endowment spending rate to an underwater endowment fund. However, a charity may *always* spend the fund's income – that is, interest, dividends, and other classic forms of income such as rents and royalties – if three conditions are met: (a) if the gift instrument does not prohibit spending income when the fund is underwater, (b) if the fund is underwater due to asset depreciation rather than appropriations that dipped into historic dollar value, and (c) if the expenditure of the income meets the standard of prudence (described in greater detail in Part II). Capital gains in an underwater endowment fund are not considered income for this purpose, unless, again, the donor has stipulated otherwise.

When Appropriations Have Caused the Endowment To Dip Below HDV. The ability to spend income from an underwater endowment fund is less assured if the fund is underwater due to appropriations that dipped into HDV (e.g., on account of the way the charity's endowment spending policy had been applied). In that situation, the New York Attorney General has said that the organization has an "affirmative duty" of restoration and has cautioned that failure to make the restoration "may subject" the board to liability for breach of the duty of care (i.e., imprudence).[3]

The contours and implications of this duty are unclear. At a minimum, it requires retention of new appreciation until the fund is again above water. Whether it also requires retention of income until restoration is complete is uncertain; this would appear to depend upon the specific circumstances facing a given organization and may also differ from endowment fund to endowment fund within the same portfolio, depending on their various purposes and other particularized constraints. There could, for instance, be situations where it would be *imprudent* to retain income of an endowment fund, in which case the board's duty of care would seem to point towards expenditure rather than retention, notwithstanding a duty to restore.

Due to the Attorney General's statement concerning this "affirmative duty," an organization with an endowment fund that is underwater due to appropriations of HDV, rather than asset depreciation, might wish to discuss the matter with legal counsel, and possibly the Attorney General, before spending fund income.

A Duty To "Top Up" Underwater Endowment Funds with Unrestricted Funds? In connection with the issue of restoration, we also note that there seems to be a widespread view that nonprofit organizations are legally obligated to apply unrestricted funds to underwater endowment funds to accomplish the restoration to historic dollar value. As the preceding discussion demonstrates, however, the legal principles are significantly more nuanced than that. Although there may be cases when it would be prudent to use unrestricted assets to replenish an underwater endowment fund, there does not appear to be an obligation to do so, except possibly in a case where the fund is underwater due to appropriations that have dipped into HDV.

Investment Portfolio Considerations

Anecdotal evidence suggests that due to the recent market losses and current climate of economic uncertainty, charities have been converting larger and larger portions of their endowment portfolios to cash. Obviously, that is a decision each organization must make based on its unique situation, including its cash-flow and liquidity needs, and its views concerning financial markets and asset allocation. To the extent, however, that organizations have concluded it is prudent *not* to be in cash, their portfolios are typically designed to generate both income *and* appreciation, taking into account both the short- and long-term needs of the organization. When an endowment fund is underwater, there may be an impetus to favor investments, such as distressed debt, that can generate high levels of income. However, an investment strategy that is overly reliant on generating income provides no anchor to protect the organization from the effects of inflation and, over a long period of time, could diminish the purchasing power of any endowment fund invested in such a manner. Additionally, such a strategy may involve levels of risk that are not consistent with the board's duty of care.

Application of the Charity's Spending Rate. If a charity has a mixture of endowment funds and employs an endowment spending policy (calling, say, for the expenditure of 5.5% per year of the average value of the entire endowment portfolio during the preceding 36 months), the ability to appropriate and spend only the income of the underwater endowment funds presents an accounting challenge. This is because endowment spending may not be drawn *pro rata* from all endowment funds if any of these are underwater or would go underwater if drawn down on a *pro rata* basis.

In this situation, either the amount determined by the endowment spending policy will have to be reduced, or the amount will have to be allocated so that funds that are not underwater bear a disproportionate share of the endowment draw. When there is a disproportionate draw, it will be necessary to reallocate the units in the portfolio. This task requires careful attention, and sometimes laborious calculations, by an organization's finance or accounting staff. If, however, *all* of an organization's endowment funds are underwater, the charity should limit its endowment draw purely to interest, dividends, and other forms of income and, if prudent, an amount corresponding to appreciation that was duly appropriated before the particular funds went underwater (see Option 2, discussed below).

Note that if the gift instrument for an endowment fund *expressly* permits application of a charity's spending rate to the fund, without regard to whether a portion of HDV is appropriated or spent, draw from that endowment fund need not be limited to income. In such a case, the gift instrument in effect overrides the default statutory rule that would otherwise apply when an endowment fund is underwater.

Option 2 – Expend Appreciation Appropriated While the Endowment Was Above Water

There is a distinction under New York law between the *appropriation* of net appreciation and its *expenditure*. If the board has properly *appropriated* net appreciation, the charity appears to have the ability to expend this appreciation even if the endowment fund drops below its HDV before the funds have been spent, so long as the expenditure is prudent at the time it is actually made. One policy rationale supporting this interpretation of the law is that it would be highly disruptive to the overall management of an organization and the fulfillment of the fund's intended charitable purposes if the charity were unable to rely on past budgetary decisions.

Funds That Are the Functional Equivalent of Underwater Endowment Funds

Due to a little-known but important New York rule prohibiting appropriation of the unrealized net appreciation on *non-readily marketable* assets (see Part II), it is possible for an endowment fund to be functionally equivalent to an underwater fund even when it is worth *more* than its historic dollar value. Such a situation may arise when an endowment fund is invested in hedge funds, private equity funds, or other alternative investments that are not "readily marketable." If the fund experiences losses on readily marketable securities and unrealized gains on non-readily marketable assets, the endowment fund may be above water only because of the unrealized appreciation on the non-readily marketable assets. Because so many charities hold non-readily marketable assets in their endowment portfolios, this New York rule may leave organizations at risk of having endowment funds that are not, strictly speaking, underwater but that are nevertheless available for expenditure only to the extent they are generating interest, dividends, and other types of income. It is important, therefore, that New York charities track the portion of their endowment portfolio that is attributable to unrealized appreciation on non-readily marketable assets – and recognize that this type of appreciation may not be appropriated.

It is important to be able to demonstrate, however, that an appropriation actually occurred and that the appropriation has not since lapsed or been treated as having lapsed. For example, it would be helpful if the records of the organization showed that the appropriation had been carried forward on its books and in its budgets.

Moreover, as explained in Part II, charities should be aware that not all types of appreciation are available for appropriation: specifically, unrealized appreciation on non-readily marketable assets may not be appropriated (or spent). Of course, a board is never required to spend previously appropriated appreciation; it may decide it is not prudent to spend those appropriations until the value of the endowment fund again equals or exceeds its HDV. Thus if a board appropriated but did not expend appreciation before an endowment fund went underwater, the board should revisit the issue of whether its subsequent expenditure would be a prudent decision.

Option 3 – Seek the Donor's Permission to Release or Modify the Endowment Restrictions

If a charity determines that it requires greater access to an endowment fund than the terms of the applicable gift instrument permit, it may wish to approach the donor and make a case for the donor's release or modification of the restrictions. The heirs or executor of an individual donor ordinarily do not inherit the donor's right of consent, so the right dies with the donor. For a foundation or other donor that is not an individual, the right of consent lasts as long as the donor is legally in existence.

The release could come in the form of permission to spend the endowment in its entirety, permission to spend no more than a specified portion annually, permission to borrow against the value of the donor's endowment fund, permission to borrow a portion of the endowment fund, subject to a later obligation of repayment, and/or permission to redirect the purpose for which the endowment was originally established. Any such release should be prepared with assistance of legal counsel.

If a donor refuses consent, New York law provides no avenue for circumventing this refusal. That is to say, the charity will have to live with whatever restrictions the donor originally imposed.

Option 4 – Seek Judicial Release of Endowment Restrictions

For a charity seeking access to underwater endowment funds, a fourth option – which is available only when the donor is dead, disabled, impossible to identify, or unavailable – is to initiate a proceeding for judicial relief. In such a proceeding, the charity could seek permission to spend a specific amount from an underwater endowment fund, or it could seek permission to apply the organization's spending rate to the fund, even though that would drive the fund further underwater. The need for relief of this type could become critical if endowment funds remain underwater for several years running, as can happen in a prolonged economic downturn.

In its petition to the court, the organization must include the Attorney General as a necessary party, and the Attorney General will either object to the charity's petition or issue an Affidavit of No Objection.[4] Not surprisingly, the burden for obtaining judicial approval to dip into the HDV of an endowment fund is quite high. Such relief is not available unless an organization can establish, in effect, that without the relief it will fail or be so diminished as to be a fundamentally different organization, or that without relief the specific intentions of the donor will be frustrated. For example, the organization could show that a particular program or activity supported by the endowment fund will have to be terminated and could argue that this would thwart the donor's basic charitable purpose.

As part of the Attorney General's review process, the charity will often be asked to take measures to satisfy the Attorney General that the proposed expenditure from the endowment fund is warranted, prudent, and narrowly tailored to the need at hand. In recent cases, the Attorney General has required that the expenditure of the HDV be limited to a specific dollar amount and be styled as a borrowing from the fund (i.e., an amount that must be repaid when the charity's fortunes improve) rather than as an outright invasion. The Attorney General may also evaluate aspects of an organization's governance as part of this review and may request – or even require as a condition of an Affidavit of No Objection – remedial measures to strengthen governance. If the endowment fund had dipped below HDV on account of investment losses, the Attorney General may inquire about how those losses came about and may evaluate the organization's investment policies and procedures. Finally, the charity can expect the Attorney General to insist that the organization demonstrate how spending or borrowing from the endowment fund's HDV dovetails with a credible plan for a financially stable future.

In all events, the process of obtaining judicial relief from the restrictions on an endowment fund can be time-consuming and expensive and, generally, should be viewed as an option of last resort.

Endowment Borrowing

It is often asked whether charities may borrow *from* their endowments. Less commonly, charities ask if they may borrow *against* their endowments (i.e., use endowment assets as collateral for a loan or a commercial line of credit). There is little authority on either question. Staff members in the New York Attorney General Charities Bureau have stated that judicial relief ordinarily should be obtained whenever a charity borrows from an endowment fund or uses endowment assets as collateral for debt, unless the donor has expressly permitted borrowing or the use of the fund as collateral. Because the issues are complex, an organization should seek legal advice before engaging in either activity or if it has questions about endowment borrowing that has already occurred.

II. Rules Governing Endowments in New York

For those with limited familiarity with endowment law, we provide this summary of some of the basic rules under New York law.

The Gift Instrument Governs, but Rules of Construction Guide Its Interpretation. The starting point for all endowment law analysis is donor intent. A charity's governing board is bound by the terms of the endowment gift instrument.[5] For example, if an endowment fund is given to a university, and the terms of the gift instrument provide that "principal" is to be held intact and the "income" is to be used only for the benefit of the university's library, the board must abide by the terms of the gift, and any amounts classifiable as income under New York law may not be used for other purposes (e.g., student scholarships).

"Income" is defined by statutory rules of construction, which may be overridden by specific language in the gift instrument.[6] Under these rules, a limitation in a gift instrument to spend only the "income" is generally construed in New York to mean interest, rents, dividends and *appreciation*; by the same token, the term "principal" is generally construed to *exclude* appreciation. Hence, unless specifically prohibited by the donor, the board may expend both interest and dividends and certain appreciation of the fund for the specified purpose. Not all appreciation is available for expenditure, though, as will be discussed below.

Historic Dollar Value May Not Be Appropriated or Spent. Absent express donor permission, the governing board may not appropriate or expend the HDV of an endowment fund. HDV is defined as the value of all contributions to a fund, valued at the time of contribution.[7] As indicated above, the New York Attorney General interprets New York law as imposing on a board an "affirmative duty" (i.e., a fiduciary duty as part of the prudent management of the organization) to restore an endowment fund to its HDV.

Decisions to Appropriate Endowment Funds Are Subject to a Standard of Prudence. Under the prudence standard set forth in the New York Not-for-Profit Corporation Law ("N-PCL"), directors and officers of not-for-profit corporations must exercise "that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."[8] The statute requires that in appropriating appreciation, the board must consider factors that include the long- and short-term needs of the charity in carrying out its purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Implicitly, the prudence standard also governs a board's choice of the endowment spending rate.

Unrealized Appreciation on Non-Readily Marketable Investments May Not Be Appropriated for Expenditure. New York is unusual, and perhaps unique, among U.S. jurisdictions in limiting appropriations of unrealized appreciation to the appreciation on *readily marketable* assets.[9] This limitation was incorporated into New York law to prevent charities from making overly optimistic valuations of unrealized appreciation on *non*-readily marketable assets.[10] The N-PCL provides no definition of what sorts of investments are or are not readily marketable (and more than one interpretation may be supported by the statute), but a conservative interpretation would treat as readily marketable only those investments that are traded on a public exchange. A less conservative approach might be to treat as readily marketable only those assets that can be sold within a relatively short period of time.

In all events, this rule complicates the task of determining the amount of an endowment fund that is available for expenditure, because a charity must evaluate the composition of its endowment portfolio to identify the portion of each endowment fund that is and is not invested in readily marketable assets, in order to ensure that the organization appropriates no more than the amount of appreciation on each fund that is attributable to readily marketable assets or to *realized* appreciation on non-readily marketable assets.

Separate Accounts Must Be Kept of Each Restricted Fund. Each restricted fund held by a charity must be accounted for separately.[11] This rule affects the manner in which a charity applies its spending rate, because the spending rate must be applied with regard to *each* endowment fund's purposes, historic dollar value, and available income and net appreciation. Adding confusion to the complexity is the fact that accounting standards require that endowment assets be reported on a charity's financial statements on an aggregated basis, which does not necessarily present a complete picture in terms of the actual amount that, as a legal matter, is available for expenditure with respect to each particular fund. As a result, a board cannot readily tell by looking at financial statements what amount is actually available for expenditure.

A discussion of the disjunction between accounting rules and legal rules is beyond the scope of this article, but boards should be aware that a disjunction exists, particularly as in certain circumstances the financials may appear to *overstate* the amount of restricted funds held by the charity, thereby giving boards the impression that they have less cash available for expenditure than in fact they do.

"Appropriation" May Be Distinguished from "Expenditure." As noted in Part I, there is a distinction between the *appropriation* of net appreciation and its *expenditure*. New York law appears to permit the charity to expend an amount corresponding to appreciation that was properly appropriated by the board (e.g., when the annual budget was approved), even if the endowment fund is below historic dollar value when the appropriated monies are spent. Of course, the expenditure, like the initial act of appropriation, must be prudent, and a board may conclude, when a fund has fallen below HDV, that retaining the appropriated amount is the prudent course to follow.

Annual Reporting Is Required. The charity's treasurer is required to report annually to the members or the board of the organization concerning the administration and use of the assets in the endowment funds held for specific purposes and the income from those assets.[12]

The Donor May Release the Restriction Preventing Expenditure of HDV. New York law provides that upon the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument.[13] If the donor refuses, New York law currently provides no avenue for circumventing a living donor's consent, because judicial relief is available only in the situation of a donor who is dead, disabled, unavailable, or impossible to identify.[14]

Under Certain Circumstances Judicial Release of Restrictions May Be Sought. If the donor is not available for consent for the reasons given above, the charity may initiate a proceeding under one of two provisions of New York law to seek release from the restriction. Under one, the charity must be able to demonstrate that the restriction is "obsolete, inappropriate, or impracticable."[15] Under the other, the charity must be able to show that the restriction is "impossible or impracticable."[16] Charities will need the assistance of legal counsel in determining which of these is advisable.

III. Uniform Prudent Management of Institutional Funds Act – Coming Soon to New York?

The New York legislature may soon be asked to consider a new legal regime that would significantly alter existing endowment law, both for not-for-profit corporations and for charities structured as charitable trusts. The Uniform Prudent Management of Institutional Funds Act, or "UPMIFA," which has garnered widespread support in the nonprofit community, was adopted by the National Conference of Commissioners on Uniform State Laws in 2006 and has become law in about 30 states and the District of Columbia. Although legislation based on the model statute has not yet been introduced in Albany, the text of a proposed bill is in circulation within the charitable community, and it is likely that a bill will be introduced in the near future.

The provisions of New York law discussed above represent New York's enactment of UPMIFA's predecessor model statute, the Uniform Management of Institutional Funds Act ("UMIFA"). New York adopted UMIFA in 1978 with certain modifications, chief of which is the distinction in the law between readily marketable and non-readily marketable assets (discussed in Part II above).

UPMIFA itself grew out of the last economic downturn and was designed to address precisely the situation facing charities now, namely, underwater endowment funds. As the drafters of UPMIFA explain in their prefatory comments, the new model statute is intended to modernize the law and also to give greater flexibility to charities in coping with fluctuations in the value of endowment funds, while maintaining a framework for regulatory oversight.

Changes Introduced by UPMIFA

Elimination of HDV. The most pertinent change introduced by UPMIFA is its elimination of the concept of historic dollar value. In making this change, the drafters cited, among other reasons, the arbitrariness of HDV in fixing value at the time of the gift, HDV's lack of consideration to issues surrounding inflation, and HDV's meaninglessness as a benchmark for endowments that have grown significantly. In place of HDV, UPMIFA expands the prudence standard, giving boards more guidance when making decisions to expend endowment funds. The new standard states: "In making a determination to appropriate or accumulate, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall 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; and

(7) the investment policy of the institution."[17]

According to the UPMIFA drafters, these factors emphasize the importance of the intent of the donor, by which is meant donor intent "as expressed in the gift instrument," rather than the wishes expressed by the donor at the time the expenditure is made by the charity. Of course, any express restrictions contained in the gift instrument – including a prohibition on spending HDV – must be honored; the parameters on expenditure set forth by UPMIFA, like those under current New York law, remain default rules.

Donor Release or Judicial Release of Restrictions. UPMIFA, like UMIFA, permits a board to release an endowment restriction upon consent of the donor. However, if a doner refuses to consent, UPMIFA permits a charity to seek judicial relief anyway. UPMIFA also expands the circumstances under which judicial modification of the restriction is appropriate. In addition, UPMIFA introduces a provision that permits an institution to release or modify a restriction on an endowment fund *without* court approval, upon 60 days' notice to the Attorney General, in instances where the fund's value is less than $25,000, more than 20 years have elapsed since its establishment, and the property will be used consistently with the gift's charitable purposes. (As of this writing, the draft language now in circulation in New York retains these changes except that it would raise that threshold to $100,000 and annually adjust this amount for inflation, and it would require the passage of only 10 years since the establishment of the gift.)

Optional Provisions. UPMIFA contains two optional provisions: (1) a rebuttable presumption of imprudence for an expenditure of an amount greater than 7% of the fair market value of the fund; and (2) a provision that resurrects the concept of HDV for institutions with endowment funds aggregating less than $2 million, requiring that if such an institution plans to appropriate funds that would cause the endowment to fall below aggregate HDV, it must notify the Attorney General at least 60 days beforehand. (The draft UPMIFA legislation being circulated in New York contains neither of these optional provisions.)

Like UMIFA before it, UPMIFA is silent as to any distinction between appreciation on readily marketable assets and non-readily marketable assets. Also like UMIFA, UPMIFA has retroactive application, so it would apply to endowment funds without regard to when they were created. (The proposal circulating in New York likewise draws no distinction between readily marketable and non-readily marketable assets and also has retroactive application.)

Effect of UPMIFA Changes on Options for Spending Underwater Endowment Funds

If enacted, UMPIFA will change the result in each of the four options for underwater endowment funds described above in Part I.

Options 1 and 2 (to spend income only or to spend previously appropriated appreciation) become irrelevant in the UPMIFA landscape, unless the optional notice provision for smaller charities is enacted, because a charity is no longer confined to spending only the income of an underwater endowment or appreciation appropriated before the endowment dipped below HDV. If the optional notice provision is enacted, HDV remains relevant but is of uncertain significance.

Option 3 (to seek donor release of restrictions) remains available but is no longer *required* if the donor is living and may not even be necessary, given the breadth of discretion that UPMIFA would create.

Option 4 (to seek judicial release of restrictions) may become obsolete in the case of applications to spend below HDV if courts conclude that they will not adjudicate in advance the extent to which a charity is permitted to spend down an endowment fund. In other words, courts may conclude that charitable boards simply have to decide, in the exercise of their own judgment, how much of an endowment fund may be prudently spent. (Of course, judicial relief would still need to be sought for modification of other types of restrictions, such as restrictions as to administration of the fund or the purposes for which funds may be spent.)

Additionally, borrowing from an endowment fund should be permissible under UPMIFA if it can be established that the borrowing is prudent.

IV. Parting Words

It is an understatement to say that charities are facing difficult choices when it comes to their endowment spending decisions. Current New York law does not make it easy for boards to obtain relief from their endowments for financial exigencies. UPMIFA, if enacted in New York, will radically change the landscape of endowment law, but we would like to emphasize three core principles that we believe will stand organizations in good stead under either legal regime.

First, the gift instrument is paramount. Charities should always look at the gift instrument first because it determines what steps an organization may take without seeking approval in advance by the donor or a court.

Second, boards must remain aware that they always operate within the constraints of the prudence standard. Thus, even if a gift instrument permits a particular expenditure, the board may not make the expenditure unless it is prudent. Even though UPMIFA, if adopted, will add greater specificity to the contours of this standard, the principle remains the same.

Finally, good process remains the best protection against legal liability. The Attorney General has emphasized time and again that a board's process in coming to its investment and endowment spending decisions is of critical importance. Although process alone may not be a sufficient condition for prudence, adequate process provides a bulwark against later objections that a particular decision was imprudent by enabling boards to demonstrate that they were informed, that they considered the relevant alternatives, and that they arrived at their decisions collectively and by means of disinterested deliberation. ◆

Endnotes

[1] This is customarily done on a unitized basis, similar to the way a mutual fund manager keeps track of the ownership shares of the dozens of investors who are owners of a mutual fund. That is, each endowment fund, like each owner of a mutual fund, is assigned a particular number of units within the investment portfolio, based on how much was contributed in the first place and how much has been added (or subtracted) since the fund was created.

[2] The advice given in this article also applies to education corporations chartered by the Board of Regents.

[3] See the Attorney General's undated publication entitled "Advice for Not-for-Profit Corporations on the Appropriation of Endowment Fund Appreciation," available on the internet at http://www.oag.state.ny.us/bureaus/charities/pdfs/endowment.pdf.

[4] Ordinarily, a charity submits a proposed petition to the Attorney General for review prior to filing any documents with the court.

[5] *See* N-PCL §§ 102(a) & 513(b).

[6] *See* N-PCL § 513(d).

[7] *See* N-PCL § 102(a)(16).

[8] N-PCL § 717(a).

[9] The charity may use "so much of the net appreciation, realized (with respect to all assets) and unrealized (with respect only to readily marketable assets), in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by [N-PCL Section] 717 (duty of directors and officers)." N-PCL § 513(c).

[10] The legislative history indicates that this provision in Section 513(c) was meant to ensure that only appreciation on "salable" assets could be used, the rationale being that this would serve as a "restraint upon any temptation for a board in need of current funds to resort to optimistic appraisals or evaluations of assets that are not readily marketable."

[11] N-PCL § 513(b).

[12] N-PCL § 513(b).

[13] N-PCL § 522(a).

[14] N-PCL § 522(b) states that judicial relief may be sought only "[i]f written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification. . . ." Estates, Powers and Trusts Law ("EPTL") § 8.1-1(c) arrives at this result by requiring that a court order releasing or modifying a restriction "is effective only with the consent of the creator of the disposition if he is living."

[15] N-PCL § 522(b). Which court the charity must make application to depends upon whether the gift was made in a will or other instrument; the charity files its petition with the Surrogate’s Court if the gift instrument is a will and the New York Supreme Court otherwise.

[16] EPTL § 8-1.1(c).

[17] UPMIFA also provides guidance on the factors that should be taken into consideration when managing and investing a fund, but these are beyond the scope of this article.

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