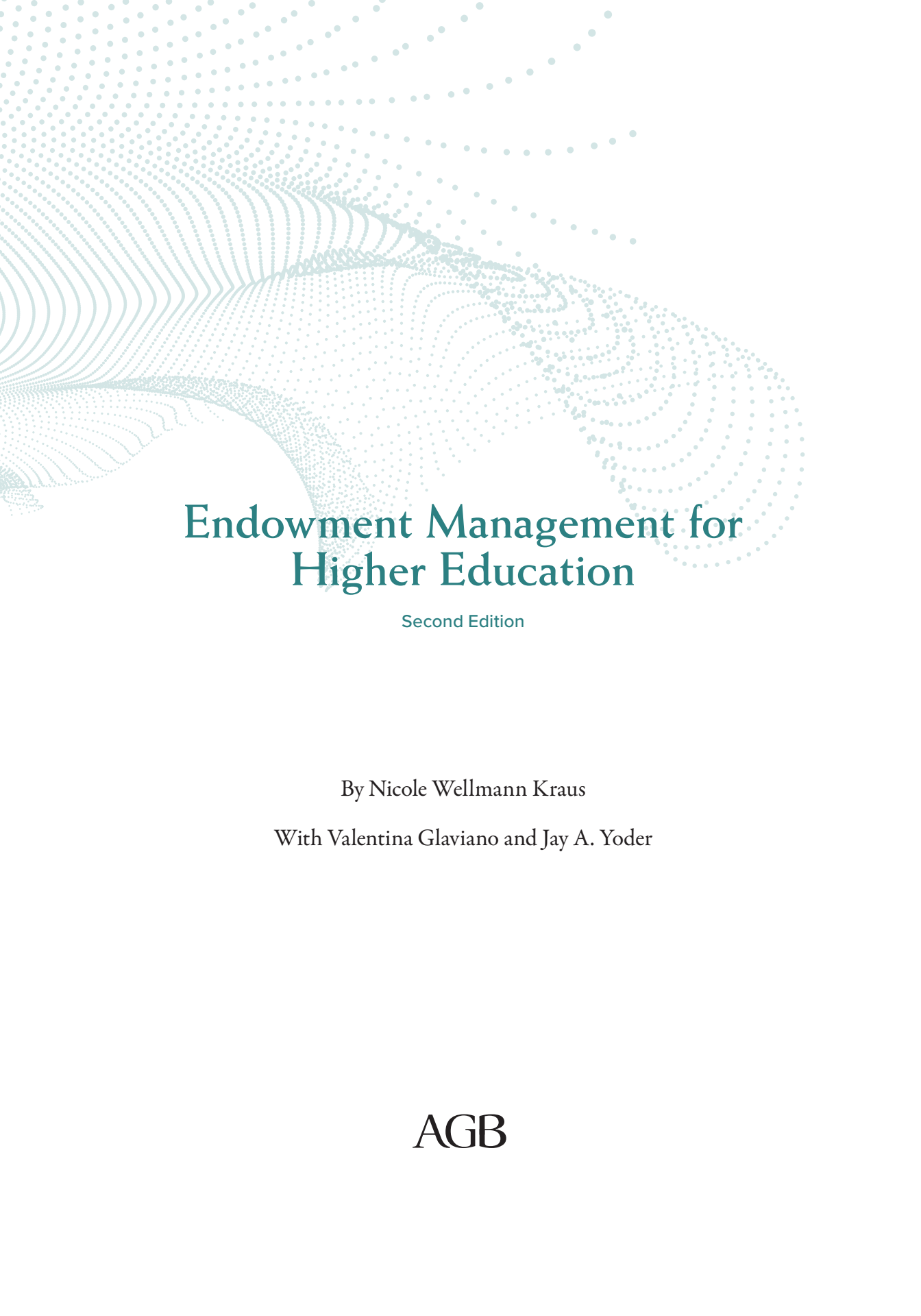




# Endowment Management for Higher Education

Second Edition

By Nicole Wellmann Kraus

With Valentina Glaviano and Jay A. Yoder

AGB



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### About AGB

The Association of Governing Boards of Universities and Colleges (AGB) is the premier membership organization that strengthens higher education governing boards and the strategic roles they serve within their organizations. Through our vast library of resources, educational events, and consulting services, and with nearly 100 years of experience, we empower 40,000 AGB members from more than 2,000 institutions and foundations to navigate complex issues, implement leading practices, streamline operations, and govern with confidence. AGB is the trusted resource for board members, chief executives, and key administrators on higher education governance and leadership. For more information, visit [www.AGB.org](http://www.AGB.org).



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Printed in the United States of America.

ISBN 978-1-951635-21-3

ISBN 978-1-951635-22-0 (ePub)

ISBN 978-1-951635-23-7 (Kindle)

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## Acknowledgments

We greatly appreciate our colleagues at AGB, who provided the opportunity to work on this project with them, and to do it again in this revised, second edition.

Our understandings of endowment management have evolved by working with excellent committees over the years. A special thank-you to all the clients we have had the pleasure of serving and working alongside to fulfill their investment goals. We would like to thank our colleagues and former colleagues at Strategic Investment Group, where there are many great opportunities to hone our craft. Hilda Brillembourg-Ochoa, Michael Bishop, David Ordoobadi, Tim O'Hara, and Ken Grossfield—valued colleagues and gifted writers—were invaluable resources, and we offer a special thank you to Brian Murdock for his support.

We offer a heartfelt thank-you to Charley Ellis, the former chair of the Yale Investment Committee and author of the Afterword in the first edition, whose generosity, encouragement, guidance, and willingness to read many versions of the first edition over a number of months made it much more valuable. The feedback from Clint Stevenson and Cathleen Rittereriser was profoundly helpful. David Bass provided helpful feedback on this new edition, and graciously agreed to pen the Foreword.

Our families are the ultimate gifts to us, and we would like to thank our supportive families and friends, who provided inspiration as well as inestimable help with the extra hours required to complete this labor of love.

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## Foreword

Endowments are a long-established philanthropic model, providing educational institutions with dedicated pools of assets that serve as perpetual funding for programs, faculty positions, scholarships, and other purposes, while also affording donors a means of segregating gifted assets from other institutional funds to ensure that their philanthropic purposes are fulfilled in perpetuity. Modern endowments are also powerful financial tools, leveraging immensely complex investment strategies to maintain and grow philanthropic resources even as other institutional revenue sources decline. Effective endowment management similarly starts with fundamental principles of trusteeship (integrity, independence of thought and collective decision-making, a focus on long-term strategy and sustainability) but requires sophisticated policies and practices informed by the expertise and wisdom of board members, staff, and investment service providers.

Since this book was last revised in 2017, the COVID-19 pandemic underscored both the critical role endowments play in institutional finance, and the importance of setting and adhering to prudent endowment management policies. During the first year of the pandemic, many institutions experienced steep drops in tuition and other operating revenue and incurred unplanned expenses. While endowment funds cannot close such budget gaps, they can buffer the impact of financial crises, enabling institutions to maintain funding for student financial aid and other critical purposes. The year delivered a reminder that endowment management requires a steady hand and solid policy. After precipitous declines in the first quarter of 2020, investment markets quickly rebounded, growing to record highs by the end of the calendar year. Investment committees that adhered to prudent policies could celebrate a record year. Boards that abandoned policy or tried to time the market likely eroded the value of the portfolios under their management for years to come.

The year 2020 also highlighted growing disparities in institutions' wealth, financial sustainability, and ability to provide equitable opportunities and outcomes for students, raising questions about the ways higher education both perpetuates and mitigates these long-standing disparities. The Black Lives Matter protest movement galvanized interest in how philanthropy and investment practices align with institutional commitments to racial equity and social justice. Boards are, and will continue to be, challenged to make endowment management more diverse and inclusive, and ensure that investments align with institutional missions and values.

The second edition of *Endowment Management for Higher Education* provides a comprehensive overview of endowment management for governing boards of colleges, universities, and institutionally related foundations, outlining fundamental fiduciary responsibilities as they relate to endowment management, current best practices in investment and spending policy, portfolio construction, and guidance on management models and staffing. Among numerous other updates, this edition

includes a new chapter on aligning the endowment portfolio with institutional mission and the incorporation of environmental, social and governance (ESG) values into endowment management.

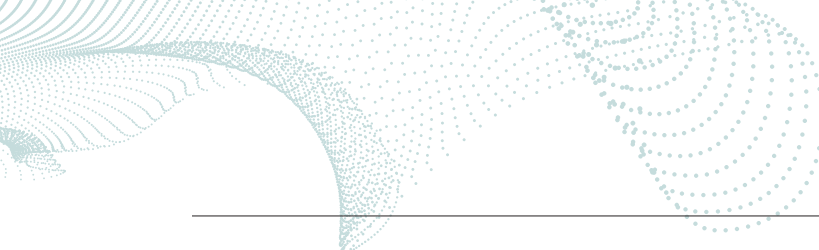
AGB owes a debt of gratitude to Nicole Wellmann Kraus and Valentina Glaviano for their work on this new edition of the book and to Strategic Investment Group, whose commitment and support made it possible. Having worked closely with dozens of investment committees over more than two decades, their guidance is informed by both technical expertise and a profound understanding of the ways board policy, culture, and dynamics contribute to effective endowment stewardship. In a period in which colleges and universities are facing enormous challenges and undergoing significant changes, we are delighted to provide boards with this valuable guide to prudent investment management and a reminder of the very long-term impact their work will have on the students, institutions, and communities they serve.

David Bass

*Executive Director, Philanthropic Governance*

*Association of Governing Boards of Universities and Colleges*

*January 2022*



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# Introduction

The volunteers who serve on the investment committees of boards of higher education institutions, institutionally related foundations and certain institution investment corporations assume important fiduciary responsibilities. Their challenge is to help secure the future of their colleges and universities by managing their endowments wisely. They also undertake the important social role of preserving intergenerational equity, ensuring that today's students and future students benefit equally from the endowments. This book is dedicated to these volunteers' service. It has been written in the hope of providing guidance to facilitate their effective stewardship of the endowments underpinning our colleges and universities.

Society attaches ever-increasing value to educational attainment. At the same time, rising costs in higher education amplify the pressure on the investment committees of public and independent colleges to boost their investment returns. Endowments are an increasingly precious resource to cover rising costs, strengthen financial resilience, support important initiatives, and provide financial aid to students and budgetary support to help keep higher education affordable. The work of a college or university investment committee member has never been more important. The future of access to and excellence in higher education is at stake.

Market returns since the Great Financial Crisis have been higher than average. These unusually high returns were accompanied by a greater ability of some students to pay for tuition, increased capacity of donors to contribute to endowments, and the stronger overall financial health of higher education institutions. These favorable developments came to an abrupt end with the emergence of the COVID-19 pandemic. The severe disruption and uncertainty caused by the pandemic has been a major setback for many institutions. While, the economic and market impact of the pandemic was relatively short-lived, there will be lingering scars from the pandemic's dramatic impact on economic activity and human behavior. Many institutions will also likely bear scars that will take time to heal. The pandemic should serve as a wake-up call to all about the precarious footing on which many institutions operate. The darkest periods of the pandemic revealed the vulnerability of both our endowments and our operations, and underscored the need to redouble our efforts to increase the resilience of the institutions we serve.

Husbanding endowment resources through complicated and unforgiving times in financial markets presents a whole set of additional challenges. For years, an 8 or 9 percent return on endowments has been commonly used in long-term budget

plans. However, many members of investment committees believe that it will be more difficult going forward to generate the level of investment returns required to preserve intergenerational equity. This undertaking was best defined by economist and Nobel laureate James Tobin, who aptly noted: “The trustees of an endowed institution are the guardians of the future against the claims of the present. Their task is to preserve equity among generations.” Markets are becoming increasingly complex, and in slower-growth markets, more modest investment returns will be generated. Opportunities to beat the market are growing scarcer while the opportunities for costly missteps mount. Access to compelling managers continues to prove important to generate the returns needed, and the smallest institutions have an additional challenge that their portfolios are often not large enough to get the attention of the managers who could generate distinguished returns.

Yet growing endowments are indispensable to maintaining higher education as we know it. Current budgetary outlays rely on regular transfers from the endowment, and an increasing number of students rely on endowed scholarships, while the long-term financial viability of universities and colleges depends on preserving and increasing endowment resources. Without endowments to help defray ever-rising costs, higher education would be an unattainable dream for many talented young people. Endowments need the benefit of the board’s guidance to meet the current demands placed on them and their long-term goal of providing a growing resource of support to the institution into the future.

The challenges of investing are both technical and human. To excel, endowment stewards must be as attentive to landmines in governance as they are to those in global markets. Stories abound of institutions with brilliant technical investment processes but poor governance practices that undermined the work of their investment teams.

Given all these challenges, those agreeing to serve on investment committees shoulder important responsibilities. Yet the emotional rewards are also great. Helping to expand the endowment of an alma mater or another beloved institution, and thus helping to secure its future, can be a source of great pride.

This book is a new edition of *Endowment Management for Higher Education*, published in 2017. This new edition includes additional observations gleaned from the authors’ combined nine decades of working with investment committees. In particular, we have included an entirely new chapter on Environmental, Social and Governance (ESG) investing given the emphasis that many are placing on mission- and values-oriented investments.

Unfortunately, markets continue to teach painful lessons for all types of investors, including those charged with protecting and increasing institutional endowments. Drawing on our experience as well as insights shaped by this tumultuous era, the authors hope that this book will be useful for any member of an investment committee.

Before delving into the intricacies of endowment management, the following list reviews some of the important lessons of recent years, including those born of the COVID-19 crisis: