
# University endowments and the financial crisis

*The devastating impact of the financial crisis on the value of endowments highlights the need for more rigorous investment management policies among institutions of higher learning.*

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A report by the National Association of College and University Business Officers (NACUBO) and the Commonfund Institute (2009) estimated an overall decrease in endowment market value of roughly 23% as a result of investment losses in the period from July 1 to November 30, 2008 (p. 3). The overall losses for this period equate to a decline of about $94.5 billion in endowment assets, much of which was incurred by the institutions with the largest endowments (Ibid.) and those heavily invested in alternative investments (Denmark & Segal, 2009). This represented the biggest drop in the value of endowments since the 1970s (Zezima, 2009), a time when endowment growth was affected by low returns and high interest rates (Clarke, Malott, and Mehrotra, 2005, p.22).

The impact of the financial crisis endowment value has been so severe that many universities around the world have faced considerable challenges maintaining historical levels of operations (Zezima, 2009; Denmark & Segal, 2009). For instance, Harvard, the world's richest university, in only four months lost 22% of the $36.9 billion of endowment assets reported at the end of June 2008 (Marks & Wu, 2008). Harvard normally covers about 35% of the university's operating budget through endowment returns. However, the unprecedented $10 billion loss in fiscal year 2009 resulted in wage freezes, cuts to student funding and staff layoffs, and halted construction of major infrastructure projects (Ibid.; Denmark & Segal, 2009). Last February, Harvard Management Co., which employed over 200 people to manage the university's investments, announced it was going to dismiss about 25% its workforce (Herbst-Bayliss, 2009).

The University of Toronto (UT) is another academic institution that – following the crisis – faces the consequences of excessive investment risk exposure. In 2000, UT followed the investment models used by Harvard and Yale and established the University of Toronto Asset Management Corporation (UTAM) as a subsidiary of the University (Church & McFarland, 2009). UTAM's approach as a 'Manager of Investment Managers' allowed the University to grow its endowment from just over $1 billion at the beginning of its operations (Ibid.) to over $2.1 billion by the end of 2007 (UTAM, 2009). However, in 2008, UT's investment losses amounted to $1.5 billion, a drop of almost 30% over the fund's value in the previous year (Church & McFarland, 2009).

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Certainly, the impact of the recent financial crisis on the value of investments and the prevailing expectation of low long-term investment returns have called into question the effectiveness of prevailing endowment management and investment policies (Denmark & Segal, 2009; Smailes, 2009; Commonfund Institute, 2009, p. 101). Colleges and universities in North America have been forced to re-evaluate their investment models and spending practices (Denmark & Segal, 2009). For example, Harvard CIO Jane Mendillo has said that she is going to reduce the university's 13% allocation to private equity and bring more of the assets in-house to ensure greater liquidity and transparency (Ibid.). Enhanced financial analysis and risk management practices will also be an important aspect of a revised investment model for universities (Ibid; Smailes, 2009). Most endowments' administrators agree that the key to managing risk is understanding it more fully, using metrics and stress tests that look at the whole range of potential outcomes and applying them to the whole spectrum of asset and liability classes (Ibid.).

It is now widely understood how, in the months leading to the credit crisis of 2008, poor corporate governance practices such as the securitization of toxic sub-prime mortgages within some of the world's largest financial institutions, along with the misleading credit ratings given to those investments, exposed the entire financial system to excessive risk. Amidst the more volatile investment climate resulting from the default on these mortgages and the ensuing credit crisis, there is a growing recognition of the material impact of corporate governance issues on the long-term value of investments.

How can universities strengthen their in-house capacity to analyze and mitigate emerging investment risks? How can colleges and universities assume their responsibility to develop and promote new standards of financial literacy required to prevent similar crises from happening in the future? CURI contends that a refocus on risk management along with the widespread adoption of *Responsible Investment* (RI) frameworks by academic institutions can serve as a valuable tool to accomplish these goals.

It has been argued that RI can help avoid additional financial crises by enhancing corporate governance surveillance and building more sustainable capital markets (UN PRI, 2009, p. 1). To do this, modern RI practice should involve a comprehensive analysis of "a broad range of environmental and social risks, a more proactive approach to corporate governance and increased transparency and accountability of both the investors' own operations and those of the companies they invest in" (Ibid.).

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*Several universities have established advisory groups to provide formal and ongoing advice regarding emerging ESG risks and opportunities that should be taken into account in decisions about the investment of their endowment and pension funds. Engaging experts from a diverse set of academic and professional backgrounds within a Responsible Investment framework, can provide Universities with valuable tools that can help address the investment implications of unsustainable corporate behaviour and enhance investment performance.*

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