


MICHIGAN STATE
UNIVERSITY

December 1, 2010

MEMORANDUM

To: Trustee Finance Committee
From: Fred L. Poston 
Subject: Endowment Spending; Board Investment Policy

RECOMMENDATION

BE IT RESOLVED that the Trustee Finance Committee recommends to the Board of Trustees that it amend its Investment Policy by deleting Section XI of that Policy and replacing it with the new Section XI set forth in Attachment A.

BACKGROUND

Section XI of the Investment Policy is entitled "Endowment Spending". Section XI(1) establishes the annual spending rate for institutional funds which are invested in the University's Common Investment Fund ("CIF").

Revised Section XI does not change the CIF spending rate, which was confirmed by the Board last April and which is the subject of an annual review by the Board Finance Committee and by the Investment Advisory Subcommittee. It does make clarifications in how the funds made available for spending will be calculated, including that the amounts distributed will be net of investment costs, which is the University's current practice.¹ See paragraph 2(b) of revised Section XI.

Another such clarification is included in Section XI(3), which is a revision of Section XI(2) of the existing Investment Policy. A small set of endowment funds may not be invested in the CIF because of legally binding instructions given by donors in the gift instruments establishing these funds. Such instructions may relate to the investment of the funds or expenditures from such funds. The spending rates for such funds will often be different from the spending rates for endowment funds invested in the CIF.² The amended policy gives the Vice President for Finance and Operations and Treasurer ("VPFO") authority to determine what the spending rate for each such fund should be each year, provided that the rates meet applicable legal requirements and are reported to the Board Finance Committee.

¹ See the Statement of Investment Objectives for the CIF, Exhibit A to the Investment Policy, which establishes long-term performance goals for the CIF "after fees and expenses".

² In the past, spending rates for separately invested funds have been lower than spending rates for endowment funds invested in the CIF.



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Revised Section XI also makes changes which derive from Michigan's adoption of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") in September, 2009. One such change is the statement in Section XI(1) that the priorities for the use of the University's endowment funds are expenditures for the purposes for which those funds were established and accumulation of amounts for reinvestment to preserve the value of those funds, and their purchasing power, against inflation. In the commentary to UPMIFA prepared by the committee which drafted UPMIFA on behalf of the National Conference of Commissioners on Uniform State Laws, it says, "UPMIFA clarifies that in making spending decisions the institution should attempt to ensure that the value of the fund endures while still providing that some amounts be spent for the purposes of endowment fund." This is also consistent with current University practice.³

Finally, in paragraph 2(c), revised Section XI authorizes the President and the VPFO to make annual assessments for endowment stewardship, including fund raising, against the University's endowment and other institutional funds established entirely or primarily with private donations. Consistent with UPMIFA, the amount of such assessments must be reasonable and appropriate when considered in the context of other uses of endowment funds, such as programmatic expenditures and preserving the purchasing power of such funds against inflation. In any event, the assessment cannot exceed one percent of the average market value of those funds without further Board action, although the assessment may well be less than one percent. The President and the VPFO will report to the Board on the amount of the assessment and how it was determined in connection with the annual review of the endowment spending rate by the Investment Advisory Subcommittee and the Board Finance Committee.

Charging endowment funds for fund raising and other stewardship costs is an increasingly common practice in higher education. For example, the vast majority of other Big Ten/CIC institutions (or the related foundations which are responsible for their development activities) make such a charge. In response to a recent survey conducted by the Association of Governing Board of Universities and Colleges ("AGB") and the Commonfund Institute, 87 percent of the institutionally related foundations participating in the survey reported that they assess an endowment management fee. The average assessment among participating foundations was 1.3 percent; the median assessment was 1 percent. AGB reported, "Given the long-term return on investments in fund raising, many institutions believe it makes sense to consider such a use of endowment revenue as a contributor rather than an impediment to endowment growth."⁴ AGB also noted that reliance on such fees seems to be increasing among institutionally related foundations. The committee which drafted UPMIFA also sanctioned the use of the endowment fund expenditures for this purpose. In its commentary it stated, "Expenditures from an endowment fund may include distributions for charitable purposes and amounts used for the management

³ The Statement of Investment Objectives for the CIF, Exhibit A to the Investment Policy, says that "the investment objectives of the CIF are . . . to achieve a total rate of return sufficient to generate the amount annually made available for spending by the University's programs supported by endowment funds and still provide a modest increase in the inflation-adjusted unit value"

⁴ Individual endowment funds benefit from a larger overall endowment because the size of the University's total endowment affects the investment opportunities available to the University and its ability to diversify its investments, among other reasons.

and administration of the fund, including annual charges for fundraising. The value of a fund . . . will reflect increases due to contributions and investment gains and decreases due to distributions and investment losses.”

cc: L.K. Simon, K. Wilcox, W. Beekman, R. Noto, D. Brower, N. Carter, G. Klein, K. Lindahl

XI. Endowment Spending

1. In fulfillment of its fiduciary duties as trustee of the University's endowment and other Institutional Funds, the Board causes those Funds to be invested to generate amounts that may be expended for the purposes for which those Funds were established ("programmatic spending") and amounts that may be accumulated for reinvestment to preserve the value of those Funds, and their purchasing power, against inflation.¹ These are the priorities for the use of the University's endowment and other Institutional Funds. The Board may also permit reasonable and appropriate costs to be charged to the endowment and other Institutional Funds. These charges may include reasonable and appropriate costs of administering and managing the University's Institutional Funds, such as reasonable and appropriate internal and external investment costs and, for certain Institutional Funds, fund-raising costs. Additional returns, if any, generated by the investment of the Institutional Funds may be used to add real principal growth to such Funds, to better preserve their long-term value, to improve and further diversify the investment options for such Funds, and, thus, to enhance opportunities to stabilize and increase annual expenditure rates for such Funds.

2. In accordance with these precepts:

(a)(i) The University will make available for programmatic spending 5.0% of the average market value of the CIF as calculated for the 20 quarters of the five calendar years prior to the beginning of the fiscal year in which the spending is expected to occur, expressed as a dollar per unit annual distribution amount based on the number of units in the CIF at the time of the

¹ The CIF Statement of Investment Objectives, Exhibit A, states that "the investment objectives of the CIF are . . . to achieve a total rate of return sufficient to generate the amount annually made available for spending by the University's programs supported by endowment funds and still provide a modest increase in the inflation-adjusted unit value"

calculation. Programmatic spending distributions will be made to CIF unit holders on a periodic basis during the fiscal year based on the number of units in the CIF held when each periodic programmatic spending distribution is made.² The VPFO will determine when the periodic programmatic spending distributions will occur.

(ii) This programmatic spending rate shall be reviewed annually by the Finance Committee, after review by the Investment Advisory Subcommittee. In connection with these reviews, the University's investment staff shall present analyses of the projected impact of inflation on the University's endowment and other Institutional Funds, including how inflation is expected to affect their purchasing power (i.e., the expenditures of amounts for the purposes for which those funds were established).

b. Reasonable and appropriate internal and external investment costs for the CIF, including the costs of the investment consultant, the investment managers, and the investment custodians and the University's own investment management costs (staff and support), shall be deducted in determining the average market value of the CIF available for programmatic spending pursuant to paragraph 2(a)(i) above.

c. The President and the VPFO are authorized to make annual assessments for endowment stewardship, including fund raising, against those of the University's endowment and other Institutional Funds established entirely or primarily with private donations. The amount of the assessments must be reasonable and appropriate, particularly when considered in the context of the University's priorities for the use of its endowment and other Institutional Funds. In any event, the amount assessed may not, without further Board action, exceed 1 percent of the

² The per unit annual distribution amount will be allocated evenly over the periodic programmatic spending distributions during the fiscal year. The amount of the periodic programmatic spending distributions will not be reduced if the number of units in the CIF increases between when the per unit annual distribution amount is calculated and when the periodic programmatic spending distributions occur.

average market value of the CIF units held by such Funds. The calculation of the amount assessed and its allocation to the Funds subject to assessment shall be conceptually consistent with the methodology by which programmatic spending distributions are calculated and allocated under paragraph 2(a)(i) above. Assessments will be made periodically during the fiscal year, as determined by the VPFO. Not less than 30 days prior to the annual review of the programmatic spending rate pursuant to paragraph 2(a)(ii) above, the President and the VPFO shall provide a written report to the Finance Committee and other members of the Board stating the amount, if any, of the assessment for the following fiscal year and how it was determined.

3. If the University has accepted a gift to an endowment fund documented by a gift instrument in which the donor gives legally binding instructions for the investment of, or expenditures from, that fund which are inconsistent with the foregoing, the University will comply with those special instructions. The VPFO shall calculate the annual programmatic spending distribution and assessment for each endowment fund which is not invested in the CIF in accordance with applicable law and report the programmatic spending rate and assessment amount for each such fund to the Finance Committee. Insofar as possible, given each such fund's investments and the instructions of its donor, the priorities for the use of such funds should be the same as those for endowment funds invested in the CIF.