



Managing Wellesley's Endowment

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Endowment Basics

- The endowment's purpose is to support the mission of the College by providing *sustainable and reliable support* to the operating budget *today and into the future*.
- Endowed funds allow the College to make commitments that are essentially perpetual, for example hiring a tenured professor.
- The College's endowment consists of approximately 3,000 individual funds established for a variety of purposes. It includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. In the case of donor-restricted endowment funds, gifts are generally made to support an activity such as financial aid or a professorship in perpetuity.
- For investment purposes, individual endowment funds are pooled together. Individual endowment funds own units (shares) in the pool, much like a mutual fund.

The Endowment Value and How It Changes

- The value of the endowment at any point in time is determined by the market value of the investments.
- $\text{Endowment Growth} = \text{Investment Return} + \text{Gifts} - \text{Spending}$
- Since endowment funds are supporting perpetual activities, it is important that they keep up with inflation. Maintaining purchasing power requires:

$$\text{Investment Return} \geq \text{Spending Rate} + \text{Inflation}$$

Endowment Spending

- Endowment spending constitutes about 40% revenues in the operating budget.
- The Board of Trustees approves endowment spending for the upcoming fiscal year early in the calendar year.
- Spending is determined according to a policy which is reviewed every 3 years. The policy aims to balance steady support to the operating budget with the maintenance of purchasing power.
- At their October meeting, the Board approved changes to the assumptions used in the calculation of spending and a reduction in the target spending rate which reflected lower investment return expectations.
- If the spending purpose for an individual endowment is not met, funds from that endowment are not spent.
- In most cases, the College cannot spend the principal of endowed funds.
- The Investment Office transfers cash to the College every month.

Investment Decision Making

- The Investment Committee of the Board sets policy and oversees the Investment Office.
- The Investment Office staff makes policy recommendations to the Investment Committee on investment policy issues like asset allocation, risk, and liquidity.
- The Investment Office executes the investment strategy by researching and selecting new asset classes, strategies, and managers, overseeing existing managers, and handling the operational aspects of managing the portfolio.
- Members of the Investment team act as staff to the Proxy Voting Subcommittee, but the Subcommittee sets policy and decides issues not covered by the policy.

Designing a Portfolio to Meet Wellesley's Investment Objectives

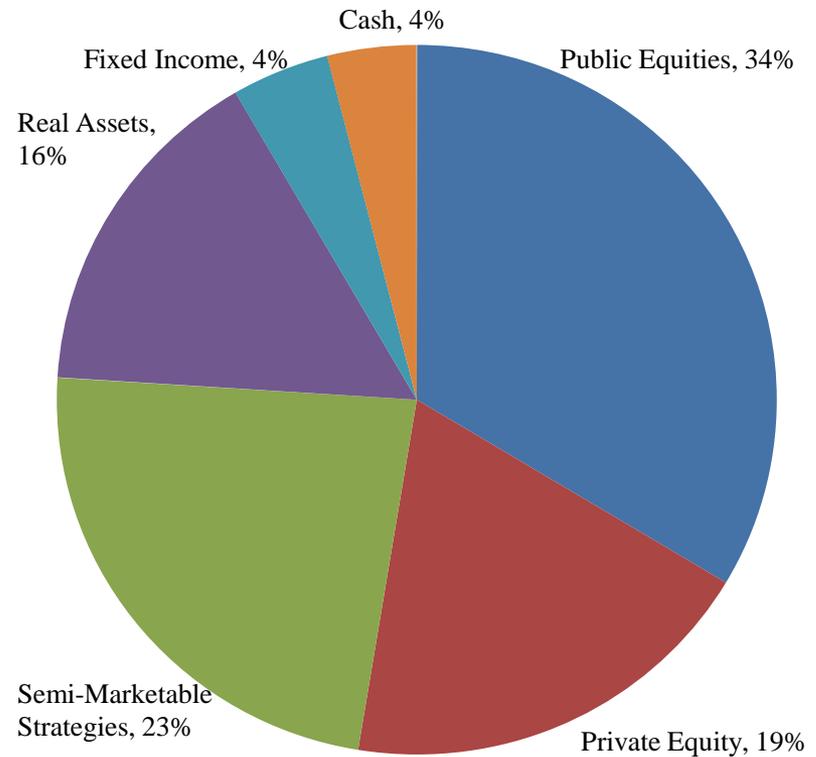
- With a spending rate of approximately 5% and assuming inflation of 2.5%, the portfolio needs to earn 7.5% over time to maintain purchasing power.
- Generating that return when the risk-free rate is close to zero is challenging, and we have reduced our return expectations.
- How we think about prospective returns:

Expected Return	=	Risk-free Rate	+	Asset Class Risk Premium	+	Manager Value Added
		1%		Varies by asset class depending on risk of loss, volatility, liquidity		Lower in efficient markets (but for Wellesley, not 0), higher in less liquid and private markets

Diversification

- Portfolio diversification reduces risk because holding assets that are not perfectly correlated lowers the volatility of returns.
- The endowment is diversified across:
 - Asset classes
 - Geographies
 - Strategies
 - Managers

Asset Allocation
June 30, 2013



Decision Criteria for Thinking About Divestment

Given the importance of the endowment in fulfilling the College's mission, actions that might impair the investment return must meet a high hurdle.

Four criteria that I would suggest are:

- 1. Relationship to Mission:** Is addressing the issue part of Wellesley's mission?
- 2. Urgency:** Does the issue truly warrant action? How quickly must we move?
- 3. Effectiveness:** What actions should we consider in this situation? How effective will any particular action be in addressing the concern? Will we have an impact if few others take action? What is the likely cost of the action and how would that cost impact Wellesley's mission?
- 4. Alternatives:** Are there reasonable alternatives to divestiture?

The Cost of Divestment

- Fossil Free Wellesley has requested that the endowment divest of all direct holdings in the largest 200 publically traded fossil fuel companies.
- The endowment holds approximately 0.5% in such names in three accounts. These accounts represent 6% of endowment assets.
- Restricting the mandates of these managers is not possible, so divestment would require the College to terminate these manager relationships.
- Over the last 10 years, these managers have beat their benchmarks by 1.75% a year. Finding new managers who would perform as well and be willing to manage a restricted mandate is highly unlikely.
- Assuming that replacement managers earned the benchmark return, the cost of divestment would be:

6.0%	x	1.75%	=	0.10%
Exposure to terminated managers		Performance that could not be replaced		Reduction in endowment return
0.10%	x	\$1,600 million	=	\$1.6 million/year
Foregone return		Current endowment value		Cost per year

Unanswered Questions

- How would divestment fit with Wellesley's mission?
- How effective would divestment be?
- How would the decisions of other institutions impact the effectiveness of Wellesley's actions?
- What other actions might Wellesley undertake that might be more effective or less costly?

Timetable for a decision

- At last week's meeting, Fossil Free Wellesley asked that the Trustees reach a decision at their February 2014 meeting.
- The Trustees explained the challenge of reaching a decision that quickly. They are committed to meeting with FFW again in February, if not before, and indicated that they anticipate reaching a decision by early spring 2014.
- Jay Turner, chair of the Academic Council Sustainability Committee, committed the resources of the Sustainability Committee to engage the Wellesley community on the topic of climate change and what it means, specifically, to our institutional approach to sustainability.