Nikki Kraus, CFA

What Do Board Members Need to Know About Endowments?

Effective endowment management must weave together many interconnected strands. Trusteeship *spoke with Nikki Kraus, CFA, managing director and global head of client development at **Strategic Investment Group** and co-author of AGB's book* **Endowment Management for Higher Education**.

Can governance really make a difference in managing endowments?

The importance of sound governance is often underestimated. I have been fortunate to meet with as many as 50 investment committees a year, and often too little time and attention are given to developing and nurturing a culture of good governance. Ultimately, you need the right people in the right structure working toward the right purpose. Special care must be taken when appointing members of the board—and especially the investment committee—to ensure they have the requisite wisdom, humility, and collegiality to work effectively with others in solving problems. Board turnover is natural, and these inevitable leadership transitions emphasize the importance of having a sound structure and clear purpose that establish clear expectations and procedures to balance new ideas as well as foster stability.

Governance is underappreciated because quantifying its impact is difficult. When it comes to the endowment, many often assume that an amazing investment team is all that is needed to generate stellar returns, yet the amazing investment team would never have been assembled and retained in the absence of sound governance, which entails fiduciary oversight and not management. Governing boards that lose sight of the importance of sound endowment governance run the risk of diminishing returns—when they are otherwise working so hard to maximize them.

What are your top four recommendations for board members?

Engage key stakeholders across the board. In my conversations with experienced committee members who have served on boards through good times and bad, two recurring themes have emerged: 1) It is important to take a comprehensive view of the institution's financial profile when establishing the long-term investment strategy and 2) It is important to communicate often with key stakeholders on the board about why the investment strategy was adopted. Let's not forget the lessons we learned as a result of a lack of confidence and clarity in the investment strategy going into the Great Recession. Many board members who were not confident in the investment strategy demanded change at the absolute wrong time, and because they lacked strong governance structures, they made costly changes.

Establish clear accountability. Many colleges have built up their asset bases and liquidity since the crisis, yet clear lines of responsibility and oversight around some sizable asset pools seem to be lacking. This confusion has created unfortunate surprises when assets assumed to be available—as a backstop to the operating budget, for example—have already been spent or committed elsewhere.

Fundraise for endowments. Many institutions will not reach their goals for endowment size without prioritizing new gifts.

Resist the temptation to spend more than 5 percent. In the recent NACUBO-Commonfund Study of Endowments, expected returns averaged 7 percent. If your spending rate is greater than 5 percent, you may not preserve intergenerational equity. In addition, because the principal is diminished, the required spending to sustain the equivalent dollar contribution to the operating budget becomes an even higher percentage. Overspending is a slippery slope that few organizations overcome.