Penn
UNIVERSITY of PENNSYLVANIA

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MEMORANDUM

To: Council of Deans
Senior Planning Group
Senior Roundtable

From: Stephen D. Golding

Date: August 6, 2015

Subject: Policy for Investment and Withdrawal of Unrestricted Endowment

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Despite the upheaval in the credit and equity markets over the past two years, Penn has been fortunate in avoiding cash investment and overall liquidity issues for both the University's operating cash pool and the endowment. However, given the unsettled state of the economy and to allay the risks associated with the illiquidity of long-term investments, we do think it important to re-communicate existing guidelines and to establish some new policies for investment of unrestricted funds, and at the same time enable leadership of the University's Responsibility Centers to pick an appropriate type of investment that meets their investment objectives and time horizon.

The AIF is designed to be a long-term investment vehicle, and the cost of earning greater returns than a short-term cash investment like TIF is some degree of both volatility and illiquidity. The AIF is invested in a variety of different asset classes and vehicles. Some of these investments are illiquid and involve long-term contractual lock-ups. This is particularly true of the so-called alternative asset classes which include private equity, real estate and natural resources. Over time, it is expected that these less liquid investments will grow to 25% of the portfolio from the present 13% (if you include certain hedge fund investments, our illiquidity profile is even greater).

Large unanticipated outflows from the endowment could pose both liquidity and asset allocation challenges (the latter occurring as liquid assets are sold down to meet redemptions, leaving remaining investors with a substantially higher-than-target allocation to illiquid asset classes as well as a collective liability for any unfunded commitments). Universities and other non-profit organizations that have liquidated portions of their endowment pools to meet operating needs due to the economic downturn have experienced irreparable harm to the long-term health of their endowments.

Thus, the AIF is not an appropriate vehicle for investments with relatively short time horizons. At Penn, to protect all investors, it is critical that investing schools, centers and departments use the AIF only for investments that are truly long-term in nature. Further, we need to ensure that any withdrawals from the AIF deemed necessary are well-planned and coordinated with the Treasurer's Office and the Office of Investments.

To that end, we are instituting a formal policy to cover the investment of unrestricted funds into the AIF and withdrawal of unrestricted investments from the AIF.

Effective immediately, all new investment of funds into the AIF must be made for a minimum duration of five (5) years. Unrestricted funds previously invested in the AIF will be expected to remain within the AIF for at least five (5) years from the original date of investment; however, we can work with schools or centers that have planned for earlier withdrawal. Additionally, we are requesting that any school or center considering withdrawal or liquidation of unrestricted funds from the AIF ("quasi endowments") notify the Vice President for Finance and Treasurer prior to initiating any such action – three months in advance for withdrawals of $1 million or more; one month in advance for withdrawals of less than $1 million. We are also requesting that, as part of your budget preparation, you highlight any planned withdrawals or liquidations to meet capital or operating needs to enable us to do necessary cash flow planning.

Withdrawal of funds for restricted term endowments are dictated by the terms of the donor agreement. Restricted permanent endowments are not subject to withdrawals.

In order to provide an alternative for a shorter-term investment of funds by schools, centers and departments, the Office of Investments has created an intermediate-term investment option, a mutual fund consisting primarily of fixed-income investments and securities of varying maturities, which is expected to have returns greater than the TIF-based rate routinely applied to school and center bank and capital funds. Since there is a possibility of some short-term volatility (including negative returns), we are limiting investments in the intermediate-term fund to a minimum duration of two (2) years.

The Treasurer's Office and Office of Investments will be following up with more information regarding the intermediate-term investment option.

If there are any questions, please feel free to contact me.

cc: Craig R. Carnaroli
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