

## **Endowment Funds in Pakistan**

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An Endowment fund is defined as “A donation of money or in-kind to a non-profit organization, which uses the resulting investment income for a specific purpose”<sup>1</sup>. An endowment refers to the total of a non-profit institution's investable assets, also known as principal, which is meant to be used for operations or any other specific use as restricted by the donor. Most endowments are designed to keep the principal amount intact while using the investment income for charitable efforts or operational expenses. (Clemson University, 2014). Endowment funds can take several forms including restricted, unrestricted and term based and are mostly administered as a registered Trust or Fund by educational institutes, charitable organizations and public entities. <sup>2</sup> in majority cases, the endowment funds are restricted and the main objective is maintaining intergenerational equity, and hence not all funds can be spent in present.

Over the years, endowment funds have made a major role in providing crucial support to educational institutes particularly and other non-profit organizations also to withstand the macro and micro challenges. These funds have supported the operations of the educational institutes in their day to day spending as well as capital spending projects.

This article explores the current status of endowments funds in Pakistan especially with respect to Universities and the positive role endowment funds can play for Pakistan’s universities by learning and adapting to best international practices.

It is pertinent to note that the quality and success of an endowment fund depends on the way it is organized and managed. Most renowned endowments have a well drafted and comprehensive investment policy that clearly outlines the annual spending and withdrawal policies, risk policy, asset allocation policy and other important areas. Table 1 outlines the investment nature of Endowment Funds.

<b>Factor</b>	<b>Nature</b>	<b>Risk and Return Trade off</b>
Time Horizon	Long	High Risk Tolerance
Contribution of endowment to operating expenses of Organization	High	Low Risk Tolerance
Ability to adjust spending	Low	Low Risk Tolerance
Size of Endowment	Large	High Risk Tolerance
Objectives and Nature of relevant Board of Directors/Investment Committee	Risk Averse and Vice Versa	Low Risk Tolerance and Vice Versa

Table 1<sup>3</sup>

For the universities, US based endowment funds can be characterized as the best role models over the years for developing countries like Pakistan and India. This warrants the attention of the capital markets in Pakistan that how US educational institutes have emerged as key players of the capital markets and continue to do so.

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<sup>1</sup> CFA Institute Primer, Investopedia Definition

<sup>2</sup> <https://www.investopedia.com/terms/e/endowment.asp>

<sup>3</sup> CFA Institute Primer 2019

Data by National Association of College and University Business Officers (NACUBO) as of 2021, the average endowment size in USA stood at USD 1.1 billion for 720 universities and colleges. The average spending rate by endowments has remained constant at 4-5% over the years since 2012 – 2020 irrespective of the fund size but in 2020, the share of spending from endowments has gone up for meeting operational expense owing to COVID impact. The target return for endowments has remained around 7% over the years comprising of inflation expectations, expense requirements and spending allocation while the net average investment rates of return have varied over the years as shown in Figure 1.

**Average and Median Annual Net Investment Rates of Return\* for U.S. College and University Endowments and Affiliated Foundations Fiscal Years 2021 to 2012**

	2021 %	2020 %	2019 %	2018 %	2017 %	2016 %	2015 %	2014 %	2013 %	2012 %
Average	30.6	1.8	5.3	8.2	12.2	-1.9	2.4	15.5	11.7	-0.3
Median	30.1	1.8	5.1	8.0	12.5	-2.1	2.2	15.8	11.7	-0.5

\*Net of external management fees and expenses.  
Returns are for the years ending June 30. All returns are equal weighted.

4

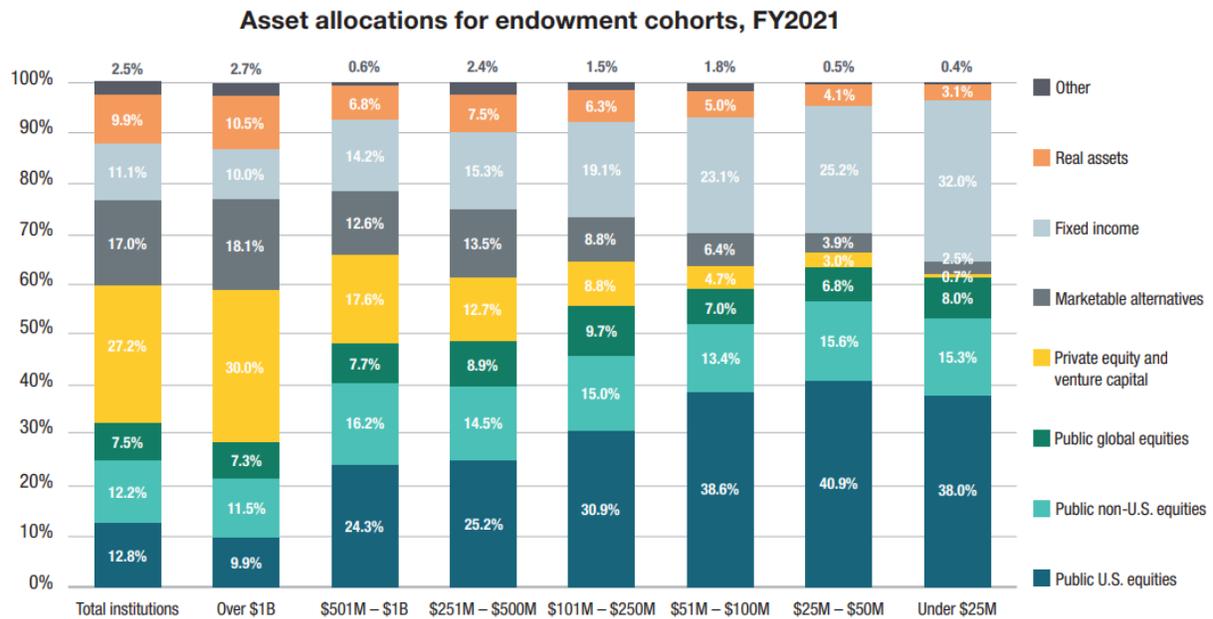
Figure 1

Interesting observations can be drawn while looking at the asset allocation of university and college endowment funds as shown in Figure 2.

- As the endowment size grows, the asset allocations tilt towards private equity, venture capital and marketable alternatives in line with the financial theory that size affects the risk tolerance level of the fund and allows a larger ticket size for building positions in alternatives
- Public US and non – US equities are preferred by small sized endowments more than the large sized while share of fixed income also comes down as the size grow

These observations are consistent with the investment theory that large sized funds have the liberty to allocate larger positions to non-traditional asset classes and thus generate higher returns, albeit greater return dispersion also. A key point to remember is the long term vs short term perspective of endowments. Endowments are set in perpetuity hence they need to demarcate carefully between short term and long term allocations in terms of meeting operational expenses and preservation of fund against inflation. Nevertheless, medium to small sized endowments have been exploring alternative asset classes to allocate investment over long term [Figure 2]. In most case, an average endowment returns tracks a traditional 60-40 portfolio.

<sup>4</sup> NTSE Data 2022 - <https://www.nacubo.org/Research/2021/NACUBO-TIAA-Study-of-Endowments>



5

Figure 2

Harvard University carries the largest endowment fund size of USD 51.9 billion as of FY21 with an endowment value per full time equivalent student of USD 2.27 billion. The significance of this fund lies in its critical role and reliance for funding the university operations. 39% of the university’s operational expenses have been met by using the funds generated from endowment while only 17% are being met Student Income. The highest share of spending goes to cover faculty salaries, financial aid and other student activities. Approximately 94% of dollars supporting student financial aid at Harvard come from institutional sources, including gifts, the endowment and unrestricted funds. The other 6% comes from the federal government aid initiatives and other outside sponsors. How do they do this?

They have established a Harvard Management Company (HMC)—a nonprofit, wholly owned subsidiary of Harvard University to manage the endowment fund. HMC has a dedicated team of experts governed by Board of Directors to support the long term objectives of the university. The university follows a stringent set of guidelines while managing its fund based on a target annual endowment payout rate of 5-5.5% of market value. The actual payout rate varies each year based on endowment returns. Annual endowment distribution after considering a variety of factors, including guidance from a payout formula that provides a steady stream of income to support current needs while preserving the endowment’s future purchasing power. Recently, HMC has established a dedicated office in Singapore where they are focused on making investments in startups particularly<sup>6</sup>.

<sup>5</sup> NTSE Public Tables and Data – 2022 - <https://www.nacubo.org/Research/2021/NACUBO-TIAA-Study-of-Endowments>

<sup>6</sup> Harvard Annual Report 2022

Following the similar trend is MIT, which boasts an endowment fund of USD 25 billion, excluding pledges as of June 2022<sup>7</sup>. Similar to Harvard, the endowment fund is used to cover for scholarships, research and innovation fostering purposes. MIT also has carved out a special unit with the name MITIMCo to manage and oversee the investment activities of endowment fund under a Board which meets regularly to set the policies and review them; with the main objective of generating high real rates of return without extraordinary volatility. As a part of its strategy, MIT hires external managers for its endowment fund management which helps it to take exposure across multiple asset classes. This helps to manage the fund in the most diverse and professional manner. MIT endowment fund takes exposure in alternative assets including real estate, private equity.

<b>TABLE 5. INVESTMENTS</b>					
<i>(in thousands of dollars)</i>					
	Level 1	Level 2	Level 3	NAV	Total Fair Value
<b>Fiscal Year 2022</b>					
Cash and short-term investments	\$ 437,314	\$ -	\$ -	\$ -	\$ 437,314
US Treasury	2,268,472	-	-	-	2,268,472
US government agency	-	30,087	-	-	30,087
Domestic bonds	28,330	1,038,067	127,650	-	1,194,047
Foreign bonds	101,352	327,075	-	-	428,427
Common equity:					
Domestic	157,741	-	236,320	-	394,061
Foreign	1,198,950	55,941	15,398	-	1,270,289
Equity:**					
Absolute return	-	-	-	5,008,840	5,008,840
Domestic	-	-	-	2,238,425	2,238,425
Foreign	-	-	-	2,640,950	2,640,950
Private	-	-	-	11,028,666	11,028,666
Real estate*	1,937	-	3,884,874	1,374,864	5,261,675
Real assets*	5,029	-	317	237,927	243,273
Split-interest agreements	-	-	80,970	-	80,970
Other	-	-	19,720	-	19,720
Derivatives, assets/(liabilities)	92	3,323	-	-	3,415
<b>Investments, at fair value</b>	<b>\$ 4,199,217</b>	<b>\$ 1,454,493</b>	<b>\$ 4,365,249</b>	<b>\$ 22,529,672</b>	<b>\$ 32,548,631</b>

Figure 3

MIT has diversified its investments in different asset classes but favors equity exposure in less efficient markets to generate high real returns over long term. They have further bifurcated their endowment assets in pooled and non – pooled investments where non-pooled are managed for meeting operational expenses whereas the pooled investments build long term exposures. Therefore, the investment policy is well crafted and managed to reflect the investment objectives of the fund. [Figure 3]

Yale University carries an endowment fund of size USD 41.4 billion on June 30, 2022. Much similar to Harvard and MIT, this fund is crucial to Yale’s survival and spending from endowment is the largest source of revenue for the university to almost 30% of the operational budget. The investment strategy of Yale include exposure to public equities, alternatives, leveraged buy outs, venture capital, real assets to earn

<sup>7</sup> <https://news.mit.edu/2022/endowment-2022>

1007#:~:text=At%20the%20end%20of%20the,knowledge%2C%20research%2C%20and%20innovation.

<sup>8</sup> MIT Treasurer Report 2022

a return of 12% per annum over 10 years, outperforming mean 10-year return of most competitor endowments.<sup>9</sup>

While comparing the same for the Universities in Pakistan, there is a different landscape altogether. In Pakistan, the relevant legislation for Charitable endowments goes back to the Endowment Act 1890 and Trust Act 1882 of United India. SECP also issues guidelines and disclosure requirements for Endowment Funds especially pertaining to Section 42 companies that are non-for profit in nature. Apart from this, each university or organization ideally develops its own endowment rules and governing policies that operate as a separate Trust or Fund within the company.

There are several examples of universities in Pakistan that have defined and set their endowment rules and policies for organized management of the fund including COMSATS, AKU, IBA and few others. As per the general practice and in line with international standards, these endowments funds could be registered as a separate Trust or could be a part of the cash pool of the company. It is often managed by either the Board of Directors and in some cases a dedicated Investment Committee, that oversees the placements, expenses and operations of the endowment.

As per the FY19 annual report of IBA Karachi, they have built their endowment and reserves steadily from around 1.6 billion PKR in FY15 to 2.8 billion in FY19. The corresponding contribution from this category to total IBA Karachi revenues stood at 8 percent s of FY19. IBA has been building its endowment fund through active fund raising from Government and non-Government sources. The endowment fund is managed by a Friends of IBA Committee comprising of senior experts and Alumni, through a dedicated investment policy.<sup>10</sup>

There are several universities that do not have a separate endowment pool for supporting income and operations. One such example is Bahria University, as per financial statements of FY21, they have classified their excess cash as PKR 4 billion as a General Fund and hence has not disclosed investment details separately barring other income of PKR 207 million<sup>11</sup>.

For LUMS, the endowment fund value stood at PKR 2.85 billion in FY21 as compared to PKR 1.5 billion in FY18 and PKR 1.4 billion in FY17 respectively, registering consistent growth through income generation and higher funding. During FY21, the endowment fund earned an income of PKR 102 million out of which 3.5% of the operational expenses are being met by annually. In addition, a closer look at the endowment fund of LUMS [Table 2] reveals that it has invested mostly in Government securities and with a limited exposure to other non-traditional asset classes that we observed in the endowment funds of leading international universities. The second important observation is the long term nature of most investments especially in PIBs<sup>12</sup>.

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<sup>9</sup> Yale Reports 2022 - <https://news.yale.edu/2022/10/04/yale-reports-investment-return-fiscal-2022>

<sup>10</sup> IBA Karachi Annual Report – 2019 – IBA Website

<sup>11</sup> Bahria University Annual Report – 2021 – Bahria University Website

<sup>12</sup> LUMS Annual Report - 2021- LUMS Website

Table 2

PIBs	1,401,855,360	77%
TFCs	135,000,000	7%
Mutual Funds/Equity	276,792,303	16%
	1,813,647,663	100%

The endowment report CY19 of Aga Khan University, Faculty of Health Sciences also sheds light on some interesting points<sup>13</sup>. AKD's endowment fund relies on it for supporting various initiatives including academic posts, student scholarships, research, and patient welfare etc. It is one of the most professionally managed funds that focuses on long term financial security of the organization. They use a formal method for calculating the annual spending % from endowment on the basis of as a percentage of the income from the fund's rolling 12-quarter market average where any surplus return is invested back for capital growth. The table 3 below shows the summary of the endowment fund of AKU in 2019.

	PKR
Total Amount Gifted Historically	250,707,421
Market Value on January 1, 2019	1,133,173,658
New Gifts in 2019	1,200,000
Endowment Earnings (Loss)	89,313,469
Amount Distributed	-72,491,167
Market Value on December 31, 2019	1,151,195,960
Return Earned on Endowment Fund during year	8%

Table 3

What can be learnt from this analysis of Pakistan educational endowments and those managed outside that significant room for improvement exists for educational institutions to recognize the true potential of endowment funds. They can contribute significantly to their operational management as well as research and scholarship funds to support under – privileged kids' right to higher education. More importantly, research grants and scholarships can be supported much more aggressively through active endowment fund management.

They need to adopt that endowments should be managed professionally using capital market experts and institutions to better balance the risk return trade off. This requires either setting up a separate company like in case of Harvard or a department which could work with external managers similar to MIT strategy for maximizing the performance of endowment fund. Many universities with small to medium sized funds can set up an in – house team to manage the fund at a relatively lower cost.

Pakistani universities struggle to meet their operational expenditures and scholarship demands due to limited budgetary support by HEC and Government, whether public or private. At this point, the local universities are not deploying a systematic marketing strategy to solicit funds for endowment. Some prominent private sector universities including IBA, LUMS and few others have been relatively active in raising funds for endowment but majority does not. Only with a professionally managed approach with a well-defined strategy in place, the educational institutes can become active players in capital markets plus meet their growing need of funds. Similar to USA, the role of private sector universities is slowly outpacing

<sup>13</sup> Patient Welfare Report - AKU 2019 – AKU Website

the public sector in Pakistan and thus need to cultivate a culture of private sector fund raising/private philanthropy. One of the greatest resources for universities could be their Alumni Network which can pave the way for funding, investment avenues and expertise.

Furthermore, the financial reporting of the educational institutions in Pakistan remains vague and non-standardized much like the Non-profit organizations (NPO) which inhibit the willingness of strategic donors to set up endowments. One example is of The Citizens Foundation (TCF) which has voluntarily improved its financial disclosures including a well – drafted investment policy including endowments which helps its fundraising cause. Although ICAP and other professional bodies have made progress in standardizing NPO reporting in Pakistan, scope of improvement is large. This can be extrapolated to the educational institutions in Pakistan which need to work on their transparency and disclosures as a stepping stone for better endowment related fund raising.

Lastly, developing a market for endowment funds will prove to be a positive for the Pakistan capital markets as it will benefit from higher institutional participation and jobs creation for upcoming capital market professionals. This would require policy level guidelines to simply registering of Endowment Funds especially as a Trust and easing the regulatory environment which USA also pursued including ease in limits to various types of asset classes, tax incentives and others.