

Scott Malpass

Scott Malpass is the Vice President and CIO of the University of Notre Dame Investment Office. He recently spoke with PREA's Jared Chase about his long history with the university, the strategies for its endowment investing, and a new venture to help Catholic institutions benefit from the endowments and his experience and expertise.



You have been a student, an instructor, and an investment leader at Notre Dame. Tell us a bit about your history with the university, from your college days to your role as CIO.

I had a tremendous experience as a student, and it certainly changed my life. It allowed me to think about the things I could achieve by being here and the confidence I was gaining and the people I was meeting—students from all over the nation, faculty, the Catholic mission. I started out premed and graduated with a biology degree, but I didn't have a clear sense of what my career was going to be. Notre Dame faculty members like to say, we educate the mind, the body, and the spirit, and all three of those were developed while I was here as an undergraduate student.

How did you wind up back at the university after your experience as an undergraduate and then in the graduate business administration program?

I didn't know what I wanted to do, so I literally left graduation still uncertain about my next steps. I took the GMATs that summer; I did well and then decided to see if I could actually get into the Notre Dame business program that fall. The program was relatively young and small at the time and still being developed. Because I had been there as an undergrad and had really good GMATs and the school was building its credentials, I thought I might have a chance. I was accepted for the fall. I had a great experience in the full two-year program. I interned the summer between the two years at the Irving Trust Company on Wall Street. It was a traditional, relationship-oriented bank, not a capital markets bank, and it did a lot of overseas correspondent banking. That summer was very formative for me. As I was making this transition from science into the markets, it gave me a lot of confidence. I also met kids from other great schools around the country.

My experiences that summer inspired me to do something in the banking field. Irving hired me full time, and I started right after graduation. I worked there two years in the custodial group, the master

custodial services, with large pension funds. A little investment consulting arm was embedded in that group. It was a three-person team, and that was the team I had interned with in the summer. We did a lot of work with some of Irving's large pension clients on asset allocation and manager search. I worked with Exxon, Warner-Lambert, Bristol-Myers, and Woolworth; Irving was also the custodian for the Notre Dame endowment. Father Richard Zang, who was the rector of the graduate dorm, was the CIO. I had known him going into Wall Street, but I had not really had a lot of interaction with him on endowment matters.

I came back to Notre Dame in August of 1988 to work with Father Zang; he was moving on to a different assignment in the order. I ended up becoming CIO at Notre Dame nine months after I joined the office at the age of 26. The endowment was about \$425 million.

This would not have happened without the leadership of Bob Wilmouth, who was the Chairman of the Investment Committee. Bob had been Chair of the committee since 1978, and he thought it was time to modernize the operation. The endowment was close to half a billion—the 24th-largest endowment at the time—and to raise more money, the university was conducting more sophisticated, larger fund-raising campaigns. Notre Dame was a school for immigrant Catholics when it started, but it was getting a wealthier alumni base than it had prior. There was a sense that we needed to provide the kind of stewardship to donors and their money that would be commensurate with the larger endowment funds at the time that were more sophisticated because they'd been around longer and managed more money.

Bob Wilmouth inspired me, coached me, mentored me, and gave me the confidence to take this on. We started building a team, an operation, an office. He stayed on as Chair until 1995, and then Jay Jordan took over; he has been Chair ever since. The continuity and leadership of our Investment Committee, combined with my tenure and the tenure of many of my directors, has been the secret to our suc-



Jared Chase
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cess—a strong sense of mission and purpose about the place and a sense of purpose in helping students and faculty.

I have a great Investment Committee and an office of 38, including 18 on the core investment team. All of the 18 are Notre Dame alumni, as are many of the others. We have built a very sophisticated investment organization with a bunch of what I call “patriots,” not mercenaries. They love Notre Dame and what it stands for.

How would you recommend other institutional leaders go about the process of attracting and retaining investment staff?

Getting people who believe in the institution and what it is trying to accomplish, even if it is not a big place, is key. At a place like Notre Dame, where it is a real community and very residential, having a lot of good student interaction and meeting some really talented kids is easy. I team-teach with finance faculty an elite course in which students manage a live portfolio. Students have to apply to get into the class; we take 25 students each semester. Through this teaching, I’ve met some of our top kids and have recruited a bunch of them. In addition, students intern in our office. I advise a couple of different clubs; students have me speak about the endowment and my career. Of the 18 alumni on the core investment team, almost half of them were my students. You have to play to your advantages—being on a residential campus with a strong community, teaching, meeting top students, having a lot of student interaction is an advantage I have. I try to hire the best ones who I think are a good fit.

Many graduates want to try investment banking and move to a big city such as New York, Chicago, or Boston. Investment banking or consulting provides plenty of great positions. Some graduates do a junior-year summer banking internship and decide they don’t want to go into investment banking; they want to be investors, do research, and manage money. This is a great step for those kids. We interview 400 to 500 money management firms a year. These young graduates meet a lot of money managers and see what excellence looks like in the business. We are a global investor, so they get to travel, and we give them ex-

posure to all facets of the business. This is a relatively small office with a great family culture. A lot of students prefer that, and those are the kids we try to get.

Do you get the sense that CIOs of university endowments in general, many of which have that sort of built-in pipeline of talent, avail themselves of it to the same extent, either by teaching classes or recruiting students who are interested in finance to work within the endowments?

Yes, I think there are other examples of it, but it is not as prevalent as you would think. David Swensen has attracted some Yale alumni to work with him. David is a graduate of Yale; I am a graduate of Notre Dame. But a lot of the big endowments are not run by alumni of their schools; they don’t have the same affinity we have. When I first came to Notre Dame, the CIOs of the top 20 to 25 endowment firms were generally alumni of those schools, but that has changed, and I don’t think they have tapped into the resources the way we have.

By many measures, Notre Dame’s returns have been robust. Which of the metrics are you proudest of and which would you like to improve further?

Two things really stand out. One is the growth in the amount of financial aid we give students today. In 1988–1989, we were giving out about \$5 million a year in financial aid/grant money to undergraduates. We are now giving out \$120 million a year. In terms of financial aid, we are one of the most competitive schools in the nation. I am very happy about that because that is why we are here: to help really talented kids from all over the country afford a great education, regardless of need. That is what inspires me and my team the most.

I’m also really proud that we did not have to cut endowment spending through or after the financial crisis. Our returns in fiscal 2009 were in line with the median of the endowment universe. Many of our peers were hit much harder, were more leveraged, and had more in real estate, which was hit very hard this cycle. We were able to hire some really good, young faculty who came on the market at a time when our peers from the Ivy League schools were laying off staff, cutting endowment spending, cutting costs, cutting programs, and stopping construction projects. We

didn't have to stop one project on campus during that period. Our construction funding policy requires that a donor's money actually be in-house before we start a project. We don't start things and then figure out how we are going to pay for them.

You don't use bonding or anything of that nature?

No, we do issue debt for certain projects where donations would be unlikely—utility work, for example, but for a project for which we are trying to get a gift, we have to have the money before we start construction. Prudent fiscal management is a tradition at Notre Dame, partly because of our religious roots. We have issued debt, but even that is low relative to our peers'. We have half to 60% of the outstanding debt of a lot of our peers around our endowment size. We are Triple A rated and have a conservative, long-term view.

You mentioned that the investment decisions and endowment characteristics that are responsible for Notre Dame's performance relative to peers include things such as high leverage levels and real estate exposure. Are there others?

The real estate issue was somewhat unique to that particular financial crisis. In other crises, real estate came through a lot better than other areas. We build really good long-term relationships with managers, and because of that, we get their best thinking about new products, ideas, and opportunities. When really good people leave those firms and start their own firms, we often get that first call to look at them as a new potential LP or client. They may want only five or six clients and raise a billion or less and then close. Building those relationships has given us this huge information advantage about the quality of the partners, their distinctive edge, and skills. We get a lot of our best ideas from our managers because we build great relationships with them and spend time with them. Private equity has been a huge advantage for us; it is 30% of our fund. Our 30-year IRR is approximately 27%, net. Our venture capital component of that has been more than 30%.

You also have the advantage of being an early mover into private equity, correct?

Yes. That actually started before I got here. We had a small private equity allocation, some Boston-based

firms going back to 1980, but it was only a couple percent. Because we invest long term and can lock up part of the fund and take some illiquidity, that has worked for us. Our public team has done some fabulous work in the emerging markets. We developed some real value-added relationships there. A good example is in the fiscal year ending June 30, 2014, the emerging markets index was up 15%, and we were up 35% net.

Another distinguishing characteristic is that we travel overseas a lot. I've been going to China since 1990 almost every year and sometimes multiple times a year. I lived in London for almost three months this past spring thinking about whether we want to have an office or a rotational program overseas. We have a very global perspective, and that has allowed us to get out and meet many more people than most funds.

You mentioned China. Do you have other areas of particular geographic focus globally?

In the emerging markets, you have to have some scale and enough partners. We are not going to do anything if we don't find the right people. Our biggest emerging markets are China, India, Brazil, and Africa as a group. But the quality of the people we partner with makes the difference.

Through those partners, are there any new emerging markets on the horizon that you are considering or that you have entered recently?

We are always looking at the landscape. A couple of years ago we did a two-year, very intensive review of the emerging markets, holistically thinking about maybe a ten- to 15-year strategy. We visited more than 30 emerging markets, some of which we had been to multiple times but several we had never been to. We wrote a report for our board, thinking about a long-term blueprint, so it is an ongoing conversation. Things are volatile: some markets look like they will undergo reforms and are going to open up with more opportunities, and then things happen politically and those markets fall back. A few years ago people thought Turkey was going to be a great new market, but there is huge risk there now. Investors have to be thoughtful and not get carried away and recognize that there are still a lot of risks.

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When you evaluate alternative investments and emerging markets, what are the primary benefits you are looking for—diversification? alpha generation?

We are looking to find people with real skill. We are not doing alternatives just to do them. In fact, quite frankly, most people shouldn't do them because they don't have the staff and the team to source them, to build relationships, to understand them.

If smaller investors are going through the process of deciding whether to get into alternatives, which in-house characteristics or capabilities should they be sure they possess? Clearly, a competitive advantage is one, but is there a size below which building that advantage is insuperably hard?

The size thing is important, but it is more the approach. When I came to Notre Dame and started doing this, I was pretty naïve and young, so I started talking to a lot of people. We didn't rely on a consultant. I wanted to learn this stuff, so I took real ownership of it. I met potential partners, other funds, other endowment funds and got advice and developed expertise. I think if you want to develop relationships with the top people and have them think of you as a sophisticated investor and have them want you to be a client, you have to do the leg work. A consultant can help you develop your network, but you have to get out and meet people. The consultants generally aren't going to get you to the top people always, in every asset class. That takes direct ownership and building those relationships. Having tenure, as I and my team have, has reinforced that.

Maybe that is something that a smaller organization can consider, but they are probably not going to build anything reliable within five or ten years.

Exactly. It just takes time. But as you start getting relationships in place, then you have to oversee them. Then you have to have a team and a staff. Is the board of a small organization going to provide the resources to build a team? I was able to hire a team and staff and build the organization to help me continue sourcing but also to maintain and develop existing relation-

ships. I couldn't do that by myself today. Just in private equity, we have more than 70 relationships. It is a lot of annual meetings and a lot of calls, plus you have to review their deal memos, and you have to make sure they are doing what they said they are going to do; you have to pay attention to risk. Size is definitely an issue, but it is more the approach and commitment.

What is your current allocation to real assets?

It's 14%, but our target is 15%.

What kinds of items are included in your definition of real assets?

The three components are real estate, energy, and commodities. For us, it is primarily income-producing real estate, about half of that—about 8%. Private energy partnerships are at about 5%. Then we might have about 1% in commodities. We haven't done much recently in commodities other than private energy partnerships. We used to have a gold position; we played the super cycle in metals and mining stocks and gold from 2003 to 2013. We got rid of all that last year. Chinese demand has slowed, and we haven't seen a lot of inflation.

Would you say across those three areas that a common theme is a combination of inflation hedging and looking for market opportunities?

It is primarily finding skilled, really smart people who have a unique approach. But there is definitely a role for inflation hedging there as well.

What are the most important factors in manager selection?

Integrity, and that is not just a cliché here. We spend a lot of time getting to know the people, what makes them tick, what their values are. And after that, do they have the wherewithal to be long-term partners? Do they have a unique edge? Are they really committed to continue to grow, develop, and fine-tune? No matter how good you are, you are always evolving. Because of regulations today, you also have to be really good at the back office. There was a time when great investors did not have to focus on the back office as much; they had someone else do that. Today, investment firms have to be involved, have to

be aware of everything, have to set up a structure and hire a highly skilled compliance team.

Do you do some direct investment on occasion?

We have a couple of direct real estate investments, and we occasionally do an ETF for rebalancing, but we are primarily hiring managers to do our investing.

How important are fees when you are looking at either managers or particular funds, especially in the alternative space?

They are definitely a factor. There has to be alignment. I'm fine paying higher fees to someone good. It is fees and terms. It is not just the level of fees, but what are the liquidity rights? Is the incentive fee over a hurdle? In the hedge fund world, is the incentive a one-year annual or a multi-year? All the features from an economic standpoint guide the relationship, and there has to be alignment. We have some great private equity partners and venture funds that get premium carry over a certain IRR, but that is fine because if they are doing that well, I'm going to pay some incremental amount. My net return is still going to be the highest in the industry. There has been movement, particularly in the hedge fund world, to have better alignment. Sometimes general partners call us and talk through what the right alignment should look like.

Do you have any thoughts on co-investment as a tool to build alignment?

We are doing more co-investing. I think that is where size starts to become an advantage. It was not something I was thinking about doing when I was first building our private equity portfolio or our real estate portfolio. After I got to know these groups, understood the business, understood the kinds of deals, investments, and companies they were building, co-investing with some of them made sense. But we wouldn't do it with everybody.

In recent years, some investors have moved to reduce their number of manager relationships. What do you think of this approach?

That is a good question, but it is also a little misleading because we include private equity funds that we

are not going forward with but that still have some of our money in a prior fund, so they are still managing money for us. We have about 175 managers today. At one point I thought it would be nice to get lower, but it's actually gotten higher. There is some concentration, though. The ten largest portfolio managers manage 34% of the fund, and with the next ten we actually get to 50%.

You have spoken about principles such as integrity that are important to investors in general. How do Notre Dame's Catholic identity and commitment to responsible investing influence investment decision making?

It is fully integrated. We have had a social responsibility policy for as long as I am aware of; I believe it dates back to the 1940s. Catholic social teaching has always been part of the process. In 1993, the US Conference of Catholic Bishops developed a set of investment guidelines for social responsibility in response to Catholic groups that were looking for guidance. We use those guidelines, which were updated in 2003, as the foundational piece for our SRI approach.

In that document, the bishops recognize the church as an economic actor that is raising money, helping the poor, spending money on projects, so there has to be a sense of stewardship. People aren't going to give money if it is not being properly stewarded. The bishops go through a series of issues and talk about how Catholics should look at them vis-à-vis an investment portfolio. Some issues are more important than others, so there is a hierarchy. Sanctity of life issues are at the highest level of concern. Other issues include defense, pornography, the environment, etc. The document is well written and gives a sense of what is really important in Catholic social teaching and where there is some judgment. It is very balanced in its tone.

We also use screens, and we have restricted securities. Our managers have to abide by that. We give them that list at least annually. They agree up front that they are going to abide by that. We get separate accounts where we can in our public portfolios, which at our size is not a problem. Then for some hedge funds that do not have separate accounts, there is a very intense monitoring system put in place and dialogue with the manag-

In selecting managers, we spend a lot of time getting to know the people, what makes them tick, what their values are.



ers. Things like real estate are not really an issue. I was always worried that private equity would be an issue, but it is not. The companies that would be excluded are not really targets for private equity investors. The Investment Committee of our board does an annual review on socially responsible investing. We talk through the landscape and other issues that are coming up, and we test those against our policies. We get theologians to guide us if we need to. Notre Dame has a top-tier theology department and a lot of scholars who are really versed on these matters, and I tap into that as needed.

You are among a group of leaders establishing the Catholic Investment Services, a fund to manage the assets of Catholic universities and foundations. What is the objective of this initiative?

Because of my role at Notre Dame, I frequently get calls from social service agencies, Catholic high schools, dioceses, hospital foundations, religious orders, etc. “We see that Notre Dame has done well; we know you comply with the bishops’ guidelines; you have a whole department. What advice can you give us? Can you review our portfolio?” My goal for a long time has been to try to find a solution for them, so they actually would have access to the best managers and still comply with the bishops’ guidelines. There is a range of sophistication, but many of these groups don’t have financial people; they are people of God or are trying to do something good in the world or help the poor or educate. There are thousands of these organizations just in the US. I would say from what I see, most of them are not being managed very well. They try, but they just aren’t getting the right vehicles.

I talked to Jack Brennan, the former CEO of Vanguard, who is on our board and is the Vice Chair of the Investment Committee. We formed a working group of some folks on my team, Jack, Dick Flannery of The Investment Fund for Foundations (TIFF), and then we hired Peter Jeton as CEO. The goal is to provide first-rate investment management while still complying with the bishops’ guidelines. We hired TIFF to be the manager; it has a full investment and back office team and a 20-year record.

Because CIS was a start-up, it had no money and needed to find a partner. TIFF has a strong investment culture, a great team, and we are supplementing TIFF’s network with the Notre Dame network. I’m getting some of the managers I work with to help us be part of this program as well. So it is unique in that sense because the leverage of TIFF and the leverage of Notre Dame come together to help put an array of managers together that would be generally impossible for most organizations, including Catholic groups, to have access to. Notre Dame launched it with \$100 million in July.

Do you foresee Notre Dame staying involved in the organization or at least providing advice and input?

Yes; I am a founding trustee, and I am on the board. My team is happy to assist the TIFF team with ideas in collaboration. We want this to be really excellent; otherwise, it is not worth doing. TIFF is the lead, but as a founding trustee, I will be very involved in making sure we have the right array of managers and access to the right people. CIS is not-for-profit; we have 501(c)(3) status. We can do something to help some of these folks get more resources so they can do more of the good works they are already doing. I think that is a great thing.

Previously in the Quarterly, we have written about CIO outsourcing. Is what you are doing an example of that? It doesn’t sound like it is.

We are not looking for organizations to get rid of their consultants or CIOs. Most of these organizations don’t have CIOs. We want to be their partner. We are telling them to think of us more as one of the managers. You are very perceptive; it is not really an OCIO product—we never talked about it that way, but some of the press might have latched on to that because of my involvement.

Thank you for sharing with us your investment and management insights, which clearly have served Notre Dame well. ■

Jared Chase is PREA’s Staff Writer and Editor.