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Vested interests

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Scott Malpass '84, '86MBA and I have always been able to talk, although he uses lots of words that I don't know. Debt issuance, unitized basis, smoothing mechanism, private equity, hedge fund, venture capital, leveraged buyout fund.


Photo: Barbara Johnston

Today we are sitting at the end of a long table in a conference room at the investment operation's classy digs over at Eddy Street Commons. The Notre Dame vice president and chief investment officer (CIO) is looking casual and is his typically friendly and gracious self, patiently answering my questions teacher-to-student style. In fact, at one point in our conversation, he gets up and diagrams his answer on a whiteboard.

Malpass is something of an investment guru, the subject of adulatory profiles in *Forbes*, *The Wall Street Journal* and other publications that have noticed how remarkably well Notre Dame's portfolio has outperformed standard benchmarks and indices, despite the University's resolve to invest with a conscience.

Malpass came to work at Notre Dame in 1988, when the University's endowment was about $400 million — the 25th largest in higher education. Today it ranks 12th. Of course, the endowment fluctuates daily as investments rise and fall with the markets. Things are going really well as we speak, but Malpass isn't watching the ticker right now. He prefers to take the long view. He's content to pin the endowment pool he's overseeing at about $11.8 billion (including $1.1 billion from Congregation of Holy Cross entities), which was its market value at the end of the previous fiscal year — June 30, 2017.

The net income on that endowment will come under closer scrutiny from the federal government with the new tax law imposing an excise tax of 1.4 percent on it. That's estimated to cost the University between $8 million and $10 million annually, depending on the actual investment return. Malpass calls it "one of the most misguided pieces of legislation I've ever seen in my life," partly because the tax is only levied against some 30 private colleges and universities and will not affect public institutions. That, he says, "makes no sense." Nor does he understand the arbitrary nature of the formula or "why you would want to tax the success of charitable institutions."

How the new law will be implemented is still unclear, he says, and falls into the hands of the University's tax experts. "I'm not a tax guy," he says. "I'm a financial guy, an investment guy, and this doesn't change anything I do in terms of strategy or what we're going to invest in, or our return objectives. It'll be part of the cost of running the fund, but not the strategy." And there is little doubt of that success.

For some years I had assumed Malpass and his confederates — now a core investor team of 17 professionals, all intentionally Notre Dame alums — were stock-market wizards. "This will surprise some people," he tells me, "but the focus of our work is actually more in finding really skilled, interesting people to partner with. It isn't primarily some master plan of how much we're going to invest in each area. Certainly, we've discussed that. We have some general targets in how much is liquid versus illiquid. There's some basic parameters in how much in public versus private. And that mix of things results in a risk profile, right?"

I nod. He continues: "But once that's done, then the day-to-day is sourcing ideas and finding great people to work with and then creating a partnership of various investment terms." I nod again, taking this in, but ask: "Like who? People, companies, stockbrokers?" Not stockbrokers, I learn; they're just the middlemen.

He explains: "I'm talking about people — people to manage a stock portfolio for me because they're really good at that. So finding talent, outside talent, that we're going to give a piece of the endowment to for them to manage. That's what we do day to day — trying to find great people to work with. And there's always new people, new emerging talent, a lot of new, interesting people, always, globally. All over the world." About 35 percent of Notre Dame's endowment fund, he notes, is in "various international mandates."

Notre Dame has about 175 of these investment partners. They have been given an amount of money to manage, a piece of the overall endowment pie, each allocation averaging about $100 million, although the slices range from $5,000 to $500 million. The idea is for these partners to grow the size of their piece. "We monitor their performance constantly," he says. "We get their reports typically monthly, and my team is meeting with them, talking through any issues or concerns. We're always trying to improve our portfolio, better and better."

That means better and better investment partners, too. Turnover is expected. People retire, he explains, or maybe have a good run they can't keep up. While the average tenure is 10 years, Malpass and his team are always looking for new blood. "We like a smaller, a little more boutique-y owner-operator," he says. Finding new partners means "intense networking and talking to people. That's why we travel so much. You've got to get out and talk to people."

Still, Malpass likes stability. "If you talk to the top CIOs in the country," he says, "they'd say there's nobody better at building relationships than Notre Dame. We're the best at that, at sourcing and creating great long-term relationships with investment firms. We're the best." He adds, "We don't have any secret recipe. It's the stability of our team. Our shared language. Our shared history. Where you work with the same people. Share impressions. We trust each other's judgment. That takes years to develop."

This is when Malpass — also a very engaged and popular teacher in the Mendoza School of Business — heads to the whiteboard, pops open a marker and charts out the corporate alignment, the continuity, the stability that has undergirded Notre Dame's success — success that has helped transform the University and given the investment enterprise its own brand in financial circles internationally.

He cites the long-term stability of University governance — three presidents in 65 years and only two chairs heading the investment committee of the Board of Trustees since 1976: the late Robert K. Wilmouth '50M.A., who served until 1995, and the current chairman, Jay Jordan '69, chairman and CEO of the private investment firm Jordan Industries, in Chicago. "This is unheard of in today's world," Malpass explains.

The stability, he continues, is "good for investing because you have a philosophy and you stick with it. And that combination of a strong sense of mission and purpose, combined with tremendous alignment of our governance body and our goals and objectives, our brand, gives us access to the best managers. We can get introduced now to anybody because we're from Notre Dame. And we have the resources to get those people, and an investment team that's the best in the country. These are the big reasons we are successful."

The whiteboard diagram that Malpass sketches has connected these elements with colorful lines and arrows, charting the organizational hierarchy of guidance, communication and continuity. And it all eventually points to his staff. "My investment team is the best in the country," he emphasizes. "You try recruiting a top investment team to South Bend and keep them here for 20 or 30 years. All Notre Dame, by the way, all enveloped by a strong sense of mission and purpose. It's a Catholic school. They believe in the place."

That sense of mission — what's known as SRI, or social responsibility investing — is central to Notre Dame's investment strategies. I remind him of a lunch conversation we had a couple of years ago when a band of students was protesting the University's investment policies, calling for divestment in fossil fuel companies. "Divestment," he said then and repeats today, "is such a blunt tool." He says it means "you want the whole industry to go away," and cites the contraceptive, abortifacient and embryonic stem-cell industries as examples. "We don't want those industries. We divested them all. We don't do them."

Energy companies, however, present less clear-cut dilemmas. "Do we restrict companies in the energy sector because of bad corporate behavior or bad environmental records?" he asks. "Yes. Absolutely. We have a lot of them." He says, in fact, Notre Dame does not invest in about 30 coal companies for environmental reasons. But investing in other energy companies can provide opportunities to support renewable, cleaner forms of energy.

Malpass, a member of the Vatican Bank's board, cites Father Theodore Hesburgh, CSC, and his objections to apartheid in South Africa with setting Notre Dame's course for investing with a conscience. "That's where Father Ted was so brilliant," he explains, "because he'd been to South Africa, and he knew the heads of these corporations and he wrote them. And he said, 'I'm troubled by some of the things I see related to the apartheid issue in South Africa.' Because of the boards he served on and all that he was doing, he knew the big companies in South Africa.

"And there was always a sense that we had to have a dual mandate, if you will, and they're not incompatible. That we are a steward and an economic actor. People give us money and they expect good stewardship and to earn a reasonable return. At the same time, they want us to be true to our ethical values and the Catholic mission. We never thought of those in conflict, and Ted set the tone for that through the apartheid issue."

The investment team works from a policy statement on social responsibility outlined by the Board of Trustees as well as SRI guidelines from the U.S. Conference of Catholic Bishops, which Malpass calls "our foundational piece, built on Catholic social teaching." The policies "talk about restricting companies whose values are inimical to the University following Catholic social teaching, and we exercise our ownership rights through proxy voting. We don't delegate that to anybody." In addition to sanctity-of-life issues, Notre Dame keeps a close eye on pharmaceuticals, defense funding and the biotech industry, and is watchful for companies violating environmental, labor or other discrimination standards.

To help turn theory into practice, Notre Dame works with a company called ISS — Institutional Shareholder Services — by buying "screens," Malpass says. "They do research on companies, looking at different criteria. If I don't want to invest in tobacco, tell me the companies who do tobacco, tell me who I have to eliminate. Or abortifacients or land mines. They'll screen the whole universe of companies and they'll send you a list and say, 'These companies do that.'"

He continues, "We send our partners a notice every year, every partner, a letter reminding them that we're a Catholic university. We have a social policy. These areas are restricted. Here's our list. You can't buy any of these companies. In addition, we ask them to make us aware about anything they hear about other companies — because it's dynamic, things change. I mean, we don't know day to day everything happening in corporate America."

If necessary, Malpass will contact a company, write a letter, ask for clarity. And now, because Notre Dame has become a major investor, the University wields influence. People listen. "The nice thing is that now we're bigger, and we have more leverage to tell people, 'I can't take a risk that you're going to invest in something objectionable. And if you want Notre Dame as a partner, then you have to do this.' And they do. Almost all of them do." These days, he says, with $12 billion to invest, Notre Dame gets a lot of respect.

Malpass and I remember the days when the investment operation occupied a closet-sized office tucked under the stairs on the ground floor of the Main Building, staffed solely by Father Richard Zang, CSC, '61, '67, '69MBA. Back in the late 1970s, I wrote copy for the fundraising effort to explain the value of an endowment and to stress its importance to an institution with ambitions, but whose limited financial goals had been meeting expenses and affording new construction. The endowment became more of an institutional priority during Hesburgh's presidency.

"I talked to Father Ted a lot over the years," Malpass recalls. "It was such a sensible thing — a permanent fund that you invest wisely over time, with earnings to support a particular program in perpetuity and, really, to create excellence. I still think back to the famous story when Father Ted was announced as president and they asked him how Notre Dame could become one of the top universities in the land and he said, 'Well, all I know is the top schools have the biggest endowment funds, so we need to raise money and build an endowment.' That just resonated with me when I came to Notre Dame in this role, and I've always been passionate about it."

That was in August 1988. Malpass had graduated from Notre Dame in 1984 with a degree in biology but turned his career toward business when he entered the University's MBA program. The story goes that he came back to campus with $20 in his pocket and needing a job and a place to live. Father Zang not only ran the one-man investment office but was rector of St. Joseph Hall, an old seminary converted into a men's graduate student residence hall across St. Joseph Lake from campus. Malpass became an assistant rector there. Two years later, Zang helped Malpass get an internship with a pension consulting group in New York.

Two years after that, Bob Wilmouth, then chairman of Notre Dame's investment committee, wanted the University to have more professional management than Zang could provide. Malpass got word of the opportunity and was soon hired as an assistant CIO, serving for a year as an understudy to Zang. In the spring of 1989, Malpass became Notre Dame's chief investment officer, inheriting Zang's one-room office with no computer. Foot traffic on the overhead stairs would rain ceiling dust onto his head.

Today his team not only manages Notre Dame's endowment but that of other Holy Cross entities. That part of the portfolio can be traced to 2007, when Father William Beauchamp, CSC, '75J.D., '81M.Div., the former Notre Dame executive vice president, was the chief financial officer for the congregation's Indiana Province and president of the University of Portland. It made sense that Malpass, who once reported to Beauchamp, could apply his team's expertise to other Holy Cross institutions.

Similar thinking led to the establishment in 2014 of Catholic Investment Services. CIS was started with $100 million in Notre Dame seed money, and now has about two dozen clients with $650 million in assets. Based in Boston, with a three-person staff headed by Peter Jeton, CIS manages investments for Catholic schools, hospital foundations, dioceses and religious orders. There are about 4,000 Catholic organizations in the U.S. with about $150 billion in assets, says Malpass, and many could benefit from better investing policies, networks and know-how — the kinds of advantages Malpass and his team have provided to Notre Dame.

Kerry Temple is editor of this magazine.

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