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As Endowment Values Plummet, Some Institutions Consider Suing Over Investment Advice

By Kathryn Masterson

As many as five endowments for colleges or charitable foundations that have suffered significant investment losses or were unable to access money in their accounts in recent months are considering legal action against their brokers or investment managers, alleging misrepresentation of risk or mismanagement, says a New York-based securities lawyer.

Jacob H. Zamansky, who is leading the first of several lawsuits against the failed investment bank Bear Stearns, says the endowments have contacted him about making claims that brokers recommended investments unsuitable for endowments or misled them about the stability of certain investments.

While some endowments are trying to work out deals with brokers and investment managers, others are getting closer to filing lawsuits, Mr. Zamansky says. He expects to see cases brought by endowments in the next several months.

Earlier this year, Mr. Zamansky filed suit against a broker who had recommended that an individual invest his charitable foundation's money in auction-rate securities. His client was

surprised when his money was later frozen and unavailable to make grants.

"I think there should have been a much more conservative pitch from brokers after the credit crisis started and certainly after the beginning of 2008," says Mr. Zamansky, founder of the law firm Zamansky & Associates.

He also thinks donors to colleges or foundations may make legal claims against endowments if they believe their funds were put into investments that were unsuitable for endowments' investing strategies or were outside their investment mandates.

Other experts who track or work with college endowments, which until the last year were reporting double-digit returns, say they haven't heard of any institutions filing lawsuits regarding the most recent endowment declines. College endowments, they say, tend to follow a high standard of due diligence in making investment decisions and policies, usually with the approval of an investment committee with monitoring duties, but there might be isolated cases of fraud that could result in legal action.

Thomas E. Burkhardt, vice president for finance and administrative services at the University of Dayton, says institutions could

take action against investment managers who go outside the written guidelines given to them. He hadn't heard of legal actions being taken by universities, but speculated some will find their managers may have gone outside their mandates.

Dick Anderson, who directs the higher-education practice for Hammond Associates, a St. Louis firm that consults with about 120 colleges on investment matters, believes higher education will be involved in fewer lawsuits than will individual investors, because institutions tend to be more sophisticated investors. They use consultants, investment committees, and lawyers to review policies and investment documents.

"With all the layers universities have to go through," Mr. Anderson says, "they presumably understand what they're investing in."

Concerns With Smaller Endowments

John D. Walda, president of the National Association of College and University Business Officers, says he has not heard of any endowment lawsuits, but he has heard concerns about the level of analysis and openness around

certain investments, including mortgage-backed securities. He has also heard talk about changing the allocation of assets in endowment investments.

Much of the investing for larger endowments is done in-house. Colleges with smaller endowments that outsource the management of their funds might be more likely to encounter problems, Mr. Walda says. He has not heard of any institutions in that category considering legal action.

Sheldon E. Steinbach, a higher-education lawyer with the Washington-based firm Dow Lohnes, thinks smaller private institutions may have been guided into investments that were inappropriate for them or went against their investment policy, but endowments would have a tough time proving that in court, he says. Also, they will need to consider the cost and negative publicity that legal proceedings would cause.

"It may be hard to go forward," Mr. Steinbach says, "and the cost of litigation may exceed any gains in terms of what is potentially recovered."