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ENDOWMENTS IN PARADISE: WERE UNIVERSITIES HIDING OR CHASING RETURNS WITH THEIR "PARADISE PAPERS" INVESTMENTS?

In November 2017, a leak of a huge amount of financial documents occurred, which came to be known as the "Paradise Papers." This name was based on the largely Caribbean tax-and financial-reporting havens where banks, law firms, and financial institutions which had opened up huge numbers of accounts for a range of wealthy-individual and institutional investors were based. Many of these investors owned accounts set up outside of their home countries to minimize their tax payments, and included with them were university endowments*.

An upcoming paper by Gregg Fisher, Yuxiang Jiang, and Cristian Tiu examines both the potential reasons why universities invested in these offshore investments, and their investment results in doing so. Did these educational endowments seek to "hide" poor-performing, socially objectionable, investments within these structures, or were they simply seeking equity and alternative-asset managers based in these countries and locales?

If university endowments use offshore accounts to hide investments with poor returns, then, given the "bad" nature of these investments and the costs necessary to set them up, it would be expected that these endowments would underperform their peers. If, on the other hand, endowment managers invest in offshore funds because these are the best funds available in their asset classes, those endowments should show above-average returns in their (for example) private equity returns. Finally, university endowments that invested in Paradise Paper-like investments may simply have been seeking performance, and consequently took more risk, not shying away from even the "headline risk" of bad press should those investments be made public. If this is the case, we expect the Paradise Papers' endowments to outperform.

Our study examines these hypotheses using a unique data set for endowment characteristics and performance that makes it possible to identify those endowments appearing in the Paradise Papers. Our results suggest that the average endowment which showed up in the "Paradise Papers" was most likely only seeking excess returns and was willing to accept both the investment risk and the public perception risk of doing so. We document that endowments appearing in the Paradise papers have net-of-fees returns that are 29 basis points higher than those not mentioned in the Paradise papers (all other things equal), with similar risk-adjusted returns and moderately higher alpha. In aggregate, these findings reject the hypothesis that universities use offshore accounts to hide underperformance.

While the Paradise Papers' endowments outperform, their alternative portfolios are not statistically significantly different when compared to those of endowments not showing up in the hacked data. This result does not seem to support the thesis that in order to gain access to the best alternative managers, an investor should only seek offshore funds.

* The University at Buffalo Foundation, of which co-author Gregg Fisher is a board member and trustee, is one such university investor. The authors' views are not those of the University at Buffalo or the University at Buffalo Foundation.

Finally, in our study, we present evidence that the endowments mentioned in the Paradise Papers face some pressure to generate high net returns for their entire portfolios. First, the endowments in the Paradise Papers are both larger in terms of size, as well as contributing more to their university budgets, on average. They also serve universities with higher borrowing rates, which also borrow more relative to the size of their assets, and take modestly more investment risk (as measured by volatility) than their peers.

In short, our initial analysis is that these large, university-critical endowments sought out private equity, hedge fund, and venture-capital investment options in these offshore "tax haven" countries out of a desire to enhance returns and comfort with the risks in doing so. This investment behavior had the average effect of generating modestly higher return (and higher risk), and despite public perception does not seem to have been a generalized effort to "hide" poor returns or bad investments.

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