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5 Policy Areas Impacting Endowments and Foundations Today

by Amanda Novello

Commonfund Institute Federal Policy Roundup: Affirmative Action, Debt Ceiling and more.

This article highlights some of the most pressing policy considerations for endowments and foundations, particularly those that are systemically important and those directly related to the business and investment environment. In some cases, final details are yet to be determined, but are still worth considering the implications, and teasing out issues and potential outcomes. In this article, we cover 1) Supreme Court cases on affirmative action, 2) implications of the debt ceiling resolution, 3) charitable donations, tax policy and donor-advised funds, 4) efforts to increase allocations to diverse managers, and 5) ESG policy.

CONSIDERATIONS FOR THE UPCOMING SUPREME COURT RULING ON AFFIRMATIVE ACTION

Two U.S. Supreme Court cases, *Students for Fair Admissions v. Harvard College* and *SFFA v. University of North Carolina,* will challenge affirmative action, or the use of racial demographic factors in admissions considerations typically used to promote diversity. This could impact institutions across various offices and functions, from admissions to business and financial aid, potentially requiring new programs and responsibilities. The exact details of the ruling are yet to be determined, and institutions will need to understand the ways in which race is used in admissions, financial aid, and DEI programs, and have a plan for maintaining diversity without using race as a characteristic. Foundation partners are also conceiving of strategies in the case that current or future rulings apply the same principles to the broader nonprofit landscape.

The most sweeping implications of the ruling will likely be on higher education admissions, but even if race cannot be used as a factor going forward, there are other ways to pursue diversity, equity, and inclusion in admissions. Research shows that due to historical racial income and wealth gaps, using socio-economic factors in admissions decisions can be a useful proxy for race. Experts suggest other strategies, like ending legacy and faculty child preferences, boosting first-generation admissions, and geographic diversity, can bolster diversity as well. However, evidence from states that have banned affirmative action indicate it will still be a challenge to maintain affirmative action levels of racial diversity. The UC system in California, one of the nine states that already bans use of race in admissions, employs low-income and geographic factors instead of race, in combination with costly outreach programs. An amicus brief written on behalf of the UC system in response to the Supreme Court case highlighted that, despite "persistent, intensive efforts to improve the diversity of its student body through race-neutral programs, ... full realization of the educational benefits of diversity remains elusive." Twenty-five years after affirmative action was banned in the state, the UC system reported that its 2021 class was the "most diverse class ever," but that diversity has not been maintained in all its schools, particularly the most selective campuses.

These rulings may also challenge how race is considered in financial aid, requiring institutions to reassess how to financially support those who need it most, in a race-neutral way. Financial aid will continue to be a critical tool for maintaining enrollment and retaining students, especially during economic downturns that might particularly impact lower income students. This may entail looking at endowment and spending policy, especially for the plurality of institutions for which financial aid is the largest spending category. According to the 2022 NACUBO-TIAA study of endowments, on average nearly half (46 percent) of endowment spending is earmarked for financial aid. Financial aid is even more outsized for smaller institutions – those with under $25 million allocated nearly two-thirds of their spending to financial aid, on average. If the ruling is broad enough, it may also pose challenges for the nearly two-thirds of institutions that reported some level of gifting specifically tagged to Diversity, Equity and Inclusion (DEI) (NACUBO 2022).

As many institutions have surely begun, mapping use of race throughout various functions such as admissions and tuition assistance, understanding the potential legal implications of the ruling, and having adequate staff, management, and consultative relationships to amend and create new diversity-oriented but race-neutral programs will be key strategies moving forward. Lastly, communicating DEI commitments to existing and prospective students will be increasingly important for feelings of safety, belonging, and trust.

DEBT CEILING RESOLUTION CUTS SPENDING, INCLUDES HURDLES FOR SOCIAL SUPPORT, AND AN END TO STUDENT LOAN PAYMENT PAUSE

The debt ceiling resolution that passed Congress, the "Fiscal Responsibility Act of 2023" suspends the debt limit through 2025 while setting annual spending limits. The dampening effect on the economy is estimated to amount to anywhere from 0.1 percent to 0.5 percent of GDP in 2024 (this compares with the 2011 debt ceiling resolution that spurred an estimated a 0.7 percent hit to GDP). Since many nonprofits rely in part on government grants and funding, nonprofit leaders anticipate this, as well as coming appropriations decisions, will have a chilling effect on the charitable ecosystem, amidst increasing costs, banking uncertainties, and increased societal need.

Other details of the deal will have a direct impact on endowments and foundations, including increased hurdles to social support benefits and an official end to pandemic-era student loan repayment. Increased requirements for recipients of Temporary Assistance to Needy Families (TANF) and Supplemental Nutrition Assistance (SNAP) – programs that have proven to reduce poverty, improve educational and health outcomes, and increase employment – will increase need that many charitable organizations seek to address. The change will further impact low-income and food-insecure students who, due to existing eligibility requirements, were already unlikely to be eligible for such assistance.

Lastly, the deal ends the student loan repayment pause that began in 2020, restarting payments by the end of the summer, putting added pressure on students. A Supreme Court decision on Biden's student loan cancellation plan is anticipated to land this summer as well.[1] Institutions may think about exploring ways to mitigate the negative effects of food and financial insecurity. Race-neutral programs that address food and financial insecurity could disproportionately help students of color, since studies show that Black and Hispanic/Latino households face food insecurity rates twice those of white households, and in many cases, students of color struggle more with repaying student loans than their white peers.

POLICIES AIM TO AMEND THE TAX BENEFITS OF CHARITABLE CONTRIBUTIONS

One way to bolster the nonprofit sector amidst uncertainty and the dampening effects of the debt ceiling resolution is to make charitable donations more attractive, through tax benefits, for example. One policy recently introduced with bipartisan support, the Charitable Act (H.R. 3435/S.566), would restore and expand deductions for non-itemizers who make charitable donations, also known as a universal charitable deduction. The incentive to donate was severely eroded by the 2017 Tax Cuts and Jobs Act, which nearly doubled the standard deduction, resulting in a decline in the number of people who itemize. That coincided with a reduction in the share of taxpayers with a charitable contributions deduction and total gifts, and contributed to the nonprofit workforce shortage. The Charitable Act could theoretically help to reverse these trends.

The Charitable Act would include contributions to Donor-Advised Funds (DAFs), which have exploded in recent years in both the higher education endowment and foundation spaces, as a way for donors to have advisory input in how funds are used without the administrative burden of setting up a new foundation. There are ongoing conversations about policies and best practices that could ensure DAFs are utilized for their intended purposes.

DIVERSIFYING THE ASSET MANAGEMENT INDUSTRY

Only 1.4 percent of assets under management in the United States is managed by diverse-owned firms. One policy introduced last year, The Too Narrow to Succeed Act, would culminate in a Department of Labor study of best practices for diversifying assets under management, especially in large, pooled funds like pensions and trusts. While that policy would not mandate change, it would provide a pathway toward more equitable asset allocations and encourage existing efforts to increase diversity in asset management. Managers of endowments and foundations, including Commonfund, have focused on increasing manager diversity, as one of many pathways toward orienting the massive amount of money held in the space ($880 billion in private foundations alone, according to the Urban Institute) toward racial and economic justice.

According to the 2021 Commonfund and Council on Foundations' Study of Foundations, roughly only 12 percent of institutions surveyed said they seek to invest with diverse managers. Those numbers are likely to climb, since in the same study, more than 40 percent of institutions reported having discussions about diverse managers, and 24 percent of private foundations were looking into or planning to invest with diverse managers in the next year (new survey data will be released later this summer). A few years ago, Commonfund developed a diverse manager portal to increase exposure to firms that don't have extensive existing networks and to build our diverse manager pipeline.

1 If the Supreme Court rules on Biden's debt forgiveness plan before June 30, the payment pause could be lifted sooner, as the original repayment deadline is tied to that decision.

POLICIES FOR AND AGAINST ESG INVESTING

The use of environmental, social, and governance (ESG) factors in investment decision-making has become a hot-button issue, prompting a flurry of legislative efforts to both encourage or legitimize ESG investing, or to ban it. At the federal level, the Department of Labor upheld the legality of ESG investing for ERISA funds (with Congressional and state challenges, but ultimately the DOL policy remains), and the SEC is working on implementing climate disclosure rules that would increase transparency and improve diligence around climate risk, mirroring existing EU rules. All the while, Commonfund data show that institutions are increasing discussion and policy around ESG investing, and institutional investors are incrementally adding ESG strategies across their portfolios.

Other policies that are in play that could impact your institution include, but are not limited to: Loan forgiveness – the U.S. Supreme Court will decide whether to uphold the Biden administration's plan to provide $20k to Pell recipients and $10k to others; the College Cost Transparency and Student Protection Act, a bill that would call on the U.S. education secretary to establish consistent terms and definitions for financial aid; issues around Title IX and independent schools; potential Department of Education (DOE) gainful employment rules; and lastly, the DOE issued a no cost extension of Higher Education Emergency Relief Funds (HEERF) to address ongoing impacts of the pandemic. Institutions must apply by June 20 for up to a 12-month extension.

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