AGENDA ITEM 6E.

COLLEGE ILLINOIS!® PREPAID TUITION PROGRAM
TREASURY PROPOSAL FOR FUNDING RECEIVED

Submitted for: Action

Summary: On April 26, 2022, we received $230 million from the State of Illinois as part of an FY22 supplemental appropriation bill that was signed by the Governor. This money received is meant to cover the College Illinois unfunded liability based on the June 30, 2021, actuarial projections produced by Gabriel, Roeder, Smith & Company (GRS), our actuary.

Investment staff partnered with GRS and Callan LLC, our investment consultant, to analyze and evaluate various scenarios and investment options. Scenario analysis with GRS included a review of the weighted average tuition and fee assumption and the actuarial rate of return assumption (select and ultimate rate structure). After internal ISAC consultation and deliberation, followed by discussions with the Callan team the scenarios were narrowed down to one that was used as the basis for the asset allocation study. Subsequently, more in-depth investment evaluation and analysis was performed. Key inputs to determine the optimal investment approach are our return needs, our risk tolerance, and our liquidity budget.

Of note, based on the actuarial soundness report as of June 30, 2021, the College Illinois program expects significant cash outflows over the coming two years ($125 million for FY23 and $120 million for FY24). The total expected cash outflows over the next two years exceeds the money received ($230 million) as part of this appropriation. The expected yearly cash outflow for FY23 amounts to approximately 20% of the investment portfolio. The materiality of the cash outflows will increase year over year as the corpus of the portfolio declines. *Therefore, the desired liquidity budget is high.*

Next, we evaluated options within a risk-return framework. Our goal is to maximize the expected rate of return of the College Illinois trust fund to ensure we meet our expected future liabilities per our actuarial assumptions, while being cognizant of the risk taking needed to achieve those returns. Additionally, our goal is to also protect fund assets from drawdown risk as much as possible given the runoff scenario of the fund and the limited window of time. *Therefore, the desired return profile is to meet the actuarial rate of return while minimizing the risk taking needed to achieve the rate of return.*

Below we have a broad summary of the main investment options for the new funding:

1. Keeping the money at the Illinois Public Treasurer's Investment Pool (IPTIP) also known as The Illinois Funds account earning 0.815% (as of May 13, 2022) with virtually zero risk. *Note, the money is currently being held in this account.*
2. Keeping the money at our Interest and Dividend account at Northern Trust earning 0.45% (as of May 13, 2022) with virtually zero risk.
3. Investing the money in a laddered bond portfolio of U.S. Treasuries which is expected to earn over 2.08% per year with virtually zero risk. The bond ladder portfolio would be a mix of US Treasuries with different maturity dates matching the College Illinois program's cash outflows.
4. Investing the money in fixed income or equity securities, or a combination of both. In this case the expected rate of return is likely to be higher than any of the previous three options. This option carries a higher risk posture and therefore higher volatility and drawdown risk. The drawdown risk is of particular concern to investment staff and consultant, as we might not have enough time to recover from it, given the short time frame under consideration due to the significant expected outflows noted above.

Therefore, investment staff and consultant are recommending option number three, which meets the assumed rate of return requirements while minimizing risk. In this option, we would build a laddered portfolio of U.S. Treasuries that would help us meet our expected cash outflows and earn an attractive yield in excess of 2.08% based on the current 1-year U.S. Treasury rate as of the date (5/6/2022) of writing this memo with virtually zero risk.

To manage this portfolio of U.S. Treasuries, we recommend using Garcia Hamilton & Associates (GHA), one of our current fixed income managers, given their high degree of expertise in this area of the market. This proposal leverages our existing relationship with GHA and their market expertise to manage a unique and customized strategy for ISAC, which involves virtually no risk.

GHA is currently on the Watch List, and therefore per our Statement of Investment Policy, we require Investment Committee approval for GHA to receive a new contribution. The proposed bond ladder would be a separate portfolio that GHA would manage for less than two years. We are not adding any money to our current investment in their intermediate govt/credit strategy (the strategy that is currently on our Watch List). Nonetheless, as of March 31, 2022, our existing portfolio managed by GHA is outperforming for all trailing periods as they exhibited very strong relative performance in 1Q22.

Based on preliminary conversations with GHA, we are confident that they can structure an optimal laddered portfolio of U.S. Treasuries for the College Illinois program. The proposed strategy will help ISAC earn the highest possible yield while matching the timing of our expected cash outflows with virtually zero risk. Further, GHA has indicated to investment staff very competitive pricing.

The Investment Committee reviewed the options and recommendation presented above at the May 26, 2022 meeting of the Investment Committee. The Investment Committee members approved unanimously the recommendation presented by investment staff and investment consultant.

Action Requested: For the Commission to approve the Investment Committee recommendation (based on investment staff and investment consultant recommendation) to invest the funding ($230 million) received from the State of Illinois in a laddered portfolio of U.S. Treasury securities to be managed in a separate account by Garcia Hamilton & Associates, an existing manager.