College Illinois!® Investment Advisory Panel Meeting

October 6, 2010

James R. Thompson Center
100 W. Randolph St.
Chicago, Illinois

Attendees:

Susan Keegan – Panel Member
Alex Rorke, Panel Member
David Ikenberry, Panel Member
George Clam, Panel Member
Andrew Davis, ISAC
Frank Bello, ISAC
Kim Lee, ISAC
Nick O'Keefe, ISAC
Larry Zeller, ISAC
Pat Krolak, Marquette Associates
Eric Gaylord, Marquette Associates
Debora Calcara, Commission Secretary

Mr. Bello thanked those present for taking the time to meet and then asked all present to introduce themselves. He then asked Pat Krolak with Marquette Associates to give a brief market update.

Mr. Krolak provided the members with a brief general update on the state of the market. He then noted that portfolio for September 2010 is at $1,048,000,000 and should increase once the private equity and hedge fund numbers are valuated through September. Mr. Bello confirmed that this is the largest the fund has ever been and he reminded the panel that the fund was down to $725,000,000 in March and April of 2009.

Mr. Krolak indicated that year to date from July 1 to the end of September, the preliminary return is at 5.9% and the fund is well ahead of its actuarial rate of return.

Mr. Krolak and Mr. Bello gave the panel an overview of the managers in the fund. He noted that the direct investment in ShoreBank was written down to zero due to the takeover by the FDIC.

Mr. Krolak and Mr. Bello confirmed for Mr. Clam that the policy target is still an effective level. Mr. Krolak stated that rather than being exposed to the volatility and return streams of the publicly traded markets, they are looking at alternatives for non-correlated asset classes and also not be exposed to the constant volatility that is seen in the public equity marketplace currently and therefore going to the alternative asset class of hedge funds, private equity, infrastructure and even real estate.

Mr. Clam stated that since the policy target selected is the percentage that you currently like to have in there and that there is a range that accommodates changes in your target levels periodically. He inquired that since we are at 26%, were we on a path to 15% or whether there is consideration for changing the current policy target. Mr. Krolak stated that it is more on the pace to achieve that 15% allocation to equities than less as we are looking to the alternative managers to deploy the capital into the space.

Mr. Krolak then reviewed the Kennedy-Wilson fund.

Mr. Bello noted that the fund is currently paying 66 basis points on management fees but expects this number to trend higher as the capital calls continue and more is invested in the alternative space. He indicated that it is anticipated that the average being paid is roughly 88 or 89 basis points on asset management fees as compared to similar investment portfolios.

Continuing, Mr. Bello referred to the investment policy noting that the panel is required to review the current investment policy twice per year and make any changes necessary and give their input which is then taken to the Commission for approval.

Mr. Davis stated that the internal investment team of Mr. Bello, Mr. Zeller, Mr. O'Keefe as well as himself have discussed the theoretical changes that have taken place in the business over the last year and thought it best to have a discussion with the panel on how we view risk, how to measure it, quantify it and manage it. He thinks it is time to reevaluate how risk is viewed from the perspective of the panel.

Mr. Clam suggested that they take a look to see if the correlation between different markets is either sufficiently strong or sufficiently low to provide the diversification of risk that you would expect under the circumstances. He inquired how you would split out certain segments of international or domestic and measure them against one another to fine more optimal diversification opportunities.

Mr. Bello indicated that the fund is able to map out the cash flows of the liability stream over the next 15 years and know when tuitions become due. He would like to have discussion around market risk, non-market risk and make sure there is a good definition of non-market risk.

Responding to Ms. Keegan commented that the key is selling more contracts, Mr. Davis stated that in response to that the marketing and communications department has changed their name to marketing and sales and he has hired a new director for that department so this is very high on his list. He indicated that it is going slower than he had wished but the process is moving along. He indicated they are in the process of identifying and entering into legally binding arrangements with third party sales to help sell contracts. Ms. Keegan agreed that next to a life insurance policy, one should have the prepaid tuition contract.

Mr. Ikenberry stated that the question is whether the fund is over funded or under funded, the discussion at the meeting today was about long-term investment models and talked about the left hand, but did not talk about the right hand at all and what is actually at risk to us.

Mr. Krolak stated that they do asset allocation study where they incorporate the future liabilities cash flows.

Mr. Davis suggested putting a discussion and presentation of the liability on the agenda for the next meeting.

Responding to Mr. Ikenberry, Mr. Davis stated that the liability shortfall of the program is not covered by the State of Illinois, it is called a moral obligation. He indicated that each year he reports to the Governor and the legislative leaders regarding the fiscal stability of the program and should the program need to be funded by the government to meet shortfalls, the Governor is required to ask the legislature for help but they are not obligated by law to fund the shortfall.

Mr. Bello provided the panel information on the transition of assets from US Bank to Northern Trust indicating that the transfer was completed successfully.

Mr. Bello updated the panel on the selection of the hedge fund managers. He also stated that they qualified four firms for a manager of manager program. Mr. Davis indicated that he envisions putting five percent of the assets into that pool in the next 12 months.

Mr. Bello stated that the pricing for the contracts for the next fiscal year has been completed and approved by the Commission. Mr. Davis indicated that for the first time a plan will cost over $100,000 and that is for eight semesters at the University of Illinois-Urbana-Champaign. Mr. Bello reminded the panel of the next Commission meeting. He thanked the panel members for their participation and adjourned the meeting at 2:55 p.m.

Respectfully submitted,

Debora A. Calcara
Secretary to the Commission