AGENDA ITEM 8.

REVISION OF *COLLEGE ILLINOIS!* INVESTMENT POLICY

Submitted for: Action

Summary: In January 1999, the Commission adopted its initial Statement of Investment Policy for *College Illinois!*. State law requires that the Commission review and adopt this policy annually. After requesting and receiving input from each of the program's current investment managers, as well as recommendations from the program's investment advisor, revisions once again are being proposed to the adopted policy.

Watson Wyatt Investment Consulting, investment advisor for *College Illinois!*, prepared this revised policy. These revisions to the policy were discussed with members of the program's Investment Advisory Panel at its most recent meeting on October 11, 2002, held in the ISAC Deerfield office. As is the established practice, *College Illinois!* staff and a representative of Watson Wyatt reviewed the revised policy with Panel members and explained the rationale for each proposed change. Panel members agreed that the revised policy, as presented here, be forwarded to the Commission for action. For ease of reference, additions to the policy are underlined and any deletions are struck through.

This year, all proposed policy changes reflect an updating of the Investment Policy to recognize further diversification of program investments – specifically, in this instance, hiring of an intermediate fixed income manager (Richmond Capital Management) and an international equities manager (Jarislowsky Fraser Limited).

A representative of Watson Wyatt Investment Consulting will be in attendance at the Commission Meeting to discuss the proposed policy revision and respond to any questions.

Action requested: That the Commission approve the following resolution:

"**BE IT RESOLVED** that the Commission approves the Statement of Investment Policy for *College Illinois!* as revised and that the Commission directs all investment decisions for the program be consistent with the provisions set forth in the policy."

COLLEGE ILLINOIS!

STATEMENT OF INVESTMENT POLICY

Approved on January 22, 1999
~~Revised November 9, 2001~~
Revised November 8, 2002

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PROLOGUE

The "Program" Defined

This document represents the Statement of Investment Policy (Policy) for *College Illinois!*. The purpose of *College Illinois!* is to promote the furtherance of higher education for the citizens of the State of Illinois by providing a vehicle that will assist with the systematic savings for tuition and fees for Illinois public institutions of higher learning.

The “Commission” Defined

In this Policy, the “Commission” refers to the Illinois Student Assistance Commission.

The "Investment Advisory Panel" Defined

In this Policy, references to the "Investment Advisory Panel" or “Panel” are to the Panel which will provide advice to the Commission on issues related to the investments of *College Illinois!* The Commission appoints members of the Panel.

The Commission's Authority and Responsibilities

The Commission will conduct their responsibilities with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose. The Commission may delegate functions that a prudent entity acting in a like capacity and familiar with those matters could properly delegate under the circumstances. A Commission member or other fiduciary shall discharge their duties with respect to the Program solely in the interest of the Program.

The Commission will generally be responsible for the following:

(1) Complying with applicable laws, regulations, and rulings.

(2) Developing a sound and consistent Investment Policy, revising the Policy to reflect changing conditions within the markets or Program, or to refine the Policy in order to make it more effective.

(3) Searching for and maintaining qualified investment managers and consultants.

(4) Monitoring and evaluating investment performance and compliance with this Policy.

(5) Establishing the primary duties and responsibilities of those accountable for achieving investment results.

(6) Producing an Annual Report covering the following subjects:
   (a) investment performance summary including comparisons to benchmarks
   (b) current and historical asset allocation in the Program
   (c) progress toward the stated performance objectives in the Policy
   (d) other pertinent matters

(7) Providing guidelines to investment managers regarding their voting of proxies or investment securities owned on behalf of the Program.

(8) Taking action under circumstances to terminate an investment manager or consultant for failing to perform according to stated expectations or to abide by this Policy.

(9) Establishing and reviewing the appropriateness of the Program's asset allocation policy.

The Investment Advisory Panel's Authority and Responsibilities

The Panel will generally be responsible for the following:

(1) Complying with applicable laws, regulations, and rulings.

(2) Providing advice to the Commission for developing a sound and consistent asset allocation and Policy, recommending revisions to the allocation and Policy to reflect changing conditions within the markets or Program, or to refine the allocation and Policy in order to make them more effective.

I. PURPOSE OF POLICY

To Record Long Range Policy

This document represents the conclusions and decisions made after a deliberate and focused review of the Program's expected obligations and funding resources over a long-range future period. The Program's investments represent an opportunity:

- to provide a resource for future tuition payments to beneficiaries
- to insulate the Program's assets against the deterioration of purchasing power caused by inflation
- to diversify assets across and within capital markets

The Commission recognizes that investment markets have repeatedly demonstrated broad performance cycles having two fundamental characteristics, which bear heavily on the Program's expectations toward its future:

(1) The cycles cannot be accurately predicted as to either their beginning points, ending points, or their magnitude, and

(2) There is little or no relationship between market cycles and the convenient fiscal or calendar periods commonly used for measurement and evaluation.

Although the Commission will review investment performance and investing activities on a regular, periodic basis, the formation of judgments and the actions to be taken on those judgments will be aimed at matching the emerging long term needs of the Program with the proven, long term performance patterns of the various investment markets.

To Promote Understanding Among Various Functional Roles

This document is intended to serve as a reference tool, an operating code, and a communications link between the Commission and

- its staff,
- its own new members,
- its Investment Advisory Panel,
- its investment managers, and
- its other professional advisors.

To Address Fiduciary Obligations

This document records the Commission's logical and diligent process of study, examination, evaluation, and conclusions about the most suitable combination of investment risk level and rate of return which will satisfy both the Program's emerging obligations and the priorities for funding them.

The Commission recognizes its duty to remain aware of conditions and developments in the Program's investment activity, but it is not believed desirable or productive for the Commission to react to short term situations in a manner which contradicts the long term approach underlying this Policy Statement.

II. ASSET ALLOCATION

Development of Long-Term Asset Allocation Policy

An asset allocation study will be conducted periodically to determine an appropriate long-term asset allocation policy to achieve investment objectives.

Asset Classes to be Used

The Commission has decided it is most appropriate to use the following asset classes:

Domestic Common Stocks, small, mid and large
International Stocks, including emerging markets
Domestic Bonds, and
Cash and Equivalents

The allocation to cash and equivalents will be determined by staff to be sufficient for expected expenditures.

Long-Term Target Allocations

After study of long term historical capital market performance, the Commission finds that the following target mixture, at market value, of asset classes is expected to produce the desired performance at acceptable risk levels over time:

Domestic Large Capitalization Common Stocks	~~50%~~45%
Domestic Small/Mid Capitalization Common Stocks	10%
International Stocks	5%
Domestic Bonds	38%
Cash and Equivalents	2%

These targets will be reached as soon as practical.

Allowable Ranges Around Target Allocations

The Commission recognizes that a rigid asset allocation would be both impractical and, to some extent, undesirable under various possible market conditions. Therefore, the allocation of assets may vary from time to time within the following ranges, without being considered an exception to this Investment Policy:

Domestic Large Common Stocks	~~40% to 60%~~35% to 55%
Domestic Small/Mid Stocks	5%~~-~~ to 15%
International Stocks	0% to 10%
Domestic Bonds	30% to 45%
Cash and Equivalents	0% to 5%

Allocation Among Different Investment Management Styles

In considering asset classes, the Commission has concluded that assets should be invested through a combination of active and passive management. As assets of the Program increase, additional diversification will be achieved through additional active management in different investment classes and styles.

The Commission's approach in making allocations among investment managers will be to:

(a) have "core" allocations in both equities and fixed income. Core management typically follows the performance patterns of a broad market index for that asset class and may be either active or passive.

(b) have a relatively equal balance among the major different active management styles that are considered non-core.

Stocks will be sub-allocated to different investing styles:

(a) Index replication (S&P 500 Index)

A passive management open end fund which maintains a portfolio of all, or nearly all, of the 500 stocks which make up the index.

(b) Growth Style

An active management style which generally emphasizes earnings growth and expected return on equity, with little emphasis upon dividend payout.

(c) Value Style

An active management style which generally concentrates on stocks characterized by above average yield and below average price/book, strong balance sheet characteristics and free cash flow.

(d) Small/Mid Capitalization Style

An active management style which concentrates in securities with market capitalizations ranging from $100 million to $5 billion. Core growth strategy which employs more risk while offering added return potential and increased diversification.

(e) International Equity Style

Active management through the use of commingled fund vehicles, investing in non-U.S. equities. Funds may be managed on a bottom-up or top-down basis, employ currency hedging, and include emerging market country exposure.

Bonds will primarily be invested in a total return active strategy which will employ all legally permitted fixed investments across all maturities. The investments will be through an active management style which maintains similar characteristics and duration as the Lehman Aggregate Index and in a more conservative strategy, focusing on one to ten year maturity bonds.

Manager Selection

The Commission will hire competent registered professional investment managers to manage the assets of the Program.

No investment managers shall be hired who have not, by their record and experience, demonstrated their fiduciary responsibility, their investment expertise, their investment experience, and their capacity to undertake the mandate for which they are being considered.

- Acknowledge in writing a fiduciary relationship with respect to the Program.
- Be currently registered and maintain registration as an investment advisor under the Investment Advisors Act of 1940, a bank (as defined in the Act), or an insurance company qualified to perform investment management services under the law of more than one state unless otherwise approved on an exception basis; and
- Be granted by the Program the power to manage, acquire or dispose of any assets of the Program pursuant to the Program documents.

College Illinois! will establish investment guidelines for the investment managers and will conduct thorough due diligence before the appointment of all investment managers.

Manager Terminations

Investment managers may be terminated whenever in the opinion of the Commission:

- They have committed a significant or intentional breach of their mandate or directive, they have experienced the loss of key personnel, they have breached a fiduciary duty, or for any other reason they have lost the confidence of the members.
- Performance has not been acceptable. Generally, decisions based on performance will be made only after a significant period of disappointing performance, although the period may be shorter when severe underperformance or other evidence exists that suggests inconsistencies between the investment manager's stated style and the characteristics of investments actually made.
- ~~Managers~~Managers' inability to comply with any and all state requirements.

Attitude Toward Market Timing and Short Term Allocation Shifts

The Commission wishes to allow its investment managers the opportunity to practice their art without undue interference. However, it is hereby made clear that this Policy was the product of the Commission's study of proven performance patterns in the capital markets. The Commission has reviewed considerable evidence that the passage of time causes the greatest rewards to accrue in favor of consistent investing approaches. It is not therefore, the general intention of this Policy to allow short-term judgments to introduce significant unneeded risk.

Unallocated Cash

The Commission will generally attempt to see that the Program's assets include a cash reserve sufficient to pay tuition payments and expenses due within a reasonable future period. Therefore, any investment manager performing under this Policy is not expected to accumulate a significant cash position, without prior approval of the Commission. In general, "significant" means more than 5% of the value of assets, at market, under management. One exception to the 5% rule is during trading activity. Managers are periodically allowed to exceed the 5% for very short time periods, i.e. less than 30 days. At no time will the cash position exceed 10% at market.

Re-balancing Among Asset Classes and Allocation of Net Contributions

Because different asset classes and styles will perform at different rates, the Commission will keep close scrutiny on the asset allocation shifts caused by performance.

The Commission will review the relative market values of the asset segments on a quarterly basis and will generally shift assets among classes in order to move asset allocation to within the allowable ranges and near to the specified targets in this Policy.

Proxy Voting

Investment managers have the responsibility for voting proxy issues on securities held. All proxies will be voted exclusively for the best interests of the Program and their participants. Managers will maintain written policies for proxy voting and keep a proper record of all proxies to which the Program is entitled. A written report will be provided semi-annually.

III. PERFORMANCE OBJECTIVES

Standards of Performance

In consideration of the Program's investment goals and objectives, several standards will be utilized in evaluating investment performance. These standards reflect several aspects of investment performance, including the specific objectives for the mandate, the market indices, and the performance of other investment managers.

Expected Returns and Time Horizons

Nominal Returns

Based upon actual market history (1973-~~1999~~2001) and advice from their investment consultant, Watson Wyatt Investment Consulting, regarding possible market conditions, the Commission has assumed the following target long-term returns.

	~~(Index) Return*~~	(Index Return)
Domestic Large Stocks	~~9.0%~~	8.3%
Domestic Small/Mid Stocks	~~9.1%~~	8.2%
International Stocks		8.5%
Domestic Core Bonds	~~6.9%~~	6.2%
Domestic Intermediate Bonds		5.7%
Cash	~~5.0%~~	4.1%
Total Fund	~~8.1%~~	7.7%
Inflation	~~2.5%~~	2.5%

Inflation-Adjusted Returns

The fund's investments are expected to outperform an inflation index (CPI) by at least the following margins:

	~~Points*~~	Points*
Domestic Stocks	~~6.5%~~	5.8%
Domestic Bonds	~~4.4%~~	3.7%
International Stocks		6.0%
Total Fund	~~5.5%~~	5.2%

**Compounded annually*

Expected Variability of Returns

The Commission has examined the historical patterns of volatility and variability associated with each asset class and, collectively, for the long-range portfolio mixture contained in this Policy. The expected variability of returns is as follows:

	~~Expected Market (Index) Return~~	~~Expected Standard Deviation~~	~~Expected Range of Average Market Returns~~	
			~~Worst Expected~~	~~Best Expected~~
~~Domestic Large Stocks~~	~~9.0%~~	~~±16.0%~~	~~-14.2%~~	~~17.7%~~
~~Domestic Small/Mid Stocks~~	~~9.1%~~	~~±21.0%~~	~~-19.5%~~	~~20.3%~~
~~Domestic Bonds~~	~~6.9%~~	~~±6.0%~~	~~-1.4%~~	~~8.6%~~
~~Cash~~	~~5.0%~~	~~2.5%~~	~~0.1%~~	~~10.0%~~
~~**Total Fund**~~	~~**8.1%**~~	~~**9.4%**~~	~~**-6.1%**~~	~~**25.0%**~~
~~Inflation~~	~~2.5%~~	~~N/A~~	~~N/A~~	~~N/A~~

	Expected Market (Index) Return	**Expected Standard Deviation**	**Expected Range of Average Market Returns**	
			Worst Expected	**Best Expected**
Domestic Large Stocks	8.3%	±16.1%	-14.9%	16.9%
Domestic Small/Mid Stocks	8.2%	±21.4%	-19.5%	19.9%
International Stocks	8.5%	±18.7%	-17.9%	18.5%
Domestic Core Bonds	6.2%	±6.8%	-2.8%	7.8%
Domestic Intermediate Bonds	5.7%	±5.0%	-1.2%	7.2%
Cash	4.1%	2.9%	0.1%	9.2%
Total Fund	**7.7%**	**10.6%**	**-7.6%**	**15.8%**
Inflation	2.5%	N/A	N/A	N/A

Performance Benchmarks and Targets for the Fund's Investment Managers

Market Indices

For the actively managed portion, the Commission recognizes that investment managers must use the broad capital markets as their basic tools for investing and that a portion of investment returns will not be attributable to management skills, but rather to the markets themselves. However, the Commission expects that its investment managers in each market segment will, in the aggregate, add value to the broad markets' returns, net of fees. The aggregate approach is specifically intended to recognize that different management styles exceed and lag the broad market indices in a cyclic fashion. Accordingly, based on the active mandates that have been chosen, the Commission has determined the appropriate benchmarks and universes to be:

Investment Manager	Market Index	Manager Universe
Large Cap Core	S&P 500 Index	Large Capitalization Equity
Large Cap Value	Russell 1000 Value Index	Large Capitalization Value
Large Cap Growth	Russell 1000 Growth Index	Large Capitalization Growth
Small/Mid Cap	Russell 2000 Index	Small/Mid Capitalization
International Stocks	MSCI EAFE Index	International Stocks
Domestic Core Fixed Income	Lehman Aggregate Index	Domestic Core Fixed Income
Domestic Intermediate Fixed Income	Lehman Intermediate Government Credit Index	Domestic Intermediate Fixed Income

Universes of Other Managers

The Commission expects the Program's active managers to perform credibly within a peer group of other managers/funds with similar asset mixes and investment styles. The following standards will be expected:

Expected Ranking	Time Frame
upper half	every 2 years
upper third	every 4 years

IV. OPERATIONAL GUIDELINES

General

The investment managers shall exercise due care at all times to adequately diversify the portfolio to protect against any loss associated with a single security, issuer, or single event. Assets are to be managed in conformity with the stated investment guidelines. The investment managers shall notify the Commission in writing immediately of any deviations from the investment guidelines.

Number of Managers to Be Used

In order to improve overall portfolio performance and further reduce risk, the Commission has recommended the use of multiple investment managers.

Exemptions

Although the following vehicles are expected to comply with "the spirit" of this investment policy, they are exempt from the provisions of this policy and as such the prospectus and/or appropriate Plan documents will replace this policy as the legal governing document for such funds:

- Mutual funds, commingled funds, group trusts, and common trust funds.

Managers shall notify the Commission in writing of any cases where the operational guidelines for these vehicles conflict with the general provisions of this investment policy.

The following standards apply for each active manager.

Standards for Managers

	Equities	Fixed Income
Minimum Diversification Standards		
Single security issue	(a) Maximum 10%*	(a) Maximum 10%* (25% for any U.S. Government Security)
Single economic sector group (Style benchmark definition Page 13)	(b) +/- 3 times sector weight, or 10% whichever is greater. The minimum sector weight can be zero.	(b) Maximum 15%* (except U.S. Govt.)

** Percentages relate to the market value of any single investment manager's portfolio (not to the total fund).*

	Equities	Fixed Income
Minimum Liquidity Standards	(a) Traded daily on one or more major national exchanges (including NASDAQ). (b) $100 million or more of market capitalization, except for managers classified as small capitalization managers, who may use stocks having as little as $50 million of market capitalization.	Remaining outstanding principal value of the issue must be (and remain) at least $30 million, without Commission approval.
Minimum Quality Standards	(a) At least 1 year of (publicly held) earnings history**.	Quality ratings: Minimum (Investment grade only): S&P: BBB Moody's: BAA Expected Average: S&P: A Moody's: A In the case of a split rating, the higher rating shall apply. Securities which are downgraded below the policy minimum may be held at the manager's discretion, for up to 6 months.

*** Either as a stand-alone company, or as a separately identifiable subsidiary, division, or line of business.*

	Equities	Fixed Income
Bond Maturities	N/A	(a) Minimum (single-issue) maturity: None, but maturities under 12 months will be viewed as "cash" under this policy. (b) Maximum remaining term (or estimated term) to maturity (single issue) at purchase: 35 years. (c) Maximum duration: +/-1 year of Lehman Aggregate Index.
Prohibited Categories	(a) Short sales or "naked options" (b) Margin purchases (c) Issues related to the investment manager (d) Restricted stock (e) Writing of covered call options (f) Futures contracts (unless used for hedging purposes within a fund)	(a) Issues related to investment managers (b) Non-rated paper/private placements and revenue bonds (c) Derivative instruments (d) Foreign securities
Special Categories Permitted	(a) Convertible debt (b) American Depository Receipts (ADRs) (c) IPO's up to 5% at market	(a) Yankees (b) Rule 144a securities, up to 10% at market
Portfolio Turnover Maximum expected turnover in any one quarter. Exceptions require explanation to the Commission.	50%	50%
Written Reports to the Commission	At least quarterly	At least quarterly

V. EVALUATION AND REVIEW

Frequency of Measurement

The Commission expects to measure investment performance quarterly.

Expected Interim Progress Toward Multi-Year Objectives

The Commission will follow its time horizons, as set forth in this Policy, when making judgments about indications of inferior performance. However, investment managers for the Program should be advised that the Commission intends to track the interim progress toward multi-year goals. If there is a clear indication that performance is so substandard that reasonable hope of recovery to the Policy's target level in the remaining time horizon period would require either high risk or good fortune, then the Commission will not feel constrained by this Policy to avoid an "early" decision to take corrective action.

Inconsistent Management Style Not Acceptable

As stated in other parts of this Policy, the Commission will have little or no tolerance for an inconsistent investment approach. Therefore, the Commission will carefully monitor its investment managers on several key indicators of possible inconsistency:

(1) Changes in portfolio managers,
(2) Surges in portfolio trading volume,
(3) Evidence that actual portfolio characteristics do not follow the manager's published investing style,
(4) Performance patterns not logically explainable in terms of the published style, or performance out-of-step with manager's style peer group,
(5) major ownership changes,
(6) changes in firm structure,
(7) financial irregularities, and
(8) deficiencies in reporting.

None of these indicators is taken to be conclusive evidence of inconsistency. Such a finding would be based upon the facts and situation.

Frequency of Meetings

The Commission staff expects to meet with representatives of active managers at least semi-annually and representatives of passive funds at least annually.

VI. POLICY MODIFICATION AND REVISION

Frequency of Policy Review

The Commission will use each of its periodic investment performance evaluations as occasions to also consider whether any elements of the existing Policy are either insufficient or inappropriate. However, a formal review of the Statement of Investment Policy will occur annually. Key environmental or operational occurrences, which could result in a Policy modification, include:

(1) Significant changes in expected patterns of the Program's liability stream,
(2) Impractical time horizons or changes,
(3) Change in the Program's priorities,
(4) Convincing arguments for change presented by investment managers and consultant,
(5) Legislation, and
(6) Areas found to be important, but not covered by the Policy.

Commission's Philosophy Toward Policy Modification

While the Commission will review this Policy annually, the Commission recognizes that major changes to the Investment Policy can produce potentially damaging inconsistency. Changes, particularly the type that can be characterized as reversals of direction, or "responses" to current market conditions from time to time, are viewed as particularly undesirable. But the Commission does not conclude that this Policy document should be unresponsive to changing conditions, particularly those having to do with the Program liabilities.

VII. POLICY ADOPTION

This Policy document was adopted by the Commission of *College Illinois!* on the 22nd day of January, 1999 and previously revised on November 13, 2000 and November 9, 2001. This revised policy was approved by the Commission on ~~November 9, 2001~~ November 8, 2002.

Investment Manager's Acknowledgments:

We have received this copy of the Program's Investment Policy. We have studied its provisions and believe that we can both abide by its restrictions and fulfill its goals and expectations over the timetables set forth in the Policy.

_____
Firm Name

_____ _____
Date Investment Manager