AGENDA ITEM 10.

***COLLEGE ILLINOIS!* ASSET/LIABILITY STUDY**

Submitted for: Information

Summary: Entering Fiscal Year 2003, the *College Illinois!* prepaid tuition program had completed four separate enrollment periods, during which more than 29,000 prepaid tuition contracts had been purchased, resulting in plan assets valued at more than $350 million. The program's investment advisor, Watson Wyatt Investment Consulting, has recommended since establishment of the program's investment policy in 1998 that, once the program became large enough, an Asset/Liability Study (ALS) be conducted to evaluate the appropriateness of that *College Illinois!* investment policy. Given the program's current size and maturation, it was determined that, pending completion of the actuarial valuation for the program's FY2002 Annual Report, there would be sufficient data to conduct the recommended ALS for *College Illinois!*.

An Asset/Liability Study (ALS) is an asset allocation tool that helps organizations such as ISAC understand the likely future consequences of current management policies or actions. With reference to *College Illinois!*, the recently completed ALS can be used to evaluate the program's long-term investment policy. Discussing and evaluating ALS results are intended to improve policymakers' understanding of the program's investment requirements and to help steer asset allocation decisions in the most appropriate direction, given the program's particular liabilities and Commissioners' and program administrators' attitude toward risk and return.

Three of the most important conclusions of the *College Illinois!* Asset/Liability Study are that (1) the program's current asset allocation appears reasonable from an asset/liability perspective and should return acceptable investment results for the program during the next decade; (2) by 2011, under the current asset allocation, the program's funded ratio is most likely to improve significantly from the FY2002 level; and (3) under the Commission's current asset allocation, the program is expected to maintain positive cash-flow throughout the next decade, *even under the worst-case scenarios modeled.*

A summarized version of the ALS will be provided to Commissioners in advance of the meeting and representatives from Watson Wyatt Investment Consulting will make a presentation of the Asset /Liability Study findings before the Commission at the meeting on January 31, 2003.

Action requested: None

ILLINOIS STUDENT ASSISTANCE COMMISSION

COLLEGE ILLINOIS! ASSET/LIABILITY STUDY

Overview

Entering Fiscal Year 2003, the *College Illinois!* prepaid tuition program had completed four separate enrollment periods, during which more than 29,000 prepaid tuition contracts had been purchased, resulting in plan assets valued at more than $350 million. The program's investment advisor, Watson Wyatt Investment Consulting, has recommended since establishment of the program's investment policy in 1998 that, once the program assets grew to a certain level, an Asset/Liability Study (ALS) be conducted to evaluate the appropriateness of that *College Illinois!* investment policy. Given the program's current size and maturation, it was determined that – pending completion of the actuarial valuation for the program's FY2002 Annual Report, there would be sufficient data to conduct the recommended ALS for *College Illinois!*.

An Asset/Liability Study (ALS) is an asset allocation tool that helps organizations such as ISAC understand the likely future consequences of current management policies or actions. With reference to *College Illinois!*, the recently completed ALS can be used to evaluate the program's long-term investment policy. Since the inception of *College Illinois!*, it has been necessary to form qualitative judgments about the appropriateness of various investments in order to formulate an investment policy under which the program can function. Now, for the first time, the program has sufficient assets and liabilities to meaningfully conduct more rigorous analysis (i.e., an ALS) to evaluate the appropriateness of that investment policy.

The techniques embedded in the ALS provide an extension of the normal actuarial valuation process, building upon the relationship between the program's assets and liabilities (as the ALS name suggests). Within the ALS, parameters such as inflation, interest rates, return on assets -- which in a normal valuation are assumed to be fixed, instead are allowed to fluctuate in a controlled manner around their long-term assumed values. In mathematical terms, this capacity to fluctuate over time is called "stochastic," whereas normal valuation is considered "deterministic."

By considering *College Illinois!'* assets and liabilities in this stochastic manner, likely future valuation results can be calculated for the program's Prepaid Tuition Trust Fund. Inferences can be drawn from these valuations that have potentially important implications for the program's investment policy.

Discussion and evaluation of ALS results are intended to improve policymakers' understanding of the program's investment requirements and to help steer asset allocation decisions in the most appropriate direction, given the program's particular liabilities and Commissioners' and program administrators' attitude toward risk and return.

ALS Conclusions

The most important conclusions of the *College Illinois!* Asset/Liability Study are summarized below:

- The program's current asset allocation appears reasonable from an asset/liability perspective and should return acceptable investment results for the program during the next decade.

- By 2011, under the current asset allocation, the program's funded ratio is most likely to be 94.5 percent, an improvement from the FY2002 level of 81.2 percent. The most likely minimum is 73.4 percent (75 percent chance of being at that level or above); the most likely maximum is 123.8 percent (75 percent chance of being at that level or below).

- Under the Commission's current (unmodified) asset allocation, the program is expected to maintain positive cash flow throughout the next decade, *even under the worst-case scenarios modeled*.

- Potential improvements for the program's investment portfolio include:

  - Increasing the level of equity exposure (i.e., beyond 60 percent);
  - Increasing the degree of international equity exposure (i.e., beyond 5 percent);
  - Diversifying into emerging markets; or
  - Some possible combination thereof.

- Increasing the portfolio's fixed-income exposure beyond the current 40 percent level results in uniformly worse investment performance and is not recommended.

Note that the ALS presumes that annual contract prices rise at the same rate as tuition and fee inflation. The study *does not* model or otherwise quantify the potential positive financial impact of Commission actions such as adding a premium to annual prices in future years.

Investment Advisory Panel Observations

On January 14, 2003 the ALS methodology and findings were reviewed and discussed with the *College Illinois!* Investment Advisory Panel. All six current members of the Panel were present, four in person and two via phone. The meeting was held at the ISAC Office in Springfield.

Panel members were unanimously comfortable with the Commission's current investment policy. Panel members also advise the Commission to consider expanding the degree of equities within the *College Illinois!* portfolio, possibly from 60 percent to 65 percent, although there was not unanimous agreement to recommend this change. Panel members also are uniformly opposed to moving the portfolio more heavily into fixed income investments, agreeing strongly with this ALS conclusion. The Panel also discussed at some length the option of including emerging markets within the program's investment portfolio. There was not, however, consensus on that point.

A summarized version of the ALS will be provided to Commissioners in advance of the meeting and representatives from Watson Wyatt Investment Consulting will make a presentation of the Asset/Liability Study findings before the Commission at the meeting on January 31, 2003.