

AGENDA ITEM 6D.

COLLEGE ILLINOIS!® PREPAID TUITION PROGRAM INVESTMENT POLICY ASSET ALLOCATION AND ASSET LIABILITY STUDY

Submitted for: Action

Summary: As stated in our Statement of Investment Policy, we review the asset allocation targets annually and conduct, along with our investment consultant, a formal asset liability modeling study at least every three years. We conducted a formal asset liability modeling study in 2021 and recommended changes to the asset allocation policy targets at the June 17, 2021, Commission meeting. Therefore, fiscal year 2024 is our next regularly scheduled Asset Liability Study.

As previously presented, on April 26, 2022, we received \$230 million in funding from the State of Illinois. The amount was based on College Illinois! Prepaid Tuition Program Actuarial Soundness Report as of June 30, 2021, prepared by Gabriel, Roeder, Smith & Company (GRS).

Due to this significant cash inflow, investment staff partnered with GRS and Callan LLC, our consultant, to analyze and evaluate various scenarios and investment options. This prompt analysis is the prudent step as fiduciaries managing the College Illinois trust fund.

Although we will formally update our Actuarial Soundness Report as of June 30, 2022, over the next 5 months, we started this critical analysis with the Actuarial Soundness Report as of June 30, 2021. First, we updated our FY22 actuarial rate of return assumption to be closer to actual market performance for FY22. As of the date of our analysis, we predicted a more plausible actuarial rate of return assumption to be -2.5% for FY22 versus the original actuarial rate of return assumption of +5.25%. We caution however that markets have been very volatile with daily updates on inflation, the pandemic, and the war in Ukraine among other economic news.

As expected, the lowered actuarial rate of return assumption for FY22 results in an unfunded liability as of June 30, 2022. Second, we reviewed our other assumptions such as the weighted average tuition and fee inflation and the select and ultimate rate structure used alongside the actuarial rate of return assumptions. With this updated information, GRS performed a scenario analysis. After internal ISAC consultation and deliberation, followed by discussions with the Callan team the scenarios were narrowed down to one to be the basis for the asset allocation discussion.

In this scenario we keep the Weighted Average Tuition and Fee inflation at 4.5% and reach the ultimate rate in FY2029. The ultimate rate assumption is pushed out two years further into the future since the state funding will cover our cash outflows for approximately two years.

Subsequently, more in-depth investment evaluation and analysis was performed by investment staff and Callan. 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 next 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 posture 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 needed to achieve the rate of return.*

With the few updates in assumptions, the updated asset liability study considers the new cash inflow, cash outflows, Callan's 2022 capital markets assumptions and proposed asset allocation mixes. Further, we assume that the program will remain closed to new enrollments.

Historically, we have been lowering the risk of the portfolio over the last few years. In June 2021, we updated the asset allocation to have one set of asset class policy targets versus having interim and long-term targets. Using a risk-return framework, we marginally shifted our policy targets to maximize our returns with a prudent risk posture. The approved asset class policy targets as well as the respective acceptable ranges are as follows:

CURRENT ASSET ALLOCATION POLICY TARGETS

Asset Class	Current Asset Class Policy Targets	Rebalancing Ranges
US Equity	21%	17-25%
Non-US Equity	21%	17-25%
Private Equity	1%	
EQUITY	43%	
Fixed Income	35%	31-39%
High Yield	5%	3-7%
FIXED INCOME	40%	
REIT	5%	3-7%
Real Estate	7%	
Infrastructure	5%	
REAL ASSETS	17%	
ABSOLUTE RETURN	0%	
CASH	0%	0-4%
Totals	100%	

To simplify the analysis and evaluation of the various options or asset mixes, we recommend taking a step back to reflect on: what we would like to achieve? Investment staff along with the Callan team narrowed down our options to three asset mixes. Importantly, in all asset mixes presented, the asset allocation will be dynamic. In other words, the asset allocation targets will change year-over-year as the \$230 million in funding is used to fund the College Illinois program's cash outflows and as the actuarial assumed rate of return decreases.

- **Asset Mix A** is to stay on a conservative path where we keep lowering the risk and return profile of the portfolio to meet the assumed rate of return ('conservative' option).
- **Asset Mix B** is to try to maximize the expected return enough to meet the assumed rate of return in the actuarial soundness report plus a 25bps cushion while minimizing the risk posture of the portfolio ('moderate' option).
- **Asset Mix C** is to try to maximize the duration and expected return of the portfolio by increasing the risk in the first two years, then following a path like Mix B thereafter ('aggressive' option).

Based on the previous discussions with the Investment Committee and the Investment Advisory panel on risk tolerance, the portfolio's time span, expected returns, and liquidity needs, investment staff and Callan recommend Asset Mix B (see table below):

Asset Class	Current Asset Class Policy Targets	Rebalancing Ranges	Recommended FY23 Asset Mix	Rounded Recommended FY23 Asset Mix	Rebalancing Ranges
US Equity	21%	17-25%	15.5%	16.0%	12-19%
Non-US Equity	21%	17-25%	15.5%	16.0%	12-19%
Private Equity	1%		1.6%	1.0%	
EQUITY	43%		32.6%	33.0%	
Fixed Income	35%	31-39%	25.7%	26.0%	22-29%
High Yield	5%	3-7%	3.5%	3.0%	1-7%
FIXED INCOME	40%		29.2%	29.0%	
REIT	5%	3-7%	3.5%	3.0%	1-7%
Real Estate	7%		6.8%	7.0%	
Infrastructure	5%		4.6%	5.0%	
REAL ASSETS	17%		14.9%	15.0%	
ABSOLUTE RETURN	0%		0.0%	0.0%	
CASH	0%	0-4%	23.3%	23.0%	
Totals	100%		100%	100%	

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. Additionally, the Investment Committee approved changing the US Equity and Private Equity asset class index benchmarks from the Russell 3000 to the Wilshire 5000 to better align to our current passive US Equity exposure.

After choosing a desirable asset mix that reflects the Commission's risk tolerance and other considerations, the policy benchmark for the investment portfolio would be updated to reflect the new policy targets and continue with the same asset class indices.

Asset Class	Index
US Equity	Wilshire 5000
Non-US Equity	MSCI ACWI ex USA IMI
Private Equity	Wilshire 5000
Fixed Income	Barclays US Aggregate
High Yield	BofA MLHY Master II
REIT	MSCI US REIT
Real Estate	NREIF ODCE
Infrastructure	90-day T Bills + 4%
Cash	90-day T-Bills

Action requested: For the Commission to approve the new Investment Policy Asset Allocation targets recommended by the Investment Committee. In addition, we are asking the Commission to approve the change of the US Equity and Private Equity asset class index benchmark to the Wilshire 5000.