AGENDA ITEM 9D.

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

<u>Submitted for</u>: Action

<u>Summary</u>: 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.

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.*

Along with this memorandum we are providing separately Callan's Asset Evaluation presentation, which provides the framework for this review and its recommendation.

Of note, based on the actuarial soundness report as of June 30, 2022, the College Illinois program expects significant cash outflows (page 9 of Callan's presentation) over the next two years ($113 million for FY24 and $103 million for FY25). The total expected cash outflows over the next two years exceeds the money received ($230 million) by the state in April 2022. The expected yearly cash outflow for FY24 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 help 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 2023 capital markets assumptions (page 2 of Callan's presentation) and proposed asset allocation mixes (page 5 of Callan's presentation). 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	16%	12-19%
Non-US Equity	16%	12-19%
Private Equity	1%	
EQUITY	**33%**	
Fixed Income	26%	22-29%
High Yield	3%	1-7%
FIXED INCOME	**29%**	
REIT	3%	1-7%
Real Estate	7%	
Infrastructure	5%	
REAL ASSETS	**15%**	
ABSOLUTE RETURN	**0%**	
CASH	**23%**	
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 being used to fund the College Illinois program's cash outflows and as the actuarial assumed rate of return decreases.

Below we are including a brief summary of three asset mixes which we are considering for purposes of this review. You can see further details in page 5 of Callan's presentation.

- **Asset Mix 3** 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 4** is to keep the current asset allocation which we believe is a very reasonable option and has well balance risk reward profile as well as great probabilities regarding future full funding ('moderate' option).
- **Asset Mix 5** is to try to maximize the expected return of the portfolio by increasing the risk in the first year, then following a path like Mix 4 thereafter ('aggressive' option).

Based on the expected returns, risk profile and liquidity needs, investment staff and Callan recommend Asset Mix 4 (see table below):

Asset Class	Current Asset Class Policy Targets	Current Rebalancing Ranges	Recommended FY24 Asset Mix	Recommended Rebalancing Ranges
US Equity	16%	12-19%	16%	12-19%
Non-US Equity	16%	12-19%	16%	12-19%
Private Equity	1%		1%	
EQUITY	**33%**		**33%**	
Fixed Income	26%	22-29%	26%	22-29%
High Yield	3%	1-7%	3%	1-7%
FIXED INCOME	**29%**		**29%**	
REIT	3%	1-7%	3%	1-7%
Real Estate	7%		7%	
Infrastructure	5%		5%	
REAL ASSETS	**15%**		**15%**	
ABSOLUTE RETURN	**0%**		**0.0%**	
CASH	**23%**		**23%**	
Totals	100%		100%	

We reviewed in detail all the asset mixes that are included in the Asset Allocation presentation with the Investment Committee at the May 25, 2023 meeting. The Committee was also supportive of asset mix 4, which is identical to the current asset allocation targets.

Please note, the proposed new current asset allocation targets are identical for all asset classes to the ones approved at the June 16, 2022 Commission meeting. 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 the reflect the new policy targets and asset class indices shown below.

Asset Class	Index
US Equity	Russell 3000
Non-US Equity	MSCI ACWI ex USA
Private Equity	Russell 3000
Fixed Income	Bloomberg U.S. 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 agreed upon Investment Policy Asset Allocation targets recommended by the Investment Committee. In addition, we are asking the Commission to approve the change of the Non-US Equity and Fixed Income index benchmarks to MSCI ACWI ex US and Bloomberg U.S. Aggregate respectively.