

AGENDA ITEM 7E.

**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. Key inputs to determine the optimal investment approach are *our return needs, our risk tolerance, and our liquidity budget.*

At the special meeting held on April 22, 2024 the Investment Committee and Commission approved the investment staff recommendation to largely transition the College Illinois (CI) trust fund portfolio into a liability driven strategy given the strong financial condition that the program had already secured at that time. We believe the transition completed last year was very timely and prudent, and has further strengthen the CI program and should continue to do so overtime. During the months of February, March and April 2026, financial markets experienced significant distress with the S&P 500 being down as much as 20% from its all-time highs during this period. Meanwhile our portfolio was not impacted at all by this drawdown and we continue to earn a relatively attractive rate of return with minimal risk (equating to approximately a \$20 million gain in FY25 through April 30, 2025). This is the perfect example as to why we have continued to advocate for a conservative asset allocation to ensure the fund assets and its surplus are not significantly impacted in a sustained market drawdown. The plan can take a greatly reduced level of risk and remain fully funded.

For FY26 an in-depth investment evaluation and analysis was performed by investment staff and Callan (our investment consultant) as customary.

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

Of note, based on the actuarial soundness report as of June 30, 2024, the CI program expects significant cash outflows (page 3 of Callan's presentation) over the next three years (\$86 million for FY26, \$71 million for FY27 and \$59 million for FY28). The total expected cash outflows over the next three years amounts to approximately 52% of the trust fund current market value. The expected yearly cash outflow for FY26 amounts to approximately 21% of the investment portfolio. The materiality of the cash outflows over the

coming years is significant, therefore maintaining a liquid and conservative portfolio which avoids drawdown risk is highly desirable.

Historically, we have been lowering the risk of the portfolio over the past decade. 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. In April 2024, we transitioned most of the trust fund to a liability driven strategy as approved by the Commission. Below you can see our current asset class policy targets as well as their respective rebalancing ranges, which were approved at the April 22, 2024 special meeting of the Investment Committee and Commission.

CURRENT ASSET ALLOCATION POLICY TARGETS

Asset Class	Current Asset Class Policy Targets	Rebalancing Ranges
US Equity	2%	0-5%
Non-US Equity	0%	
Private Equity	0%	
EQUITY	2%	
Fixed Income	2%	0-25%
HighYield	3%	0-7%
FIXED INCOME	5%	
REIT	0%	
Real Estate	10%	
Infrastructure	5%	
REAL ASSETS	15%	
Absolute Return	0%	
CASH	78%	
Totals	100%	

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 2025 capital markets assumptions (page 4 of Callan's presentation) and the range of potential asset allocation mixes (page 9 of Callan's presentation). Further, we assume that the program will remain closed to new enrollments.

Using such assumptions, the current asset allocation has an expected rate of return of 4.9% with a standard deviation of 3.0%. The Potential New Policy we are considering for the asset allocation is almost identical to the Current ISAC Policy and so is the risk/return profile. Please note, by increasing equity allocation from our current target of 2% to 40% (as can be seen in page 9 of Callan's presentation), we are able to increase the projected rate of return (from 4.9% to 6.2%), but in pursuit of that potential extra gain our risk profile changes significantly from 3.0% to 8.1%.

Both investment staff and Callan believe that the potential additional expected rate of return that we might be able to earn is not worth the extra risk at this point in the life of the fund. When comparing the current policy risk mix (2% Equity) to the highest risk mix (40% Equity) shown in page 9 of the Callan presentation, there are a couple of key items to keep in mind:

- As you can see in page 11 of the Callan's presentation, the chance of having negative returns in FY26 increases considerably from 4.8% to 21.5% as the percentage of equity increases.
- As you can see in page 12 of the Callan presentation, the probability of being fully funded at the end of FY26 decreases as the percentage of equity increases.

While considering the lower risk mix (Potential New Policy) in page 9 of the Callan presentation, we were very pleased to see that such conservative mix is projected to exceed the FY26 actuarial assumption of 4.429% with a very low level of equity exposure and therefore risk, as the U.S. Treasury laddered portfolio has already locked in a very attractive yield.

The College Illinois! fund assumed net investment return and discount rates are reduced by 0.286% in yearly increments from 4.429% (for FY26) to the ultimate rate of 3.00% (for FY31 and thereafter), as can be seen below.

Year Ending 6/30	Assumed Net Rate of Return
2024	
2025	4.714%
2026	4.429%
2027	4.143%
2028	3.857%
2029	3.571%
2030	3.286%
2031	3.000%

Given the assumed discount rates shown above, we believe that maintaining the U.S. Treasury laddered portfolio strategy will be highly beneficial to the financial condition of the program, as we should meet the programs projected obligations and modestly improve the funded ratio overtime as long as tuition inflation remains within our projections.

We want to highlight that the existing U.S. Treasury laddered portfolio could potentially at times show a temporary reduced or negative rate of return in a rising interest rate environment. But we are not too concerned about this potential temporary headwind as we plan to hold those securities until maturity, by which time we would earn the yields that we had locked in at the time of the purchases.

Please note, at this point in time approximately 15% of the trust fund portfolio is tied up in illiquid investments and we will continue working with the managers to liquidate the investments while trying to maximize the value of these assets. Once the illiquid investments are monetized, we will likely continue to deploy such proceeds to the U.S. Treasury laddered portfolio being implemented as long as interest rates remain relative attractive.

Investment staff is very pleased to communicate that the trust fund is fairly well insulated against any potential writedowns going forward given the moderate surplus we have been able to build. The plan is in a good position after many years of being significantly underfunded. It is important to continue to manage the risks of the plan prudently.

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?

The key is to generate a rate of return that exceeds our actuarial rate of return assumptions with the lowest risk profile possible. Therefore, investment staff along with the Callan team narrowed down our options to

one asset mix based on the fund expected returns, risk profile and liquidity needs, which can be seen in page 9 of the Callan’s presentation under Potential New Policy and in the table below. Importantly, in this final asset mix selected, the asset allocation remains highly conservative which should be a priority going forward for the reasons noted above. Additionally, we are recommending maintaining all current rebalancing ranges for all asset classes unchanged.

Asset Allocation	Potential New Policy
U.S. Equity	3.0%
Non-U.S. Equity	0.0%
Fixed Income	2.0%
High Yield	1.0%
REIT	0.0%
Real Estate	11.0%
Infrastructure	3.0%
Private Equity	0.0%
Cash	80.0%

Expected Return (1-year) 4.9%
 Risk 3.0%

Investment staff shared this proposal via email with the Investment Advisory Panel members on May 14, 2025 and with the Investment Committee members on May 23, 2025. The members from both the Investment Advisory Panel and Investment Committee have expressed support for this asset allocation recommendation proposal. Investment staff also reviewed in detail the proposal with the Executive Director and Chair of the Commission, who have expressed support for this proposal.

Based on the recommended asset mix, the policy benchmark for the investment portfolio would need to be updated to reflect the new policy targets for the asset classes and its respective indices shown below.

Asset Class	Index
US Equity	S&P 500
Non-US Equity	MSCI ACWI ex US
Private Equity	S&P 500
Fixed Income	Bloomberg U.S.
High Yield	Aggregate
REIT	BofA MLHY Master II
Real Estate	MSCI US REIT
Infrastructure	NREIF ODCE
Cash	90-day T Bills
	GRS Actuarial Rate of Return Assumption

Action requested: For the Investment Committee to recommend and the Commission to approve the asset mix shown in the Potential New Policy column on page 9 of the Callan Asset Allocation and Liability Study presentation.