

Board Meeting  
January 20, 2011

APPROVE AMENDMENTS TO INVESTMENT POLICY  
(ENDOWMENT AND OPERATING FUNDS)

**Action:** Approve Amendments to Investment Policy (Endowment and Operating Funds)

**Funding:** No New Funding Required

Endowment funds are those received from a donor with the restriction that the principal is not expendable. Quasi-endowment funds are established by the University Comptroller to function like an endowment, but may be totally expended at any time at the discretion of the University. All but a few endowment funds are pooled for investment purposes. There are a few endowment funds that are separately invested because the gift is non-marketable, or the donor has stated that the fund may not be commingled. Endowments that must be separately invested are invested to emulate the endowment pool investment program adopted by the Board of Trustees, while adhering to the special restrictions prohibiting participation in the pooled program.

As established by the Board of Trustees in previous actions, the primary objectives for management of the University of Illinois Endowment are to preserve the real value, or purchasing power, of the endowment assets and to maximize the sustainable spending stream provided by these assets.

As asset allocation is believed to be the key driver of long-term investment return, periodic review of asset allocation is essential to the oversight of any endowment. University staff and the University's investment consultant, Hewitt EnnisKnupp, conducted a comprehensive asset allocation review of the University's endowment investment program. As a result of this review, the Vice President/Chief Financial Officer and Comptroller recommends the adoption of the following amendments to the University's endowment investment asset allocation policy:

<b>Strategy</b>	<b>Asset Class</b>	<b>Current Allocation (%)</b>	<b>Proposed Allocation (%)</b>	<b>(%) Change</b>
<b>Growth Assets<sup>1</sup></b>	U.S. Equity	51.5	14.0	(37.5)
	Non-U.S. Equity	15.0	10.0	(5.0)
	Global Equity*	0.0	24.0	24.0
	Private Equity	5.0	8.0	3.0
	Hedge Funds	0.0	10.0	10.0
<b>Total Growth Assets</b>		<b>71.5</b>	<b>66.0</b>	<b>(5.5)</b>
<b>Low Risk Assets<sup>2</sup></b>	Fixed Income	<b>21.5</b>	<b>20.0</b>	<b>(1.5)</b>
<b>Real Assets<sup>3</sup></b>	Farmland	7.0	7.0	0.0
	Core Real Estate	0.0	7.0	7.0
<b>Total Real Assets</b>		<b>7.0</b>	<b>14.0</b>	<b>7.0</b>
<b>Total Assets</b>		100.0	100.0	

\* Global equity encompasses U.S., non-U.S. developed market and emerging market-domiciled public companies.

<sup>1</sup> The growth asset strategy intent is to produce investment total return and provide investment diversification.

<sup>2</sup> The low risk strategy intent is to reduce portfolio volatility, offer downside risk protection, and provide liquidity.

<sup>3</sup> The real assets strategy supports portfolio protection against unexpected inflation.

This action modifies the endowment pool investment policy to incorporate complementary asset classes to improve total investment return and diversification while providing downside risk protection. This amended policy enhances the overall risk and return characteristics of the University endowment investment program. These changes also more closely align the University's endowment pool relative to its core peer group.

Operating funds are expended to support the University's teaching, research, and public service missions. Operating funds include tuition revenues, State dollars, grant funds, self-insurance reserves, hospital and physician revenues, as well as plant and auxiliary funds. Operating funds are invested to preserve the value and safety of the principal and to maintain adequate liquidity to meet the forecasted expenses of the University. Operating funds are pooled to provide the University continuity of operations, investment flexibility, and efficient administration. Operating funds investments are diversified and the pooling of operating funds allows for the maximum rate of return on investment within prudent investment guidelines.

Funds expected to be used within one year are invested in money market instruments, providing primary liquidity, and ensuring availability when needed. Core operating funds are those which are not needed for immediate liquidity purposes. Core operating funds are invested in longer maturity investment instruments in order to earn a higher return. These longer maturity investments will experience some variation in market value as capital market conditions change. This market value variation is acceptable since these core investments are not expected to be utilized for immediate liquidity.

The recent timing of State of Illinois reimbursements has created less predictable cash flows and more uncertainty in operating fund balances. In order to provide adequate resources to meet its obligations, the University has maintained significant amounts of primary liquidity within operating funds. This emphasis on liquidity has caused balances within the operating funds primary and core layers to deviate from established policy ranges. Accordingly, the Vice President/Chief Financial Officer and Comptroller recommends that the University's Investment Policy be amended to allow for more flexibility in management of operating funds.

The current and proposed asset allocations are illustrated in the table below.

<b>Layer</b>	<b>Benchmark</b>	<b>Current Allocation Range (% of pool)</b>	<b>Proposed Allocation Range (% of pool)</b>
Primary Liquidity	90-Day Treasury Bills	5 – 35	5 – 75
Liquid Core	Barclays Capital One to Three Year Government/Credit Index	30 – 40	10 – 40
Core	Barclays Capital Intermediate Aggregate Bond Index	20 – 35	10 – 40
Permanent Core	Blended Endowment Pool Index	15 – 25	5 – 25

The Board action recommended in this item complies in all material respects with applicable State and federal laws, University of Illinois *Statutes*, *The General Rules Concerning University Organization and Procedure*, and Board of Trustees policies and directives.

The President of the University concurs.