MONTANA BOARD OF INVESTMENTS
SPECIAL BOARD MEETING CONFERENCE CALL

2401 Colonial Drive, 3rd Floor
Helena, Montana

Thursday, April 23, 2020
10:00 AM

AGENDA

CALL TO ORDER – Karl Englund, Board Chairman

1. Notice of Audio Recording and Roll Call
2. Public Comment – *Public Comment on issues with Board Jurisdiction*
3. Separately Managed Investments Policy Statement Revision – ***Decision***
4. Adjourn

The Board of Investments makes reasonable accommodations for any known disability that may interfere with a person's ability to participate in public meetings. Persons needing an accommodation must notify the Board (call 444-0001 or write to P.O. Box 200126, Helena, Montana 59620) no later than three days prior to the meeting to allow adequate time to make needed arrangements.

MONTANA BOARD OF INVESTMENTS

Department of Commerce

Street Address:
2401 Colonial Drive, 3rd Floor
Helena, MT 59601

Mailing Address:
PO Box 200126
Helena, MT 59620-0126

Phone: 406/444-0001
Facsimile: 406/449-6579
Website: www.investmentmt.com

To: Members of the Board

From: Jon Putnam, CIO

Date: April 23, 2020

Subject: Proposed Change to Separately Managed Investments Policy

Separately Managed Investments Policy

In order to accommodate management of the CARES Act federal funds, we are proposing a change to the current Separately Managed Investments Policy.

The change allows MBOI to invest cash with our custodial bank, State Street, in an Interest Bearing Demand Deposit Account (IBDDA). This will provide daily liquidity for a portion of the CARES Act funds held within the State Treasurer's Fund. Investments held within the IBDDA earn interest at the Secured Overnight Funding Rate (SOFR).

The proposed changes can be found on pages 5-6 and page 90 on the attached mark-up of the current investment policy.

MONTANA SEPARATELY MANAGED INVESTMENTS POLICY

Approved April 5, 2017
Revised April 2, 2019
Revised February 11, 2020
Revised April 23, 2020

Table of Contents

1. Introduction:

This policy is effective upon adoption and supersedes all previous Investment Policies related to the investment management of the separately managed investments that contain guidelines and objectives in the Appendices.

Montana has more than 40 separately managed investments. These separately managed investments consist of trust, insurance and operating accounts which have been created by the state Constitution, statutorily by the legislature or as part of settlements between the state and outside entities.

Each separately managed investment has unique investment needs. Each separately managed investment has a defined set of guidelines and objectives that are detailed in the Appendices or within the separately managed investment's existing investment policy statement.

Many separately managed investments participate in the Short-Term Investment Pool (STIP) and the Trust Funds Investment Pool (TFIP). The pools are commingled funds which operate similar to mutual funds. The Trust Funds Investment Pool (TFIP) and the Short-Term Investment Pool (STIP) each have their own investment policy statements.

2. Purpose:

The purpose of this policy statement is to provide a broad strategic framework for separately managed investments under the guidance of the Montana Board of Investments.

3. Legal and Constitutional Authority:

The Montana Constitution, Article VIII, Section 13, requires that the Legislature provide for a Unified Investment Program for public funds. Section 17-6-201, MCA established the Unified Investment Program, created the Montana Board of Investments (the "Board") and gave the Board sole authority to invest state funds, in accordance with state law and the state constitution.

The Unified Investment program for public funds must be administered by the Board of Investments in accordance with the "prudent expert principle," defined as:

1) Discharging its duties with the care, skill, prudence, and diligence, under the same circumstances then prevailing that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of like character with like aims;
2) Diversifying the holdings of each fund to minimize the risk of loss and maximize the rate of return, unless under the circumstances it is clearly prudent not to do so; and
3) Discharging its duties solely in the interest of and for the beneficiaries of the funds managed.

The Board, as the investment fiduciary of the separately managed investments, is responsible for establishing the investment parameters for all separately managed investments.

4. Strategic Investment Objectives

The strategic investment objective is unique for each separately managed investment. The strategic investment objective for each separately managed investment will be addressed in the guidelines and objectives in the Appendices.

However, the Board's overall objective is to achieve the highest level of investment performance compatible with each separately managed investment's risk tolerance and prudent investment practices. The Board seeks to maintain a long-term perspective in formulating and implementing investment policies and evaluating investment performance subject to the specific objectives and constraints of each separately managed investment.

5. Time Horizon

The time horizon is unique for each separately managed investment. The time horizon for each separately managed investment will be addressed in the guidelines and objectives in the Appendices.

6. Performance Measurement

The investment policy benchmark is unique for each separately managed investment. The investment policy benchmark for each separately managed investment will be addressed in the guidelines and objectives in the Appendices.

The investment policy benchmark approximates the return that would be achieved if the separately managed investment implemented a passively managed portfolio. Deviations from the policy benchmark measure the contribution of active investment management in the separately managed investment, rebalancing policy and its execution, fees and investment implementation generally.

7. Roles and Responsibilities:

Board of Investments – The Board is responsible for approving any separately managed investment Policy Statement and has the authority to manage all separately managed investments as it considers prudent, and subject to such limitations as contained in law and the Constitution. The Board reviews this document periodically and, as needed, approves any changes to the policy.

As described in the Board of Investments Governance Manual, the Board delegates authority to the Executive Director, Chief Investment Officer, and other Staff to execute the day to day duties required to carry out the Board's mission.

Executive Director – The Executive Director is empowered by the Board to sign any and all documents required to conduct Board business, unless there are specific written policies or instructions from the Board to the contrary. The Executive Director is responsible for the oversight of all separately managed investments and the establishment of the financial reporting procedures and the collection and reporting of all income.

Chief Investment Officer – The Chief Investment Officer (CIO) is empowered by the Board to serve as the principal staff person responsible for overseeing the investment activities under the Board's jurisdiction in compliance with the Board's policies. The CIO, with the support of other staff, is responsible for recommending investment policy changes for Board approval.

Investment Staff – The investment staff is responsible for, but not limited to, the following:

- Managing day-to-day separately managed investment operations;
- Investing separately managed investment assets and monitoring compliance in accordance with this Policy;
- Reporting to the Board the separately managed investment results and investment characteristics at least annually; and
- Reporting any deviations from Investment Policy to the Board.

Investment Consultant – The investment consultant assists the CIO and Staff with policy recommendations and provides advice to the Board. The investment consultant shall provide assistance to Staff as requested in conjunction with the management of all separately managed investments.

8. Strategic Asset Allocation

The strategic asset allocation is unique for each separately managed investment. The strategic asset allocation for each separately managed investment will be addressed in the guidelines and objectives in the Appendices.

9. Rebalancing

The actual asset allocation mix may deviate from time to time from the approved asset allocation ranges due to financial market performance, cash flows, and manager performance. Material deviations from the asset allocation ranges can alter the expected return and risk of the separately managed investments. Rebalancing separately managed investment assets to remain within the Board-approved allocation ranges is delegated to staff in consultation with the Chief Investment Officer (CIO) and the Executive Director. Any necessary rebalancing will be made in a timely manner and will take into consideration associated costs and current market conditions.

10. Risk Management

a. Liquidity

The liquidity requirements are unique for each separately managed investment. Staff works closely with the representatives for each account to determine their needs. The liquidity requirements are addressed by the permitted investments and corresponding restrictions within the Investment Guidelines for each separately managed investment.

b. Monitoring/Reporting – Transparency

Staff shall provide annual reporting to the Board regarding the asset allocation and performance of the separately managed investments to confirm these items are known and adhere to all Investment Policy requirements and expectations.

c. Leverage

Leverage is a significant risk factor. Assets in separately managed investments managed directly by MBOI staff are not allowed to employ leverage.

The use of derivative securities can generate additional leverage even if the derivative is being used to reduce the risk in other investments. Individual assets in separately managed investments managed directly by MBOI staff are not allowed to use derivatives.

The Short-Term Investment Pool (STIP) is not allowed to employ leverage or use derivatives. The use of leverage and derivatives within the Trust Funds Investment Pool (TFIP) is addressed within the TFIP Investment Policy.

d. Cash Investments

Cash investments held in any separately managed investment, ~~with~~in the TFIP or any managed account within it, entail an element of credit risk. Thus, only approved cash investment vehicles are permitted. These include: STIP;~~,~~ ~~the custodian's STIF~~any cash vehicle at the custodial bank; or any SEC registered money market fund employed by an external asset manager ~~all of~~ which specifically address credit risk in their respective investment guidelines.

11. Investment Pools

a. Trust Funds Investment Pool (TFIP)

The Trust Funds Investment Pool (TFIP) will provide separately managed investments with exposure to a broad and diverse spectrum of investment grade and non-investment grade fixed income as well as real estate assets. Investment grade fixed income will be primarily managed internally. Non-investment grade fixed income will be primarily managed by external asset managers. Real estate will be managed by external asset managers.

The specific strategic objectives, performance criteria, and investment guidelines for TFIP are detailed in the Trust Funds Investment Pool (TFIP) Investment Policy.

b. Short-Term Investment Pool (STIP)

The Short-Term Investment Pool (STIP) will provide separately managed investments with exposure to Cash related investments. STIP will be managed internally utilizing an active investment strategy. The specific strategic objectives, performance criteria, and investment guidelines for STIP are detailed in the Short-Term Investment Pool (STIP) Investment Policy.

12. Securities Lending

Section 17-1-113, MCA, authorizes the Board to lend securities held by the state. The Board may lend its publicly traded securities held in the investment pools, through an agent, to other market participants in return for compensation. Currently, through an explicit contract, State Street Bank and Trust, the state's custodial bank, manages the state's securities lending program. The Board seeks to assess the risks, such as counterparty and reinvestment risk, associated with each aspect of its securities lending program. The Board requires borrowers to maintain collateral at 102 percent for domestic securities and 105 percent for international securities. To ensure that the collateral ratio is maintained, securities on loan are marked to market daily and the borrower must provide additional collateral if the value of the securities on loan increases. In addition to the strict collateral requirements imposed by the Board, the credit quality of approved borrowers is monitored continuously by the contractor. From time to time, Staff or the investment manager may restrict a security from the loan program upon notification to State Street Bank. Staff will monitor the securities lending program, and the CIO will periodically report to the Board on the status of the program.

13. Exercise of Investor Rights

a. Proxy Voting

Per the Montana Constitution, Article VIII, Section 13 “no public funds shall be invested in private corporate capital stock” with the exception of public retirement system and state compensation insurance fund assets. Therefore, separately managed investments do not participate in proxy voting.

b. Class Action Litigation

Claims under state and federal securities laws arising out of losses on securities under the Board’s management are assets subject to the Board’s fiduciary duty of prudent management. The Board shall take reasonable, cost effective steps to identify, pursue and collect upon claims under securities laws for losses suffered by the Board on its investment. Accordingly, the Board maintains a detailed litigation policy, including steps outlined in the Montana Board of Investments Governance Manual, Appendix F.

14. Investment Policy Review

The Board intends to keep this Policy updated as it modifies or amends the underlying contents. As stated in the Governance Policy, "the Board shall review this Investment Policy at least annually or more frequently at the request of Board staff. Statements may only be revised in a public meeting. All Statements shall be posted on the Board's web site for review by the public."

Schedule III-D
Investment Objectives and Guidelines
State Treasurer's Fund

Effective Date of Schedule: April 2, 2019

This schedule is effective upon adoption by the Board of Investments and supersedes all previous Investment Objectives and Guidelines for this specific portfolio.

Introduction:
The purpose of this policy statement is to provide a framework for the State Treasurer's Fund investments under the guidance of the Board.

The State Treasurer's Fund consists of both assets of the general fund and all other surplus funds of the state not otherwise expressly segregated and invested separately.

Per MCA 17-1-111, "the state treasurer is the custodian of all money and securities of the state unless otherwise expressly provided by law." Per MCA 17-6-101, "Under the direction of the board of investments, the state treasurer shall deposit public money in the treasurer's possession and under the treasurer's control…"

Statement of Purpose:

The purpose of these objectives and guidelines is to:

1. Establish the investment objectives and performance standards of the State Treasurer's Fund account; and
2. Provide diversified investment exposure within the guidelines in a prudent and cost-effective manner.

Investment Objective:

<u>Strategic:</u>
The objective of the State Treasurer's Fund portfolio is to attain above benchmark total return within the parameters of the Investment Guidelines set forth below with an emphasis on investment income and preservation of principal.

<u>Performance:</u>
Success in achieving this objective will be measured by comparing the risk and return of the account to the **Short-Term Investment Pool benchmark.**

<u>Time Horizon:</u>
The State Treasurer's Fund is a permanent account. The Board expects to meet or exceed all objectives over a long-term investment horizon. Over shorter periods, the anticipated market volatility and specific actions, including risk mitigation efforts of the Board may lead to unfavorable, but expected, deviation from these objectives.

Investment Guidelines:

The Montana Board of Investments will have full discretion to manage the State Treasurer's Fund portfolio consistent with the investment guidelines stated below. Compliance with the following guidelines for permitted investments and other restrictions is the sole responsibility of the Staff. Any exceptions or compliance violations are to be reported to the Board of Investments at the next scheduled quarterly Board meeting.

Permitted Investments:

State Treasurer's Fund may only invest in the following:

1. Short Term Investment Pool (STIP) or any cash vehicle at the custodial bank.
2. Deposits held at the state's depository bank.
3. U.S. Treasury obligations.
4. Direct obligations of the U.S. mortgage agencies Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation). These obligations shall consist of only the discount notes, notes and debentures of these two agencies and does not include mortgage pass-through obligations. Coupons may be fixed or floating rate.
5. Direct obligations of the Federal Farm Credit Bank and the Federal Home Loan Bank. These obligations shall consist of discount notes, notes and debentures with either fixed or floating rate coupons.
6. Short-term tri-party repurchase obligations (repo) with an approved primary dealer, the custodial bank, or the depository bank that are collateralized at 102% of value with U.S. Treasury and U.S. Agency securities. Approved primary dealers will be the same as those dealers approved for repo investments made in STIP.
7. Fixed income obligations of other U.S. agencies or corporate entities that are directly guaranteed as to both principal and interest by the full faith and credit of the U.S. Treasury.
8. Any obligation purchased pursuant to the bond credit enhancement program of the MBOI as authorized pursuant to Resolution 219 of the Board of Investments.
9. State general fund warrants per MCA 17-6-212

Other Restrictions:

1. Securities purchases are permitted only up to an amount that is equal to one-half the projected fiscal year-end balance of the general fund.
    a. This component of the State Treasurer's Fund is subject to the uncertainty of state receipts and expenditures and may fluctuate significantly depending on economic conditions. Thus, in order to avoid a potential liquidity event, the purchase of securities is to be constrained based on the most current forecast of general fund balances by the budget office within the Department of Administration. In the event the amount of securities held were to exceed this threshold, sales are not required however additional purchases are prohibited until the test can again be met.
    b. U.S. Treasuries held at the state's depository bank are not subject to the projected general fund balance restriction. These securities are held at the depository bank to provide emergency liquidity.
    c. In addition, any obligations purchased pursuant to the bond credit enhancement program of the MBOI as authorized pursuant to Resolution 219 of the Board are not subject to the projected general fund balance restriction.

2. Securities purchased for investment are intended to enhance book income and shall normally be held until maturity unless a severe liquidity need were to arise in which case a realized loss may be incurred if necessary in the sale of securities to meet immediate liquidity needs. Realized gains may be incurred if the sale of a security prior to maturity is necessary to meet liquidity needs or otherwise is advisable in order to enhance book income by reinvesting the proceeds of such sale.
3. Securities are limited to three years to final maturity.
4. Repurchase agreements are limited to seven days to maturity.

5. Holdings of any one U.S. agency that is not directly or indirectly guaranteed by the U.S. Treasury shall be limited to a maximum $100 million at book value.
6. Repurchase obligations shall be limited to $20 million face amount with any one primary dealer. Repos held at the depository bank or the custodial bank are not constrained by this limit given the potential for extenuating market conditions that may require unusually high cash balances to be retained at either bank.

If at any time, due to market fluctuations or any other circumstances, any of the guidelines are not maintained, Staff will use its best efforts to conform to these limits in a timely manner, while considering current market conditions and the associated costs of rebalancing. At the Board's next regularly scheduled quarterly meeting, the CIO shall inform the Board of any cases that the allocations were outside the limits and either inform the Board of the actions that were taken to return the portfolio back within guidelines or a plan to do so.