

# MONTANA

## BOARD OF INVESTMENTS

### BOARD ADOPTED POLICY

**POLICY NUMBER:** 40.600

**EFFECTIVE DATE:** December 12, 2023

**TITLE:** Short-Term Investment Pool  
Investment Policy Statement

**SUPERSEDES:** May 24, 2023

**BOARD ADOPTION:** November 30, 2021

**REVIEWED:** December 12, 2023

#### I. Introduction

- A. This policy is effective upon adoption and supersedes all previous Investment Policies related to the investment management of the Short-Term Investment Pool (STIP).
- B. STIP is an investment program managed and administered under the direction of the Board as authorized by the Unified Investment Program.
- C. STIP invests the operating funds of the State of Montana, participating local government entity funds, and the liquidity requirements of the various pension and trust funds managed by the Board.
- D. STIP is a commingled pool for investment purposes.
  1. The use of a commingled pool allows for simplified investing and accounting, as well as broader investment diversification, and it provides opportunities for fee savings.

#### II. Purpose

- A. The purpose of this policy statement is to provide a strategic framework for STIP investments under the guidance of the Board.

#### III. Legal and Constitutional Authority

- A. The Montana Constitution, Article VIII, Section 13, requires that the Legislature provide for a Unified Investment Program for public funds.
- B. Section 17-6-201, MCA, in accordance with state law and the state constitution:
  1. Established the Unified Investment Program.
  2. Created the Board.
  3. Gave the Board sole authority to invest state funds, including STIP.
- C. The Unified Investment program for public funds must be administered by the Board in accordance with the "prudent expert principle," defined as:
  1. Discharging its duties with the care, skill, prudence, and diligence, under the 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.

- D. The Board created STIP to allow qualifying funds, per sections 17- 6-201, 202, and 204, MCA to participate in a diversified pool.
  - 1. State agencies with accounts that retain their interest earnings are legally required to invest in STIP.
  - 2. Local governments may voluntarily participate in the STIP.
- E. The Board, as the investment fiduciary, is responsible for establishing the investment parameters for the STIP.
- F. STIP is not registered with the SEC as an investment company and therefore is not required to abide by the SEC's rule 2a7 of the Investment Company Act of 1940.
- G. STIP has a defined set of investment objectives and investment guidelines, including permitted investments, which are detailed in this policy statement.

#### IV. Financial Reporting

- A. The STIP financial statements are included in the Board's Consolidated Unified Investment Program financial statements, which are audited by the Montana Legislative Auditor.
- B. On October 6, 2015, the Board approved that for financial reporting purposes the STIP portfolio will be reported on a Net Asset Value basis versus amortized cost.

#### V. Strategic Investment Objectives

- A. The Board's objective for STIP is to achieve a high level of investment income that is compatible with the preservation of principal, providing STIP participants with liquidity with one (1) day notification, and the prudent investment practices of the Board.
- B. No Guaranteed Return
  - 1. There is no minimum or maximum amount of interest rate or any guaranteed rate of return on STIP shares, or funds invested in STIP shares.
- C. No Warranty
  - 1. The Board makes no warranty that funds will be immediately available in the event of any failure of a third party or that STIP participants will not suffer losses due to acts of God, or other calamities, or other market dislocations or interruptions.
- D. STIP Not Insured Against Loss
  - 1. STIP is NOT FDIC insured or otherwise insured or guaranteed by the federal government, the State of Montana, the Board, or any other entity against investment losses.
- E. Reserve Fund
  - 1. This Policy requires maintenance of a reserve fund to offset possible losses.
    - a) STIP interest earnings may be used to fund this reserve before the net earnings are distributed to the STIP Participants.
    - b) The reserves may not be adequate to cover investment losses.

#### VI. Reserve

- A. The STIP will maintain a reserve account.
- B. The reserve will be available to offset realized gains or losses.
- C. Additionally, the reserve will be available to offset unrealized gains or losses, or to limit fluctuations in the net asset value (NAV), to the extent deemed prudent by Staff.

D. A deduction from earnings will occur while the amount of the reserve is below one and fifteen hundredths' percent (1.15%) of the NAV.

1. The level of deduction will be calculated based on the deemed best balance between participants' need for current earnings and the increase in safety from building the reserve.
  - a) When the reserve is between one-half percent (0.50%) and one and fifteen hundredths' percent (1.15%) of the NAV the deduction from earnings will be an amount, including recoveries, sufficient to reach the target within three (3) years.
  - b) Should the reserve fall below one-half percent (0.50%) of the NAV, staff will evaluate the amount of deduction appropriate to return the reserve to one-half percent (0.50%) and make recommendations to that effect to the Board.

E. Any use of the reserve will be reported to the Board.

#### VII. Time Horizon

- A. The STIP investment portfolio shall be managed with the goal of attaining its objectives throughout market and economic cycles, after giving prudent consideration to the investment risk constraints (described as part of the Investment Guidelines in Policy 40.601 of Governance Manual) and the liquidity needs of the participants.
- B. The Board expects to meet or exceed these 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.

#### VIII. Performance Measurement

- A. Investment performance is measured by two (2) integrated long-term return objectives:
  1. The investment policy benchmark.
    - a) The investment policy benchmark represents the return that would be achieved if the Pool implemented a passively managed portfolio. Deviations from the policy benchmark measure the contribution of active investment management throughout the fund and investment implementation generally.
  2. STIP's total performance, before all fees, to appropriate peer universes.
    - a) While the Board seeks to rank favorably compared to peers, the Board recognizes that other short-term investment funds may have investment objectives and risk tolerances that differ substantially from STIP.

#### IX. Roles and Responsibilities

##### A. Board of Investments

1. The Board is responsible for approving the IPS and has the authority to manage the Short-Term Investment Pool (STIP) as it considers prudent, subject to such limitations as contained in law and the Constitution.
2. The Board reviews this document periodically and as needed, approves any changes to the policy.
3. As described in the Board of Investments Governance Manual, the Board delegates authority to the Executive Director, Chief Investment Officer (CIO), and other Staff to execute the day-to-day duties required to carry out the Board's mission.

##### B. Executive Director

1. The Executive Director is empowered by the Board to sign any and all documents required to conduct Board business.
  - a) Unless there are specific written policies or instructions from the Board to the contrary.

2. The Executive Director and the CIO are authorized jointly to contract for investment manager services and if deemed appropriate, terminate them.
3. The Executive Director is responsible for establishing the financial reporting procedures as well as collection and reporting of all income.

C. Chief Investment Officer

1. The 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.
2. The CIO, with the support of other staff, is responsible for recommending investment policy changes for Board approval.

D. Staff

1. The investment staff is responsible for, but not limited to, the following:
  - a) Managing day-to-day STIP investment operations;
  - b) Investing STIP assets and monitoring compliance in accordance with this Policy;
  - c) Reporting to the Board the STIP investment results and investment characteristics at the Quarterly Board meetings;
  - d) Reporting any deviations from this Investment Policy to the Board; and
  - e) Reporting any deviations from the IPS Policy to the Board.

E. Investment Consultant

1. The investment consultant assists the CIO and Staff with policy recommendations and provides advice to the Board.
2. The investment consultant shall provide assistance to Staff as requested in conjunction with the management of the STIP.

X. Risk Management

A. Short-term investments held within STIP are exposed to a number of risks.

B. The objective will be to mitigate the inherent risks associated with these securities, primarily liquidity risk, credit risk, and interest rate risk.

C. Liquidity Risk

1. Based on the percentage of STIP Units Value usually necessary to meet the daily distribution requests of STIP participants, the liquidity needs for the STIP are generally low.
2. Illiquidity risk still needs to be monitored and managed by staff on a regular basis to ensure that assets are not required to be sold too quickly, or at an unfavorable time, and potentially at a discount to fair value to meet the cash needs of STIP participants.
3. In order to improve liquidity and manage both the expected and unexpected STIP participants' need for cash, the STIP Investment Objectives and Guidelines (Policy 40.601) require certain percentages of the STIP Units Value to either be invested in cash, direct obligations of the U.S. government, or in securities that will have an effective maturity for specifically defined short periods or time (daily and weekly).

D. Credit Risk

1. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation in making full and timely principal and interest payments.

2. The STIP will utilize credit ratings, issued by at least two of the nationally recognized statistical rating organizations (NRSRO), to assist in the monitoring and management of credit risk.
3. Securities of federal agencies without their own NRSRO rating will use the ratings of the United States government.
  - a) Approved List
    - (1) Purchases of securities other than U.S. government or U.S. Agency obligations are restricted to those which are pre-approved.
    - (2) The approved list shall be maintained by Staff with issuers added or removed from time to time depending on an analysis of their risk characteristics and suitability for use in the portfolio.
      - (a) At least two (2) investment staff must approve names on the list.
    - (3) One (1) of the investment staff should be part of the internally managed fixed income team and the other person from the Risk Management team.
    - (4) Issuers on the list shall be reviewed at least semi-annually for continued inclusion on the approved list.
    - (5) STIP will minimize credit risk by means of the following:
      - (a) Limiting Permissible investments to securities on the "Approved List".
      - (b) Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with whom STIP will conduct business.
      - (c) Diversifying the investment portfolio so that potential losses on individual securities will be minimized.
      - (d) STIP will maintain a reserve account.

#### E. Interest Rate Risk

1. The STIP portfolio will minimize the risk that the market value of the securities will deviate significantly from cost due to changes in the general level of interest rate by means of the following:
  - a) Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations thereby normally avoiding the need to sell securities on the open market prior to maturity.
  - b) Maintaining a dollar-weighted average portfolio maturity of one-hundred twenty (120) days or less.
    - (1) For this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities.
  - c) STIP will maintain a reserve account.

#### XI. Securities Lending

##### A. Section 17-1-113, MCA, authorizes the Board to lend securities held by the state.

1. The Board may lend its publicly traded securities held in the investment pools, through an agent, to other market participants in return for compensation.
2. Currently, through an explicit contract, State Street Bank and Trust, the state's custodial bank, manages the state's securities lending program.
  - a) The Board seeks to assess counterparty and reinvestment risk, associated with each aspect of its securities lending program.
  - b) The Board requires borrowers to maintain acceptable and adequate collateral per the terms

of the securities lending authorization agreement.

- c) 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 collateral falls below the agreed-upon ratio of over- collateralization.
- d) In addition to the strict collateral requirements imposed by the Board, the credit quality of approved borrowers is monitored continuously by the contractor.
- e) Staff or the investment manager may restrict a security from the loan program upon notification to State Street Bank.
- f) Staff will monitor the securities lending program, and the CIO will periodically report to the Board on the status of the program.
- g) The Board's participation in securities lending may change over time given Plan activity, market conditions and the agent agreement.
- h) STIP assets are currently available for securities lending.

## XII. Exercise of Shareholder Rights

### A. Proxy Voting.

- 1. 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.
- 2. The Short-Term Investment Pool (STIP) does not participate in proxy voting.

### B. Class Action Litigation

- 1. 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.
  - a) 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.
  - b) Accordingly, the Board maintains a detailed litigation policy, including process steps, outlined in Policy 10.250 of the Governance Manual.

## XIII. Investment Policy Review

- A. As stated in the Governance Policy, "the Board shall create, maintain, and revise as necessary Investment Policy Statements (IPS) for each separate account it manages. The IPS shall cite the law establishing the account if such law exists, cite the permissible investments authorized by law, and establish an investment range for each of the permissible investments. The Board shall review such policies at least annually or more frequently at the request of Board staff. IPS may only be revised in a public meeting. All IPS shall be posted on the Board's website for review by the public. The authority to approve IPS may not be delegated to staff."

Authority: Montana Constitution, Article VIII, Section 13  
 Section 2-15-1808, MCA  
 Section 17-1-113, MCA  
 Sections 17-6-201 through 17-6-204 MCA