

# MONTANA

## BOARD OF INVESTMENTS

## BOARD ADOPTED POLICY

POLICY NUMBER: 40.800

EFFECTIVE DATE: June 22, 2023

TITLE: Coal Severance Tax  
Investment Policy Statement

SUPERSEDES: May 24, 2023

BOARD ADOPTION: November 30, 2021

REVIEWED: June 22, 2023

### I. Introduction

- A. The purpose of this policy is to provide a framework for the Coal Severance Tax Trust Fund under the guidance of the Board.
- B. The Coal Severance Tax Trust Fund was established under Article IX, Section 5 of the state Constitution which requires that at least fifty percent (50%) of the coal severance tax be deposited in a trust fund in which the principal "shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature."
- C. The legislature has partitioned the Trust into several sub-funds per Section 17-5-703, MCA:
  1. Coal Severance Tax Bond Fund into which the constitutionally dedicated receipts from the coal severance tax must be deposited;
  2. Montana Coal Endowment Fund;
  3. Montana Coal Endowment Regional Water System Fund;
  4. Coal Severance Tax Permanent Fund;
  5. Big Sky Economic Development Fund;
  6. School Facilities Fund;
  7. Conservation District Fund; and
  8. Coal Board Fund.
- D. The goal of the Coal Severance Tax Trust Fund is to support various legislative programs "to develop a stable, strong, and diversified economy" in Montana.
- E. Subject to the provisions of Section 17-6-201, MCA, the Board shall endeavor to invest 25% of the permanent coal tax trust fund in the Montana economy, with special emphasis on investments in new or expanding locally owned enterprises per Section 17-6-305, MCA.
- F. The current allocation of coal severance tax trust receipts is shown in Policy 40.801 of the Governance Manual. The legislative history of the allocation of the coal severance tax trust within the various sub-funds is available by reviewing the MCA.

### II. Purpose

- A. The purpose of this policy statement is to provide a broad strategic framework for the permanent Coal Severance Tax Trust Fund and its sub-funds 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:
  - 1. Established the Unified Investment Program;
  - 2. Created the Board; and
  - 3. Gave the Board sole authority to invest state funds, in accordance with state law and the state constitution.
- 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 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.
- D. The Board, as the investment fiduciary of the accounts, is responsible for establishing the Investment parameters for all accounts.

### IV. Strategic Investment Objectives

- A. The strategic investment objective is unique for each sub-fund and will be addressed in the individual policies throughout this policy series.
- B. The Board’s overall objective is to achieve the highest level of investment performance compatible with each sub-fund’s risk tolerance and prudent investment practices.
- C. 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 sub-fund.

### V. Time Horizon

- A. The time horizon for the Coal Severance Tax Trust Fund and all sub-funds is perpetual.
- B. The Board expects over a long-term investment horizon to meet or exceed all objectives.
- C. Over shorter periods, the anticipated market volatility and specific actions, including risk mitigation efforts by the Board may lead to unfavorable but expected deviation from these objectives.

### VI. Performance Measurement

- A. The investment policy benchmark is unique for each sub-fund.
- B. The investment policy benchmark for each sub-fund will be addressed in the individual policies throughout this policy series.
- C. The investment policy benchmark approximates the return that would be achieved if the account implemented a passively managed portfolio.
- D. Deviations from the policy benchmark measure the contribution of active investment management in the account, rebalancing policy and its execution, fees, and investment implementation generally.

## VII. Roles and Responsibilities

### A. Board of Investments

1. The Board is responsible for approving the IPS and has the authority to manage the Coal Severance Tax Trust Fund as it considers prudent, subject to such limitations as contained in the Policy, the law and the state Constitution.
2. The Board reviews this document periodically and approves any changes to the policy as needed.
3. As described in the Board's 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 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. Investment Staff

1. The investment staff is responsible for, but not limited to:
  - a) Managing day-to-day investment operations;
  - b) Investing assets and monitoring compliance in accordance with this Policy;
  - c) Reporting results and investment characteristics to the Board at least annually;
  - d) Reporting any deviations from 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 Coal Severance Tax Trust Fund.

## VIII. Strategic Asset Allocation

- A. The strategic asset allocation is unique for each sub-fund.
- B. The strategic asset allocation for each sub-fund will be addressed in the guidelines and objectives throughout this policy series.

## IX. Rebalancing

- A. 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.

- B. Material deviations from the asset allocation ranges can alter the expected return and risk of the accounts.
- C. Rebalancing account assets to remain within the Board-approved allocation ranges is delegated to staff in consultation with the CIO and the Executive Director.
- D. Any necessary rebalancing will be made in a timely manner and will take into consideration associated costs and current market conditions.

## X. Risk Management

### A. Liquidity

- 1. The liquidity requirements are unique for each sub-fund.
- 2. The liquidity requirements are addressed by the permitted investments and corresponding restrictions within the policy for each separate account or within the existing investment policy statement.

### B. Monitoring/Reporting - Transparency

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

### C. Leverage

- 1. Leverage is a significant risk factor.
- 2. Assets in accounts managed directly by BOI staff are not allowed to employ leverage.
- 3. The Short-Term Investment Pool (STIP) is not allowed to employ leverage or use derivatives.
- 4. The use of leverage and derivatives within the Trust Fund Investment Pool (TFIP) is addressed within the TFIP Investment Policy.

### D. Cash Investments

- 1. Cash investments held in any separate account, within the TFIP or any managed account within it entail an element of credit risk.
- 2. Only approved cash investment vehicles are permitted. These include:
  - a) Short-Term Investment Pool (STIP);
  - b) Any cash vehicle at the Custodial Bank; and
  - c) Any SEC registered money market funds approved by the CIO for internally managed funds or employed by an external asset manager which specifically address credit risk in their respective investment guidelines.

## XI. Investment Pools

### A. Trust Fund Investment Pool.

- 1. TFIP will provide accounts with exposure to a broad and diverse spectrum of investment grade and non-investment grade fixed income as well as real estate assets.
- 2. Investment grade fixed income will be primarily managed internally.
- 3. Non-investment grade fixed income will be primarily managed by external asset managers.
- 4. Real estate will be managed by external asset managers.
- 5. The specific strategic objectives, performance criteria, and investment guidelines for TFIP are detailed in the TFIP Investment Policy.

## B. Short-Term Investment Pool

1. STIP will provide accounts with exposure to Cash related investments.
2. STIP will be managed internally utilizing an active investment strategy.
3. The specific strategic objectives, performance criteria, and investment guidelines for STIP are detailed in the STIP Investment Policy.

## XII. 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 through an agent, to other market participants in return for compensation.
2. Currently, through an explicit contract, the state's Custodial Bank, manages the state's securities lending program.
  - a) The Board seeks to assess the risks, such as 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 securities on loan increases.
  - 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 the custodial 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.

## XIII. 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 Permanent Coal Severance Tax Trust Fund and its sub-funds do 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 litigation policy, including steps outlined in Policy 10.250 of the Governance Manual.

## XIV. Investment Policy Review

- A. As required by the Board 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  
Montana Constitution, Article IX, Section 5  
Section 2-15-1808, MCA  
Section 17-1-113, MCA  
Section 17-5-703, MCA  
Section 17-5-704, MCA  
Sections 17-6-201 through 17-6-205, MCA  
Section 17-6-305, MCA  
Section 17-6-308, MCA  
Chapter 774, Laws of 2023 (House Bill No. 819)