MONTANA BOARD OF INVESTMENTS
MONTANA STATE FUND
INVESTMENT POLICY STATEMENT

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, including Montana State Fund in accordance with state law and the state constitution.

INTRODUCTION

The purpose of this policy statement is to provide a broad strategic framework for Montana State Fund investments under the guidance of the Board. The Board manages the assets under the prudent expert principle (Section 17-6-201 MCA), which provides:

> *that the Board shall manage a portfolio*
> a) *With the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;*
> b) *Diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and*
> c) *Discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program*

The Montana Constitution, Article VIII, Section 13 (4) requires:

> *"Investment of state compensation insurance fund assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of a private insurance organization. State compensation insurance fund assets may be invested in private corporate capital stock. However, the stock investments shall not exceed 25 percent of the book value of the state compensation insurance fund's total invested assets."*

Montana State Fund investments are subject to Title 33, Chapter 12 of the Montana Code. The purpose of Chapter 12 (Insurer Investments) *"is to protect the interests of insureds by promoting insurer solvency and financial strength."*

OBJECTIVES

Strategic: Attaining investment returns that assist Montana State Fund in meeting liabilities as well as maintaining stable, cost effective rates for workers' compensation insurance. Montana State Fund is the guaranteed provider of workers' compensation insurance. Workers' compensation benefit payments typically require immediate medical payments and then ongoing medical and indemnity benefits that can span 40 years. Therefore, it is important to have a well-diversified, high quality portfolio that is positioned for the long term.

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Primary investment objectives:

1. Provide investment income by assuming a prudent amount of risk
2. Preserve principal by diversifying the portfolio across risk factors

Secondary investment objective:

1. Long term capital appreciation in excess of inflation

Performance:
Success in attaining the return objectives will be measured against:

1. The income component of the Barclays Capital Government / Credit Intermediate Term Index versus the income component of the State Fund Investment Pool.

2. The return on the Barclays Capital Government / Credit Intermediate Term Index, the return on the S&P 500 index and the return on the MSCI ACWI Ex U.S. Index (international equity index), and the return of the NCREIF ODCE index (real estate), each weighted proportionately to the portfolio's holdings, over a five-year moving average.

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.

ASSET ALLOCATION – STATE FUND INVESTMENT PORTFOLIO (SFIP)

Fixed Income: A minimum of 75% of the market value of the SFIP will be invested in an internally managed fixed income portfolio.

Public Equities: A maximum of 15% of the market value of the SFIP will be invested in public equities. The allocation to public equities is targeted at 10% of total SFIP market value. Investment will be in publicly-traded stocks of domestic and international companies via the use of passive index funds.

- A maximum of 12% will be invested in an S&P 500 Index Fund
- A maximum of 4% will be invested in an ACWI ex. U.S. Index Fund

Core Real Estate: A maximum of 8% of the market value of the SFIP will be invested in core real estate. The allocation to core real estate is targeted at 5% of total SFIP market value. Investment will be in commingled funds which own and operate institutional quality real estate in the traditional property types (i.e. multi-family, office, retail and industrial).

Cash Investments: A minimum of 1% and a maximum of 5% of the market value of the SFIP will be held in cash investments. Cash investments held at the pool level, any managed account within it, or any separate account entail an element of credit risk. Thus, only approved cash investment vehicles are permitted. These include STIP, the custodian's STIF vehicle or any SEC-registered money market fund employed by our external asset manager's all of which specifically address credit risk in their respective investment guidelines.

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PERMITTED FIXED INCOME INVESTMENTS

The fixed income portfolio may only invest in the following:

- Debt obligations of the U.S. Government, including its agencies and instrumentalities.
- Dollar denominated debt obligations of Quasi and Foreign Government entities.
- Dollar denominated debt obligations of domestic and foreign corporations.
- Dollar denominated securitized assets, including U.S. Agency mortgage backed securities (MBS), U.S. Agency collateralized mortgage obligations (CMOs), commercial mortgage backed securities (CMBS), and asset backed securities (ABS).

OTHER RESTRICTIONS – FIXED INCOME ALLOCATION

1. A minimum of 20% of the market value of the SFIP must be held in U.S. Treasury/Agency securities.
2. A maximum of 10% of the market value of the SFIP may be held in dollar denominated quasi and foreign government securities.
    a. Quasi and foreign government securities must be rated equal to or higher than A3 by Moody's or A- by S&P at the time of purchase.
3. A maximum of 60% of the market value of the SFIP may be held in corporate bonds.
4. A maximum of 20% of the market value of the SFIP may be held in dollar denominated, international corporate bonds.
    a. Exposure to a single foreign jurisdiction may not exceed 10% of the market value of the SFIP.
5. A maximum of 20% of the market value of the SFIP may be held in U.S. Agency mortgage backed securities (MBS & CMO).
6. A maximum of 5% of the market value of the SFIP may be held in asset backed securities (ABS).
7. A maximum of 5% of the market value of the SFIP may be held in commercial mortgage backed securities (CMBS).
8. The average duration of the fixed income portfolio will be maintained in a range of + or – 20% of the index duration.
9. The average life for individual fixed income securities will be less than 12 years.
10. A maximum of 3% of the market value of the SFIP may be held in a single parent company issuer, foreign/quasi government issuer or ABS specific pool at the time of purchase; there is no limit on U.S. Government/Agency securities.
    a. Exposure to a single parent company issuer, foreign/quasi government issuer or ABS specific pool will be limited to 4% of the market value of the SFIP regardless of when securities were purchased.
11. Fixed income securities must be investment grade at the time of purchase as determined by Moody's (Baa3 or higher) or S&P (BBB- or higher).
    a. Securities in the portfolio that drop below investment grade may be held to maturity at the discretion of the manager. However, the SFIP may not hold more than 5% below investment grade.
12. Fixed income securities rated lower than A3 by Moody's or A- by S&P are limited to 25% of the market value of the SFIP.
    a. In the case of split rated securities, the lowest rating will apply.

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13. A maximum of 15% of the market value of the SFIP may be held in Rule 144a securities, including a 10% maximum allocation to 144a securities without registration rights.
14. Securitized assets must be rated a minimum of Aa3 by Moody's and AA- by S&P at the time of purchase.
    a. Securities in the portfolio that drop below Aa3/AA- may be held to maturity at the discretion of the manager. However, the SFIP may not hold more than 4% below Aa3/AA-.
15. Companion/Residual/Equity tranches of securitized assets are prohibited.
16. Interest only (IO) and principal only (PO) mortgage strips are prohibited.
17. Collateralized Bond / Debt / Loan Obligations (CBO's/CDO's/CLO's) are prohibited.
18. The use of derivatives is prohibited.
19. The use of leverage is prohibited.
20. Convertible securities or securities with an equity component are prohibited.
21. Securities with an inverse floating coupon are prohibited.

MBOI will notify Montana State Fund of any issues out of compliance within 5 days. Should the portfolio fall out of compliance, a reasonable cure period will be allowed so that compliance can be obtained through normal maturities or transactions at fair market value if deemed prudent by Staff in light of prevailing market conditions.

ADMINISTRATIVE

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.