

# **TRUST FUNDS INVESTMENT POOL INVESTMENT POLICY**

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## **1. Introduction:**

The Trust Funds Investment Pool (TFIP) was created by the Board on October 1, 1995. The pool is designed to provide participants exposure to a portfolio of income-producing assets. The use of a commingled pool allows for simplified investing and accounting, broader diversification and thus less risk than would otherwise be available for individual participants. The TFIP invests directly in the underlying Asset Classes. Each Asset Class has an underlying set of investment objectives and investment guidelines. Each account participating in the TFIP is separately identified for accounting and record keeping purposes.

*This policy is effective upon adoption and supersedes all previous Investment Policy Statement (IPS) related to the investment management of the TFIP.*

## **2. Purpose:**

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

## **3. Legal and Constitutional Authority:**

Article VIII, Section 13, of the Montana Constitution requires that the Legislature provide for a Unified Investment Program for public funds. Section 17-6-201, Montana Code Annotated (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.

Section 17-6-201(1), MCA requires the Board to operate under 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."

The Board, as the investment fiduciary, is responsible for establishing the investment parameters for the TFIP.

## **4. Strategic Investment Objectives**

The Board's primary objective is to provide investment income to participants. The Board's secondary objective is to achieve the highest level of investment performance. Both objectives must be compatible with the Board'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.

## 5. Time Horizon

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 the objectives.

## 6. Performance Measurement

Success in achieving these objectives will be measured by comparing the risk and return of the account to the **Bloomberg/Barclays U.S. Aggregate Bond Index** (the “Benchmark”). Performance results will be monitored and evaluated quarterly. However, success in achieving the objective will be measured on a three-year, five-year, and ten-year annualized basis.

## 7. Roles and Responsibilities

- a) **Board of Investments** – The Board is responsible for approving the IPS for the TFIP and has the authority to manage the TFIP 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 (CIO), and other Staff to execute the day to day duties required to carry out the Board’s mission.
- b) **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 the TFIP and the establishment of the financial reporting procedures and the collection and reporting of all income.
- c) **Chief Investment Officer** – 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. The CIO, with the support of other staff, is responsible for recommending investment policy changes for Board approval.
- d) **Staff** – The staff is responsible for:
  - I. Managing day-to-day operations and delegating work to external resources as appropriate;
  - II. Monitoring allocations and overseeing all investment manager due diligence activities and recommending changes to the CIO;
  - III. Monitoring and reporting to the Board the performance of each asset class and the individual managers’ performance;
  - IV. Informing the Board of any new managers or terminations; and
  - V. Reporting any deviations from the IPS to the Board.

- e) **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 separate accounts.
- f) **External Managers** – Managers are responsible for all aspects of portfolio management as set forth in the contract specific to each manager. Managers must communicate with staff as needed, regarding investment strategies and results. Managers must also cooperate fully with staff regarding administrative, accounting, and reconciliation issues as well as any requests from the investment consultant and the mastercustodian.

## 8. Strategic Asset Allocation

The current asset allocation ranges for the TFIP are in **Appendix I**. The asset allocation ranges are subject to change as modifications are adopted by the Board, at which time **Appendix I** will be revised to reflect these changes.

## 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 separate accounts. Rebalancing to remain within the Board-approved allocation ranges is delegated to staff in consultation with the 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) **Evaluation of Investment Managers**

The Investment Manager Evaluation Policy is a distinct policy that is regularly reviewed and updated separate from the IPS because staff utilizes the Investment Manager Evaluation Policy to oversee and manage other assets in addition to the TFIP assets.

### b) **Liquidity**

Many participants in the TFIP spend the income generated from their holdings. However, the total liquidity needs for the TFIP are generally low and participant capital is not expected to change dramatically on short notice. However, 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 pool participants.

A significant percentage of the investment in Core Real Estate is considered illiquid. Due to the limited liquidity of these assets, it will typically be impractical to fund participant cash needs or correct deviations from policy ranges through the purchase or sale of these assets.

The investments held in Investment Grade and High Yield Fixed Income are categorized as publicly traded securities. In “normal market” conditions many of the underlying assets can be liquidated in a relatively short period to accommodate both expected and unexpected withdrawals as well as any repositioning of the asset allocation to stay within approved ranges.

c) **Monitoring/Reporting – Transparency**

Managers shall submit periodic reports to facilitate Staff’s monitoring of the Managers’ conformance to investment restrictions and performance objectives.

Staff shall provide regular reporting to the Board regarding the asset allocation and performance of the TFIP to confirm these items are known and adhere to all IPS requirements and expectations.

d) **Leverage**

Leverage is a significant risk factor. Investment managers may utilize leverage only when permitted in the manager’s investment guidelines approved by Staff. Staff shall monitor the use of leverage and its impact on risk and return.

The use of derivative securities can generate additional leverage even if the derivative is being used to reduce the risk in other investments. Investment managers may only use derivatives when permitted in the manager’s investment guidelines approved by Staff.

e) **Cash Investments**

Cash investments held within the TFIP entail an element of credit risk. Thus, only approved cash investment vehicles are permitted. These include: any cash vehicle at the Custodial Bank; STIP; or any SEC-registered money market fund which specifically address credit risk in their respective investment guidelines.

## **11. 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 through an agent, to other market participants in return for compensation. Currently, through an explicit contract, the state's Custodial Bank, manages the state's securities lending program. The Board seeks to assess 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 collateral falls below the agreed-upon ratio of over-collateralization. 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 the Custodial Bank. Staff will monitor the securities lending program and will periodically report to the Board on the status of the program. The Board’s participation in securities lending may change over time given account activity, market conditions and the agent agreement.

## **12. Exercise of Shareholder Rights**

### **a) Proxy Voting**

Article VIII, Section 13 of the Montana Constitution requires that “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, the TFIP does 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 process steps, outlined in the Board’s Governance Manual, Appendix F.

## **13. Investment Policy Statement Review**

Per Board’s 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, 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 web site for review by the public.”

## Appendix I: Trust Funds Investment Pool Allocation Ranges

Permitted Ranges:

Approved February 11, 2020

Trust Funds Investment Pool Asset Class		
Asset Class	Range Low	Range High
Real Estate	0	30
Non-Core Fixed Income	0	10
Investment Grade Fixed Income & Cash	60	100

**Schedule II-A:  
Investment Objectives and Guidelines  
Real Estate Asset Class**

**Effective Date of Schedule: June 9, 2020**

*This Schedule is effective upon adoption by the Board and supersedes all previous Investment Objectives and Guidelines for Real Estate.*

**Statement of Purpose:**

The purpose of these objectives and guidelines is to:

1. Establish the investment objectives and performance standards of the Real Estate Asset Class; and
2. Provide diversified exposure to Real Estate in a prudent and cost-effective manner.

**Investment Objective:**

Strategic:

The objective of the Real Estate Asset Class is to attain the highest possible return within the parameters of the Investment Guidelines set forth below.

Performance:

Success in achieving this objective will be measured by comparing the risk and after-fee return of the Real Estate Asset Class to the **NCREIF ODCE Index** (the “Benchmark”). Performance results will be monitored and evaluated quarterly. However, the success in achieving the objective will be measured on a five-year, and ten-year annualized basis.

**Investment Guidelines:**

Staff will have full discretion to manage the Real Estate Asset Class 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 at the next scheduled quarterly Board meeting.

Most of the Real Estate Asset Class investments will be managed by external investment managers.

Permitted Investments:

The Real Estate Asset Class may invest only in the following:

1. Separate Accounts, Open-Ended Funds, Closed-Ended Funds, Exchange-Traded Funds (ETFs), Real Estate Investment Trusts (REITs), or Master Limited Partnerships (MLPs) managing publicly traded Real Estate, where the investments are approved by the CIO and purchased and monitored by Staff;

2. Private Investment partnership interests. These private partnerships may be direct limited partnerships, limited liability companies, or vehicles that primarily invest in partnerships, including Fund-of-Funds and Secondary Funds.
3. The Real Estate Asset Class may co-invest with private investment managers in transactions that are suitable for inclusion into a private Real Estate investment partnership;
4. Individual public or private securities received as distributions from funds are also permitted to be held in the Real Estate Asset Class; and
5. Cash – either an investment in the Short-Term Investment Pool (STIP), a vehicle available through the Custodian, or an SEC registered money market fund that is considered a “US Treasury” or “US Government” money market fund per the SEC regulations.

#### Other Restrictions

1. No less than 75% of the aggregate of the Real Estate Asset Class net asset value plus uncalled committed capital shall be invested in “Core” Real Estate. Real Estate is classified as “Core” if it is an investment in operating, substantially leased, and positively cash flowing institutional quality real estate across property types, geographies and markets;
2. No more than 35% of the aggregate of the Real Estate Asset Class net asset value plus uncalled committed capital should be in a single Fund, Partnership, or Separate Account;
3. Individual public securities received as distributions will be liquidated over a reasonable time period dependent on market conditions;

For funds with exposure across these categories, the fund will be classified in the category that is most reflective of the underlying investments in the funds.

#### Leverage

Leverage is a significant risk factor. On an individual fund basis, the leverage level can range up to 50.0 percent. Leverage consists of the combined borrowing at the property level and the fund level. On a select basis, the leverage may exceed 75.0 percent for a given investment, if it is determined to be reasonable to do so. Leverage shall be monitored on an individual fund level and new investments shall be made with the intention that the total Real Estate Asset Class leverage shall not exceed 50%.

<u>Strategy</u>	<u>Leverage Policy Range</u>
Core Real Estate Investments	0% - 50%

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 Real Estate Asset Class allocations were outside of the limits and either inform the Board of the actions that were taken to return the Real Estate Asset Class back within guidelines or a plan to do so.

While no formal diversification ranges are set forth for property type diversification or regional diversification within the United States, it is expected that the Real Estate Asset Class shall remain diversified across these factors. These and other factors shall be monitored and reported to the Board at least annually.

**Schedule II-B:  
Investment Objectives and Guidelines  
Non-Core Fixed Income Asset Class**

**Effective Date of Schedule: June 9, 2020**

*This Schedule is effective upon adoption by the Board and supersedes all previous Investment Objectives and Guidelines for Non-Core Fixed Income.*

**Statement of Purpose:**

The purpose of these objectives and guidelines is to:

1. Establish the investment objectives and performance standards of the Non-Core Fixed Income Asset Class; and
2. Provide diversified exposure to the Non-Core Fixed Income markets in a prudent and cost-effective manner.

**Investment Objective:**

Strategic:

The objective of the Non-Core Fixed Income Asset Class is to attain the highest possible total return within the parameters of the Investment Guidelines set forth below.

Performance:

Success in achieving this objective will be measured by comparing the risk and after-fee return of the Non-Core Fixed Income Asset Class to the **Bloomberg Barclays US High Yield - 2% Issuer Cap Index** (the "Benchmark"). Performance results will be monitored and evaluated quarterly. However, the success in achieving the objective will be measured on a three-year, five-year, and ten-year annualized basis.

**Investment Guidelines:**

Staff will have full discretion to manage the Non-Core Fixed Income Asset Class consistent with the investment guidelines stated below. Non-Core Fixed Income is defined as strategies primarily invested in High Yield Corporate Debt, Emerging Market Debt, Convertible Debt and Preferred Securities. 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 at the next scheduled quarterly Board meeting.

Permitted Investments:

The Non-Core Fixed Income Asset Class may invest only in the following:

1. Securities and derivatives held in separate accounts, commingled funds, limited partnerships, or limited liability companies managed by external investment managers and governed by their respective investment management contracts and investment guidelines;

## Other Restrictions

1. A maximum of 10% of the market value of the Non-Core Fixed Income Asset Class may be held in Non-U.S. securities if they are denominated in a foreign currency;
2. The average duration of the Non-Core Fixed Income Asset Class will be maintained in a range of + or – 25% of the index duration;
3. A maximum of 25% of the market value of the Non-Core Fixed Income Asset Class may be invested in dedicated Emerging Market Debt mandates;
4. The Non-Core Fixed Income Asset Class market value invested in any single mandate/portfolio using an active investment strategy, other than internally managed mandates, may be no greater than 5% of the Trust Fund Investment Pool Assets

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 may inform the Board of any cases that the Non-Core Fixed Income Asset Class allocations were outside of the limits and either inform the Board of the actions that were taken to return the Non-Core Fixed Income Asset Class back within guidelines or a plan to do so.

**Schedule II-C:  
Investment Objectives and Guidelines  
Investment Grade Fixed Income Asset Class**

**Effective Date of Schedule: June 9, 2020**

*This Schedule is effective upon adoption by the Board and supersedes all previous Investment Objectives and Guidelines for Investment Grade Fixed Income Asset Class.*

**Statement of Purpose:**

The purpose of these objectives and guidelines is to:

1. Establish the investment objectives and performance standards of the Investment Grade Fixed Income Asset Class; and
2. Provide diversified exposure to the Investment Grade Fixed Income markets in a prudent and cost-effective manner.

**Investment Objective:**

Strategic:

The objective of the Investment Grade Fixed Income Asset Class is to attain the highest possible total return within the parameters of the Investment Guidelines set forth below.

Performance:

Success in achieving this objective will be measured by comparing the risk and after-fee return of Investment Grade Fixed Income Asset Class to the **Bloomberg Barclays US Aggregate Bond Index** (the “Benchmark”). Performance results will be monitored and evaluated quarterly. However, the success in achieving the objective will be measured on a three-year, five-year, and ten-year annualized basis.

**Investment Guidelines:**

Staff will have full discretion to manage the Investment Grade Fixed Income Asset Class 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 at the next scheduled quarterly Board meeting.

Permitted Investments:

The Investment Grade Fixed Income Asset Class may invest only in the following:

1. Dollar denominated debt obligations of the U.S. Government, including its agencies and instrumentalities
2. Dollar denominated debt obligations of Quasi and Foreign Government entities
3. Dollar denominated debt obligations of domestic and foreign corporations

4. Dollar denominated securitized assets, including U.S. Agency mortgage backed securities (MBS), U.S. Agency collateralized mortgage obligations (CMOs) and asset backed securities (ABS).
5. Dollar denominated non-agency mortgage backed securities (RMBS) and non-agency commercial mortgage backed securities (CMBS).
6. Cash – either an investment in the Short-Term Investment Pool (STIP), a vehicle available through the Custodian, or an SEC registered money market fund that is considered a “US Treasury” or “US Government” money market fund per the SEC regulations.

#### Other Restrictions

1. The average duration of the Investment Grade Fixed Income Asset Class will be maintained in a range of + or – 20% of the index duration;
2. A minimum of 20% of the Net Asset Value of the Investment Grade Fixed Income Asset Class will be held in U.S. Government securities, including U.S. Treasuries, TIPS and Agency securities;
3. Securities must be rated investment grade by at least two nationally recognized statistical rating organizations (NRSRO), with the exception of securities issued or guaranteed by agencies or instrumentalities of the U.S. Government. In the case of split-rated securities, the lower rating is used;
4. Securities that drop below investment grade as defined above may be held to maturity, however the Investment Grade Fixed Income Asset Class may not hold more than 10% of its Net Asset Value in securities rated below investment grade;
5. Securitized assets must be rated a minimum of the 4th highest rating by any nationally recognized statistical rating organization (NRSRO) at the time of purchase;
  - a. Securitized assets that drop below the 4th highest rating of any NRSRO may be held to maturity, however the Investment Grade Fixed Income Asset Class may not hold more than 5% of its Net Asset Value in these securities;
6. A maximum of 10% of the market value of the Investment Grade Fixed Income Asset Class may be held in dollar denominated quasi and foreign government securities.
7. A maximum of two times the Benchmark weight may be held in Corporate securities in the Investment Grade Fixed Income Asset Class;
8. A maximum of two times the Benchmark weight in U.S. Agency MBS may be held in U.S. Agency MBS and CMO securities in the Investment Grade Fixed Income Asset Class;
  - a. A maximum of 20% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be held in U.S. Agency CMOs;
9. A maximum of 10% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be held in dollar denominated non-agency MBS (RMBS).
10. A maximum of 5% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be held in asset backed securities (ABS).
11. A maximum of 10% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be held in commercial mortgage backed securities (CMBS).

12. A maximum of 3% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be held in a single corporate parent issuer, foreign/quasi government issuer or securitized specific pool at the time of purchase;
  - a. A maximum of 4% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be held in a single corporate parent issuer, foreign/quasi government issuer or securitized specific pool at any time;
13. A maximum of 5% of the Net Asset Value of the Investment Grade Fixed Income Asset Class may be invested in Cash;
14. The use of leverage is prohibited.

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 may inform the Board of any cases that the Investment Grade Fixed Income Asset Class allocations were outside of the limits and either inform the Board of the actions that were taken to return the Investment Grade Fixed Income Asset Class back within guidelines or a plan to do so.