

**MONTANA BOARD OF INVESTMENTS  
EAST HELENA COMPENSATION FUND  
(FUND 08231)  
INVESTMENT POLICY STATEMENT**

## **INTRODUCTION**

The purpose of this investment policy statement is to outline the account objectives, permissible investments, and constraints that will guide the management of the portfolio. The policy is designed to give the investment manager flexibility to achieve in a prudent manner the investment objectives of the client, Department of Justice – Natural Resource Damage Program (NRD) to implement the restoration and oversight of environmental clean-up on and around the former site of the ASARCO smelter in East Helena.

## **BACKGROUND INFORMATION**

In 2006, the State made substantial natural resource damages claims against ASARCO, in the ASARCO bankruptcy proceeding, based upon injuries to natural resources resulting from releases of hazardous substances at ASARCO's East Helena Smelter. The State sought both natural resource restoration damages and compensatory damages for lost use of such resources. In 2008, a tentative settlement was worked out with ASARCO to resolve these NRD claims, along with EPA's claims for the site. That settlement provided for the State to receive \$5.0 million as partial consideration for its East Helena compensatory NRD claim. The State's other East Helena claim was resolved as part of the Montana Custodial Trust Settlement with ASARCO and the United States. In 2009, those tentative settlements were challenged in the bankruptcy proceeding by Grupo Mexico and other creditors, but the settlements were upheld by the Court.

In December 2009 the final bankruptcy plan was approved by the Court and there was a closing in which the \$5.0 million was transferred to NRD Program Account No. 08231, plus about \$880,000 interest earnings as provided for in the bankruptcy plan. The State is now holding this money in this account for purposes of natural resource restoration in East Helena, and for purposes of the State overseeing the Montana Custodial Trust's clean-up of the site. The State is waiting to see how the Trust's clean-up plan will be implemented before developing its restoration plan.

## **OBJECTIVES**

### Risk and Return:

Earnings alone will not be sufficient to fund expected expenditures nor will the principal provided by the settlement be sufficient. A combination of current income, total return, and use of principal will be necessary to fund the expected expenditures. It will require a return in excess of the assumed risk free rate to fund current projected expenditures, possible future cost overruns, and leave residual funds for future expenses such as operation and maintenance. This account has an average ability to assume interest rate risk. Some risk of loss of principal must be taken to provide a return sufficient to fund objectives. An allocation to the Trust Funds Investment Pool (TFIP) will be made to obtain exposure to a diversified fixed income portfolio return while reducing idiosyncratic risk. An allocation to U.S. Treasuries, U.S. Agencies and Corporate securities may be made to provide a greater certainty of cash flows from maturities. Risk tolerance will decline if long-term investments have to be liquidated earlier than estimated to meet the cash draw down schedule.

The risk and return factors along with other considerations result in the expected asset allocation shown below.

<b>ASSET ALLOCATION</b>	
<b><u>FIXED INCOME</u></b>	<u>Range</u>
<b>U.S. Treasury Bonds</b>	0-40%
<b>U.S. Agency Bonds</b>	0-40%
<b>Corporate Bonds</b>	0-20%
<b>Trust Funds Investment Pool</b>	40-60%
<b>Short-term Investment Pool</b>	<u>10-60%</u>
<b>Total Fixed Income</b>	<u>100%</u>

## **OTHER CONSIDERATIONS**

### Liquidity Needs:

Material annual expenditures are projected in each year through 2017 in the initial cash draw down schedule provided by NRD. The timing of expenditures within the calendar year will be somewhat uncertain, thus necessitating a significant cash balance be available to meet these needs without forcing an inordinate amount of TFIP sales in any one year. There will be significant seasonality in the pattern of expenditures. Liquidity needs will be met with a combination of cash on hand, earnings, maturities and sales of investments. The minimum Short Term Investment Pool (STIP) balance will be the expected next one year of expenditures less expected maturities of individual securities prior to any adjustment to reflect funding needs.

### Maturity Horizon:

The maturity horizon of the investments utilized is designed to meet the liabilities of the client with income, maturities and a reasonable amount of sales of securities and TFIP units. The liabilities are the cash needs for remediation expenditures as provided by the NRD at the outset of the account and as modifications are made in ensuing years. At this time expenditures are expected to occur commencing immediately and each year through 2017.

### Investment Limits:

1. To reduce the risk of loss on individual corporate bonds, investment purchases in any one credit will be limited to 2% of the market value of the fund at the date of purchase or 4% of the lowest projected fund balance before the securities mature, whichever is lower.
2. Corporate bond sector (Industrial, Finance, and Utility) exposure shall be constrained to no more than a 8% exposure at the time of purchase, or 12% at any time over the future projected fund balance.
3. The quality rating of any corporate bond shall be in the top of the single-A rating classification or better at the time of purchase. (e.g., A1/A+ or higher), and have at least two ratings.
4. Exposure to the securities of any one U.S. Agency are limited to 10%, and in no event will an agency security be purchased if it carries a rating that is lower than the U.S. Treasury at the time of purchase.

### Legal Considerations:

This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge the 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 a like character 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 solely 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 does not allow equity type investments in non-retirement funds.

## **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.

### **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 the custodian's STIF vehicle, STIP, or any SEC-registered money market fund, all of which specifically address credit risk in their respective investment guidelines.