

**MONTANA BOARD OF INVESTMENTS
GROUP BENEFITS FUND (MU33) (FUND 06559)
INVESTMENT POLICY STATEMENT**

INTRODUCTION

The purpose of an investment policy statement is to give the investment manager guidance in developing an investment program to meet the objectives agreed upon and enable the sponsor (Department of Administration) to monitor the progress of the plan.

OBJECTIVES

Return Requirement: To maximize the total rate of return, consistent with preservation of capital.

Current Income: Current income is important since interest earned is used to pay claims and expenses and fund reserves.

Risk Tolerance: This fund is being managed as a short-term insurance account. Risk tolerance is minimal due to high liquidity needs.

PERMITTED INVESTMENTS

The fund may invest in STIP and high quality fixed income securities. Fixed income securities purchased must be rated at least A- or A3. Corporate credit risk will be limited to 3% in any one name.

CONSTRAINTS

Time Horizon: This fund is considered a short-term fund with uncertain future liabilities. The maximum maturity for any security purchased for this fund is approximately five (5) years.

Liquidity Needs: Liquidity needs have increased given the fund's history of large reductions in fund balance. A minimum STIP balance of \$10 million is required.

OTHER

Tax Considerations: This fund is tax-exempt, therefore, tax advantaged investments will not be used.

Legal Considerations: This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge 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 manners 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 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 does not allow equity type investments.

Unique Circumstances: None

Client Preferences: None

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.

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STATUTORY REFERENCE:

MCA: 2-18-808 The purpose of this law is to establish a program under which the state may provide state employees with adequate group hospitalization, health, medical, disability, life, and other related group benefits in an efficient manner and at an affordable cost.

MCA: 2-18-812 The Department of Administration may establish alternatives to conventional insurance for providing state employee group benefits. The requirements for providing alternatives to conventional insurance are as follows:

- (1) The department must maintain state employee group benefit plans on an actuarially sound basis.
- (2) The department must maintain reserves sufficient to liquidate the unrevealed claims liability and other liabilities of state employee group benefit plans.
- (3) The department must deposit all reserve funds and premiums paid to a state employee group benefit plan, and the deposits are statutorily appropriated, as provided in MCA 17-7-502, to the department to be expended for claims under the plan.
- (4) The department must deposit income earned from the investment of a state employee group benefit plan's reserve fund into the account established under subsection (3) of this section in order to offset the costs of administering the plan. Expenditures for the actual and necessary expenses required for the efficient administration of the plan must be made from temporary appropriations, as described in MCA: 17-7-501(1) or (2), made for that purpose.
- (5) The department shall, prior to implementation of any alternative to conventional insurance, present to the advisory council the evidence upon which the department has concluded that the alternative method be more efficient, less costly, or otherwise superior to contracting for conventional insurance.

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.

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**GROUP BENEFITS FUND
CASH FLOW SUMMARY ⁽¹⁾
(in millions)**

<u>Fiscal Year</u>	<u>Book Value</u>	<u>Market Value</u>	<u>Additions to Book</u>	<u>Addition as % of Ending Book</u>	<u>Total Investment Income</u>	<u>Income Yield</u>
1997	\$32.317	\$32.413	\$1.156	3.6%	\$2.259	7.00%
1998	33.370	33.857	0.051	0.2	2.165	6.59
1999	31.500	31.419	(1.870)	(5.9)	2.215	6.82
2000	27.171	26.348	(4.329)	(15.9)	1.906	6.50
2001	20.551	20.785	(6.620)	(32.2)	1.463	6.13
2002	12.522	12.734	(8.029)	(64.1)	1.109	6.71
2003	9.442	9.637	(3.080)	(32.6)	0.610	5.55
2004	15.215	15.195	5.773	37.9	0.377	3.06
2005	27.006	26.956	11.791	43.7	0.541	2.56
2006	36.294	36.080	9.288	25.6	1.286	4.06
12/31/2006	36.459	36.336	0.165	0.5		

1 BOI Annual Reports

**ASSET ALLOCATION
(at market)**

<u>FIXED INCOME</u>	<u>6-04</u>	<u>6-05</u>	<u>6-06</u>	<u>12-06</u>	<u>Range</u>
Government/Agency Bond					
Domestic	15.0%	45.4%	50.1%	46.2%	0-60%
Corporate Bonds	13.1%	2.4%	1.8%	1.8%	0-30%
Short-term Investment Pool (STIP)	<u>71.9%</u>	<u>52.2%</u>	<u>48.1%</u>	<u>52.0%</u>	<u>20-100%*</u>
Total Fixed Income	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

* Subject to minimum balance of \$10 million.