

STREAMSIDE TAILINGS OPERABLE SETTLEMENT FUND (MU19) (FUND 02520) 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, the Department Environmental Quality (DEQ) to implement remedial actions to the area covered by the Streamside Tailings Operable Unit in accordance with the ARCO Settlement Consent Decree.

BACKGROUND INFORMATION

January 1999

In November 1998, a Consent Decree between the State, the United States, the Atlantic Richfield Company (ARCO), and others was entered into in order to settle certain litigation and to provide funding for the implementation of the remedy for the Streamside Tailings Operable Unit of the Silver Bow Creek/Butte Area (original portion) NPL Site. The settlement involves, among other things, payment by ARCO of \$80 million, over a period of three years. Those funds and the earnings from the investment of those funds are to be used by the State and EPA for the purpose of remediating the mine waste contamination at the Streamside Tailings Operable Unit over an estimated twelve-year period, with any funds, including earnings, which are not ultimately required for the remediation of the Streamside Tailings Operable Unit to be used by the State for natural resource damage restoration purposes.

ARCO payments:

March 1999	\$15 million
July 1999	\$15 million principal plus \$7 million interest (\$22.0 million total)
July 2000	\$25 million principal plus \$3.886 million interest (\$28.886 million total)
July 2001	\$25 million principal plus \$1.891 million interest (\$26.891 million total)
Total	\$92.777 million

Interest was calculated using the income yield on the Trust Funds Bond Pool.

November 2007

Major construction is projected to end during Fiscal Year 2012. At that time, a small fund balance will be needed to fund operations and maintenance going forward and the remaining balance will be transferred to the Upper Clark Fork Restoration Fund (MU21). The fund balance at that time is expected to be mostly TFBP units.

March 2013

The timing of expenditures has been slower than expected. Major construction is projected to continue through 2018.

OBJECTIVES

Risk and Return:

A combination of current income, total return, and use of principle will be necessary to fund expected expenditures. It will require a return in excess of the assumed risk free rate to fund current projected expenditures, as well as possible future cost over runs. 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

STREAMSIDE TAILINGS OPERABLE SETTLEMENT FUND (MU19) (FUND 02520)
INVESTMENT POLICY STATEMENT

objectives. An allocation to the Trust Funds Investments Pool (TFIP) will be made to obtain exposure to a diversified fixed income portfolio. 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.

ASSET ALLOCATION
(at Market)

<u>Fixed Income</u>	<u>Range</u>
U.S. Treasury Bonds	0-30%
U.S. Agency Bonds	0-30%
Corporate Bonds	0-10%
Trust Funds Investment Pool (TFIB)	50-90%
Short Term Investment Pool (STIP)	<u>0-30%</u>
Total Fixed Income	100%

OTHER CONSIDERATIONS

Liquidity Needs:

Material annual expenditures are projected in each year through 2018 in the initial cash draw down schedule provided by DOJ. 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 (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 restoration expenditures as provided and updated by the DOJ. Expenditures are projected to occur through 2020.

Investment Limits:

1. To reduce the risk of loss on individual corporate bonds, investment purchases in any one credit will be limited to 1% of the market value of the fund at the date of purchase or 2% 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 4% exposure at the time of purchase, or 6% at any time over the future projected fund balance.

STREAMSIDE TAILINGS OPERABLE SETTLEMENT FUND (MU19) (FUND 02520)
INVESTMENT POLICY STATEMENT

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 5%, and in no event will an agency security be purchased if it carries a rating lower than that of the U. S. Government.

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.

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.