MONTANA BOARD OF INVESTMENTS
UPPER BLACKFOOT RESPONSE ACTION AND RESTORATION FUND (MU3P)
(FUND 08227)
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 clients, the Departments of Environmental Quality (DEQ) and Justice (DOJ) to implement the response action ("the Response") on the Upper Blackfoot Mining Complex in accordance with the Asarco Bankruptcy Settlement ("Settlement Agreement Regarding the Upper Blackfoot Mining Complex Site") between the United States, Atlantic Richfield Company, Asarco LLC and the State of Montana; the "Watershed Restoration Agreement between the State of Montana and the US Department of Agriculture Forest Service, Northern Region, for the Cleanup of the National Forest System Portion of the Upper Blackfoot Mining Complex Site" and the "Memorandum of Agreement Between the Montana Department of Environmental Quality and the Montana Department of Justice Regarding the Upper Blackfoot Mining Complex Restoration and Remediation" between the DEQ and DOJ, both agencies of the State of Montana.

BACKGROUND INFORMATION

In April 2008, a Settlement Agreement was entered between the State of Montana, the United States, Asarco, LLC (Asarco) and the Atlantic Richfield Company (ARCO), in order to settle certain bankruptcy and other claims and to provide for the funding of response and restoration actions at the Upper Blackfoot Mining Complex. The settlement involved, among other things, the cash payment by Asarco and ARCO of $8 million dollars each shortly after the effective date of the Settlement Agreement. Pursuant to the Settlement Agreement, the State also received an allowed claim in the Bankruptcy of $19,771,554 dollars, which with accrued interest was paid on the Effective Date of ASARCO's plan of reorganization, December 9, 2009, in the amount of $23,264,855. All these funds and the earnings from the investment of these funds are to be used by the State, as Lead Agency, in consultation with the United States Forest Service, for the purpose of conducting response and restoration activities within the UBMC Site. These actions include the removal of the Mike Horse Impoundment as provided in the USFS Action Memorandum dated July 23, 2007, and any amendments thereto. In addition, the State would perform additional remedial and restoration work outside the scope of the Action Memorandum, including the cleanup of tailings along the Upper Blackfoot River, Beartrap Creek, and Mike Horse Creek and restoration of those streams with the intention of restoring westslope cutthroat and bull trout to the area. The Work is expected to be performed over a period of at least seven years. Major construction is projected to begin in calendar year 2011 and end around calendar year 2016.

The project being financed through this fund is the removal and restoration of environmental contamination at the UBMC Site. The nature of construction/remediation work includes the potential for cost overruns and unexpected expenses. DEQ will use its best efforts to inform the Board of Investments of any expected overruns or changes in the cash draw schedule and will attempt to provide notice of such changes as much in advance as possible.

OBJECTIVES

<u>Risk and Return:</u>
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

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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.

ASSET ALLOCATION

FIXED INCOME	Range
U.S. Treasury Bonds	0-40%
U.S. Agency Bonds	0-40%
Corporate Bonds	0-10%
Trust Funds Investment Pool	0-30%
Short-term Investment Pool	10-50%
Total Fixed Income	100%

OTHER CONSIDERATIONS

Liquidity Needs:
Material annual expenditures are projected in each year through 2016 in the initial cash draw down schedule provided by DEQ. 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 DEQ 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 2016, with substantial expenditures each year from 2011 through 2015 Expenditures after 2016 will be based on subsequent planning that will depend on available funding at that time.

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, which ever 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.
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 that is less than top-rated (AAA) at the time of purchase.

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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.