MONTANA BOARD OF INVESTMENTS
INVESTMENT POLICY STATEMENT
UPPER CLARK FORK RIVER BASIN (UCFRB) RESTORATION FUND MU21

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 of Justice (DOJ) to implement restoration actions on the Upper Clark Fork River Basin in accordance with the ARCO Settlement Consent Decree.

BACKGROUND INFORMATION

June 1999

On April 19, 1999, a consent decree entered into between the Atlantic Richfield Company (ARCO) and the State of Montana was approved by the Court, partially settling the lawsuit, Montana v. ARCO, USDC No. CV-83-317-H-PGH. In addition to payment of litigation costs and transfer to the State of two million dollars worth of land, ARCO has agreed to pay the State $118 million on or before July 18, 1999, plus interest from April 6, 1998. The interest to be paid by ARCO is to be based on the yield of the TFBP and the total cash payment should be approximately $128 million. The settlement amount is for environmental damages arising from injuries to the State's natural resources in the upper Clark Fork River Basin. Under the terms of the consent decree, and as required by law, the settlement amount and the interest thereon are to be deposited in the UCFRB Restoration Fund and may be used only to restore, replace or acquire the equivalent of the natural resources which were injured as a result ARCO's and its predecessors releases of hazardous substances.

July 1999

On July 19, 1999 ARCO paid the State $151,357,147. $119,348,156 was deposited into this account. This payment included the $118 million principal due plus interest from April 6, 1998.

DOJ is forecasting project spending of $5-7 million a year starting in calendar year 2001. In addition, Fish, Wildlife & Parks will be able to spend $3.7 million over the next 10 years. DOJ will also have some administrative expenses before 2001.

During July we purchased $70 million units in the TFPB and $20.5 million (par) corporate securities.

1999 - 2008

From 1999, the Citizen's Task Force and the Trustee Restoration Council had been recommending that only interest earned on the principle in the coming years be expended, unless the trustee finds that it is appropriate to invade the principle to fund significant or time-critical projects.

The account balance had been growing since spending had not exceeded income.

2009

In September 2009 the State purchased the Spotted Dog Ranch for a price of $15.2 million. Expenditures are expected to be in the $10 to $12 million range annually through 2018.

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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 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)

Fixed Income	**Range**
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)	0-30%
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.

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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.
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.

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.