THE MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE

2401 Colonial Drive, 3rd Floor
Helena, Montana

Board Member Orientation
April 29, 2011

AGENDA

1.	**Carroll South, Executive Director**	**10:00 AM**
	A. Questions & Discussion of Board Orientation Document	
2.	**Clifford Sheets, Chief Investment Officer**	**11:00 AM**
	A. Authorized investments	
	B. Rebalancing investment portfolios	
	C. Global factors impacting investment portfolios	
3.	**Lunch is Served**	**12:00 Noon**
4.	**Rande Muffick, Public Equity Portfolio Manager**	**12:30 PM**
	A. Diversifying the equity portfolios	
	B. Passive versus active management	
	C. Internal versus external management	
	D. Managing the external managers	
5.	**Nathan Sax, Fixed Income Portfolio Manager**	**1:00 PM**
	A. Bond yields, pricing, and duration	
	B. Diversifying the fixed income portfolios	
	C. Internal versus external management	
	D. Managing the external managers	
6.	**Richard Cooley, STIP/State Fund Portfolio Manager**	**1:30 PM**
	A. Diversifying the state fund portfolio	
	B. Providing liquidity in the STIP	
	C. Managing the state's daily cash flows	
7.	**Clifford Sheets, Chief Investment Officer**	**2:00 PM**
	A. What are alternative investments?	
	B. Why do we need them?	
	C. How do we choose them?	
	D. How do we monitor them?	
8.	**Dan Zarling, Research Director**	**2:30 PM**
	A. What types of analytical resources do we use?	
	B. What types of information is obtained?	
	C. How do we use the information?	
	D. Using the Bloomberg Portfolio Management System	

9. Gayle Moon, Chief Accountant **3:00 PM**

A. Daily accounting duties
B. Daily net cash wire
C. The STIP purchases/sales process
D. Monthly reconciliation responsibilities

10. Herb Kulow, In-state Investment Portfolio Manager **3:30 PM**

A. The role of the lenders
B. Due diligence activities by staff
C. How are interest rates set?
D. How are job credit interest reductions calculated?

11. Geri Burton, Deputy Director/Louise Welsh, INTERCAP Manager **4:00 PM**

A. How are INTERCAP bonds issued?
B. Are there reserve requirements for the bonds?
C. Are there arbitrage restrictions?
D. What other types of bonds does the Board issue?
E. Is the Board financially responsible for these bonds?

12. Adjournment **4:30 PM**

Montana

Board Of Investments

Board Orientation - April 2011

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BOARD HISTORY

1964 - Prior to the creation of the Board, a 1964 Legislative Council report concluded that there were major deficiencies in the state investment process. Investment administration was decentralized and there was a lack of professional, qualified staff. At the time of the report, state agencies utilized their internal staff to invest their funds.

1971 - The 1971 Legislature created the Board of Investments (Board) to manage the investment of state funds as a part of state reorganization efforts. At the Board's first meeting in August 1971 the Board established four major goals:

- Centralize the state's investments;
- Invest the state's idle cash;
- Increase earnings on the state's investments; and
- Establish a sound system of control over the investment process, including provisions for systematic financial reporting, measurement of investment results, and a regular independent audit.

The Board, initially consisting of five members appointed by the Governor, hired five staff to manage 40 separate accounts. As of June 30, 1972 the Board managed a portfolio with a book value of $326.2 million invested mostly in corporate and government bonds as depicted in the table. The portfolio generated $16.1 million of investment income during the first fiscal year.

Retirement Funds	**$ 160.6**		
Trust Funds	**66.8**	**Corporate Bonds**	**37.00%**
Treasurer's Fund	**59.2**	**Government Bonds**	**37.00%**
Insurance Funds	**23.6**	**Mortgages**	**15.00%**
Other	**16.0**	**CD's/Corporate Paper**	**11.00%**
Total	**$ 326.2**		**100.00%**

1972 - Montana voters ratified a new constitution that created a Unified Investment Program, encompassing all state funds and authorized 20 percent of retirement fund assets to be invested in stock. (Stock investments were not permitted under the old constitution.)

1973 - The Short Term Investment Pool (STIP) was created by the Legislature on July 1, 1973 as an investment vehicle to manage state and local government cash. Since its creation, the STIP has provided a safe, convenient way for state and local government agencies to invest and withdraw cash with 24-hours notice. Local governments have other investment options as permitted by law and use the STIP at their discretion.

The law creating the STIP and permitting local governments to participate was one of 10 sections contained in legislation to enact the Unified Investment Program created by the new Constitution. While there was no "statement of intent" to determine original legislative intent the language seems to suggest an implicit guarantee of local government funds invested in the STIP:

> **"17-6-204(3) The principal and accrued income, and any part thereof, of each and every account maintained for a [local government] participant in the pooled investment fund shall be subject to payment at any time from the fund upon request. Accumulated income shall be remitted to each participant at least annually."**

The STIP maintains a $1.00 share value for both local governments and state agencies.

1983 - The 1983 Legislature implemented Initiative 95 (Build Montana Program), approved by Montana voters in November 1982, and created a seven-member Montana Economic Development Board (MEDB) to manage the Program. The legislation created an "In-state Investment" component within the Coal Tax Trust, to which 25.0 percent of coal tax revenues was dedicated. The legislation also created a bonding program by which tax-exempt bonds were issued and the proceeds utilized to make low interest loans to eligible entities. The MEDB was authorized to:

- Invest the in-state investment portion of the Coal Tax Trust;
- Issue INTERCAP bonds and lend the proceeds; and
- Issue Industrial Revenue Bonds for specific projects.

1985 - The 1985 Legislature increased Board of Investment membership from five to seven by requiring that a member from each of the two pension Boards be appointed.

1987 - The 1987 Legislature abolished the MEDB and the existing seven-member Board of Investments and created a new Board of Investments (Board) with nine members. All MEDB staff and duties were transferred to the new Board.

1991 - The 1991 Legislature liquidated the "In-State Investment Fund" component of the Coal Tax Trust and encouraged the Board to invest up to 25.0 percent of the entire trust in Montana businesses.

1993 – The 1993 Legislature, for the first time, authorized the Board to contract directly with an out-of-state bank to provide custodial banking services. In December, the Board contracted with State Street Bank and Trust to provide custodial banking services.

1995 - The 1995 Legislature allocated $50.0 million of the Coal Tax Trust to an "Infrastructure Loan Program" designed to provide long-term financing to local governments to fund the infrastructure required to accommodate businesses wishing to locate within their jurisdiction.

The Legislature also changed the procedure for funding certain state entities (including the Board). Prior to this change, the Legislature appropriated funds for state entities to purchase products/services from other state entities and then appropriated the funds again to the entity providing the services/products. This process resulted in the same dollar being appropriated several times, which had the effect of inflating actual state expenditures. The new procedure authorized state entities providing the services/products to other state entities to charge a fee for the services and eliminated an appropriation to the entity.

1997/1999 - The 1997 Legislature abolished the Science & Technology Board and transferred its existing investment portfolio to the Department of Commerce. The 1999 Legislature then transferred the investment portfolio from the Department of Commerce to the Board.

2000 - The 2000 Legislative Special Session allocated $50.0 million of the Coal Tax Trust to a "Value-added Loan Program" designed to provide subsidized loans to Montana businesses conducting value-added business.

2007 - The 2007 Legislature increased the allocation for Infrastructure loans to $80.0 million and the allocation for Value-added loans to $70.0 million, and clearly defined the intent of the 25.0 percent language for the In-state Loan Program. The Legislature added two non-voting legislative liaisons to the Board.

BOARD COMPOSITION & VOTING REQUIREMENTS

State law authorizes the Board to employ an Executive Director and a Chief Investment Officer who have general responsibility for selection and management of the Board's staff and for direct investment and economic development activities. The Board prescribes the duties and salaries of the Executive Director and Chief Investment Officer and six other staff positions and the eight staff "serve at the pleasure of the Board."

Exempt Staff - In personnel terms the eight positions that serve at the pleasure of the Board are called "exempt" positions, meaning that they are exempt from the state classification and pay plan system to which most state employees are subject. The Board sets exempt employee salaries and is not subject to the state's rather rigorous recruitment and selection process when it recruits and hires these employees. The trade-off for the exempt employees is that they serve at the pleasure of the Board, which means they do not have the full range of protocols available to classified staff in terms of discipline and termination.

Classified Staff – Except for the exempt staff, all other Board employees are "classified", which means that the selection/hiring process; the discipline/termination process; and the salary-setting process are all spelled out clearly in state law and regulation.

Board Member Appointment Process – As a quasi-judicial Board, the number and qualifications of its members are prescribed by law and at least one member must be an attorney licensed to practice law in Montana. The Governor appoints all voting members and must appoint five members (a quorum) to four-year terms concurrent with the Governor's term. The remaining four members are appointed to four-year terms mid-way through the Governor's term. This process permits a new Governor to impact the governance of the Board by appointing the majority of members at the beginning of his/her term. The members serve until a successor is appointed and may be removed by the Governor only for "cause." The Governor appoints the Chairperson and all members must be confirmed by the state Senate.

Board Membership Criteria – The law specifies member criteria as follows:

- One member from the Public Employees' Retirement Board;
- One member from the Teachers' Retirement Board;

Seven members to provide a balance of professional expertise and public interest and represent

- The financial community;
- Small business;
- Agriculture;
- Labor; and
- Two ex officio, nonvoting legislative liaisons to the Board. One must be a Senator appointed by the President of the Senate and one must be a Representative appointed by the Speaker of the House. The liaisons may not be from the same political party.

Voting Requirements – As a quasi-judicial Board, there must be a quorum (5) present to conduct business and all substantive action taken by the Board must be approved by a majority (5) of the entire Board, regardless of the number of members present at the time the action is taken. In other words, if there are only five members present at the meeting they all must approve a substantive action.

BOARD ALLOCATION & AUTHORITY

All state Boards must be allocated to a State Agency for certain purposes. The Board is a "quasi-judicial" Board allocated to the Department of Commerce for administrative purposes and operates under the following legal parameters.

The Board:

- Exercises its quasi-judicial and policymaking functions independently of the Department and without approval or control of the Department;
- Submits its budgetary requests through the Department; and
- Submits reports required of it by law or by the Governor through the Department.

The Department of Commerce:

- Directs and supervises the budgeting, recordkeeping, reporting, and related administrative and clerical functions of the Board;
- Includes the Board's budgetary requests in the departmental budget;
- Collects all revenues for the Board and deposits them in the proper fund or account;
- Provides staff for the Board, unless otherwise directed by law; and
- Prints and disseminates for the Board any required notices, rules, or orders adopted, amended, or repealed by the Board.

The Director of the Department of Commerce:

- Represents the Board in communications with the Governor; and
- Allocates office space to the Board as necessary, subject to the approval of the Department of Administration.

In practical, day-to-day terms this means that the Board acts totally independent in its role as investment manager – determining when and how public funds will be invested. It also acts independently as it manages the Coal Tax Trust and INTERCAP loan programs. The Board's activity in these roles is governed only by the state constitution and state law. To assist the Board in its investment responsibilities, it retains an investment consultant that provides guidance, educational activities, performance analytics, and assistance in hiring and monitoring external investment managers.

The Department of Commerce handles most of the Board's purely administrative functions, such as personnel, invoice payment, budgeting, and budget documentation. The Board exercises sole discretion when hiring and setting salaries of its eight non-classified (exempt) staff. The Board also hires its classified staff, but the process is subject to Department approval and the salaries are governed by state law as interpreted by the Department.

Although the Department occasionally provides legal services to the Board, most of the Board's investment-related legal services are provided by outside legal counsel by contract. Although the law states that the Department Director will represent the Board in communications with the Governor, in practice, the Board's Executive Director communicates directly with the Governor, the Legislature, and the media. The Board issues its Annual Report independent of the Department and Board staff deals directly with the Legislative Auditor during and after the annual audit of the Board's operations. Board staff reports directly to the Legislative Audit Committee when the audit is presented to the committee.

BOARD MEETINGS & COMMITTEE STRUCTURE

The full Board meets quarterly at regularly scheduled meetings and may meet for specific purposes at the call of the Chair. Board packets, containing the meeting agenda and staff reports, are mailed to members approximately one week prior to the meetings and are posted on the Board's web site. All meetings are open to the public and the entire meeting is tape recorded to facilitate the preparation of minutes. Most meetings are held in Helena but occasionally meetings are held in other locations in the state.

Members receive $50.00 per diem for each meeting day and $50.00 for reviewing the Board packet. All Board member travel expenses are reimbursed per state policy.

The Board has created three committees for specific purposes.

Human Resources Committee – The Committee is comprised of four Board members appointed by the Chair. The Committee's primary responsibilities are:

- Establishing, maintaining, and updating the pay plan for the Board's eight exempt staff by utilizing compensation data from other public pension plans and/or investment boards.
- Reviewing the performance of the exempt staff and submitting exempt salary recommendations to the full Board for final approval.
- Recommending to the Board a process for filling vacant exempt positions.
- Hearing written appeals and grievances from exempt staff if the Executive Director is unable to resolve differences.

Loan Committee – The Committee is comprised of four Board members appointed by the Chair. The Committee's primary responsibilities are:

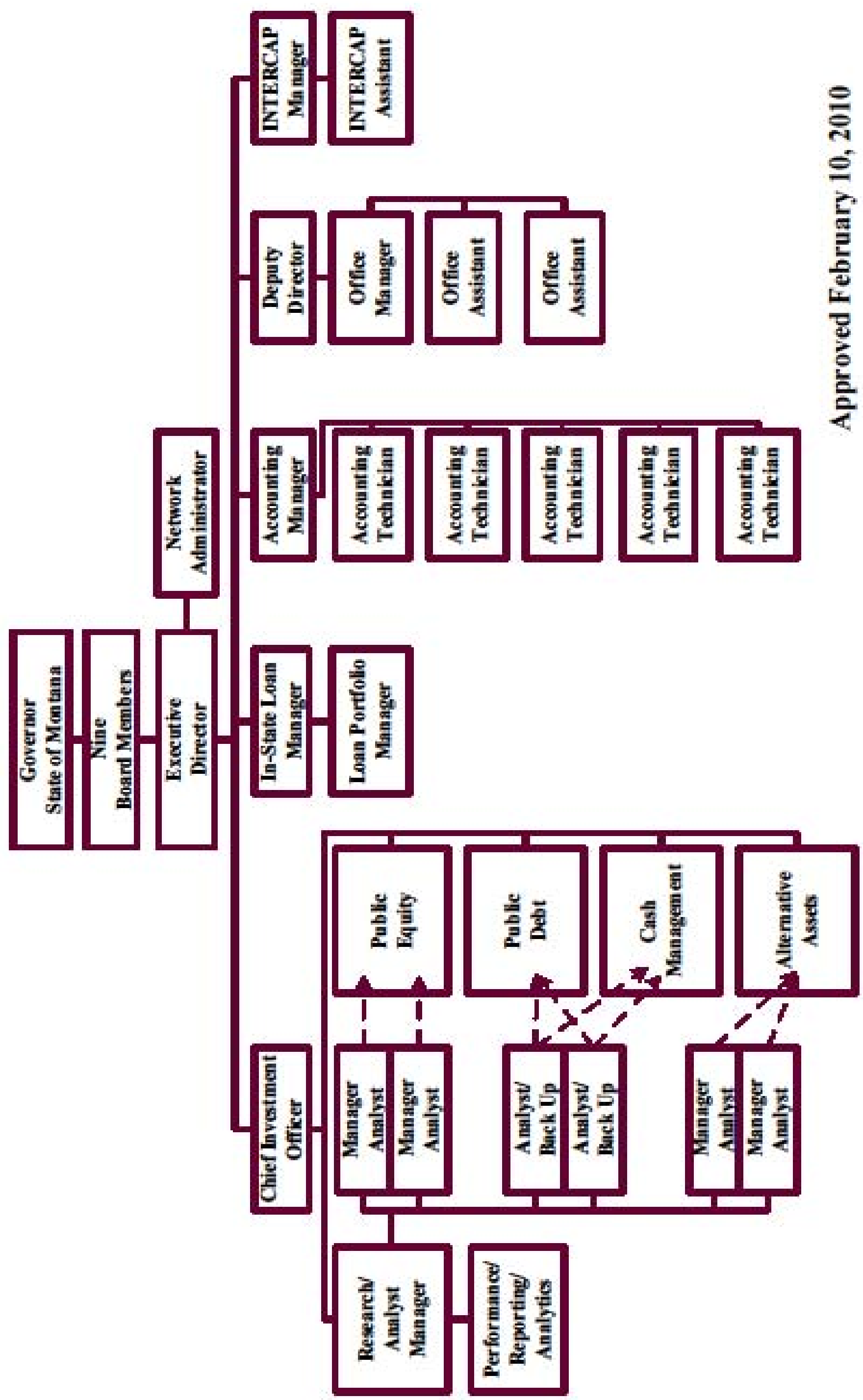
- Reviewing and approving/disproving staff recommendations for non federally-guaranteed Coal Tax Trust loans, INTERCAP loans, and the enhancement of INTERCAP bonds and Montana Facility Finance Authority bonds in excess of $1.0 million and up to $5.0 million.
- Reviewing staff recommendations for non federally-guaranteed Coal Tax Trust loans and INTERCAP loans in excess of $5.0 million and the enhancement of INTERCAP bonds and Montana Facility Finance Authority bonds in excess of $5.0 million and making a recommendation to the full Board for approval/disapproval.
- Reviewing staff recommendations to issue additional INTERCAP bonds and making a recommendation to the full Board for approval/disapproval.
- The Board has delegated to staff the authority to approve loans up to $1.0 million.

Audit Committee – The Committee is comprised of four Board members appointed by the Chair. The Committee's primary responsibilities are:

- Monitoring the Board's internal control policy and supervising the Board's Internal Auditor contractor.
- Meeting with the Legislative Auditor and reviewing its Audit Report.
- Authorizing Board staff to file for lead or co-lead plaintiff status in securities class action litigation.
- Authorizing Board staff to opt out of class action securities litigation in which it is a member.

The entire Board acts as an Investment Committee and must approve all asset allocation recommendations made by staff.

BOARD STAFF ORGANIZATION



BOARD FUNDING

The Board is considered a "proprietary" entity in state government, which means that its funding is derived from fees charged for services it provides, similar to private sector entities. Within the proprietary category there are two types of entities: 1) an **internal services** entity that provides most or all of its services/products to state entities; and 2) an **enterprise** entity that provides most or all of its services/products to non-state entities.

Board funding is provided by both **internal services** and **enterprise** accounts. Because the Board's investment function primarily serves state entities, the investment function is funded by an **internal services account**. The Board's INTERCAP Program primarily serves non-state entities and is funded by an **enterprise account**.

Internal Services Account – To prevent one state entity from overcharging another, the Legislature sets the maximum fee the entity may charge as a part of the biennial budgeting process. In most instances, the fee is based on a "per" service cost, such as state Motor Pool charges for daily and per-mile use of its vehicles. The fee-for-use process makes Motor Pool revenues totally dependent upon other state entities using its vehicles.

The Board's fee authorized by the Legislature is rather unique in that it is set as a total lump-sum fee based on the Board's anticipated expenditures during the next biennium. Consequently, the Board's investment revenue is not impacted by the size of the investment portfolio or the number of accounts it invests. To ensure that the fees closely match expenditures, the Legislature requires that the Board's account balance not exceed a "60-day" working balance. In other words, the Board is permitted to retain sufficient funds in its account to pay for 60 days worth of its operations. If the balance exceeds that limit, the Board must reduce its fees.

If expenditures exceed the fees charged during the year, the 60-day working balance will shrink. Conversely, if expenditures are less than the fees charged during the year, the balance will increase up to the 60-day maximum at which time fees must be reduced.

Enterprise Account – The Legislature does not set fees for these accounts because an enterprise entity provides few if any services/products to state entities. The Board's INTERCAP program derives its revenues from the "spread" between the interest rates on the bonds it issues and the interest rates charged on loans made from the bond proceeds. Although budgeting information is included in the Governor's budget and reviewed by the Legislature no action is taken on this information. The Board replenishes the account annually when INTERCAP bonds are remarketed with funds sufficient to meet one year's expenditures from the account.

Custodial Bank Fees – In addition to the Board's investment management fee, it charges a fee for custodial bank services. The fees are not approved by the Legislature because the Board deposits the fees in the state general fund from which a statutory appropriation is made. (Fee authority is not required when the funds are appropriated.) A statutory appropriation is made by law and is not subject to legislative approval.

External Investment Manager Fees – External manager fees are paid from investment income and are not included in the Board's budget or approved by the Legislature. These fees, based on externally-managed asset values, are too volatile to be subject to an inflexible biennial budget.

BOARD FEES & FEE ALLOCATIONS

Board staff utilizes a cost allocation system to equitably allocate the Legislatively-approved Board fees and the Custodial Bank fees to the various accounts in the investment portfolio as depicted in the adjacent table. The cost allocation centers consist of the seven investment pools, fixed income/equity investments not held in the pools, and loans/mortgages.

Cost Allocation Centers	Board Fee	Bank Fee
Retirement Funds Bond Pool	11.49%	12.06%
Trust Funds Bond Pool	10.86%	7.95%
Domestic Equity Pool	13.08%	38.01%
International Equity Pool	12.91%	12.68%
Private Equity Pool	12.05%	3.46%
Real Estate Pool	10.13%	1.38%
Short Term Investment Pool	11.45%	13.23%
All Other Funds	6.84%	10.43%
Loans/Mortgages	11.19%	0.80%
Total	100.00%	100.00%

Board Fees - Board fees are allocated 78.0 percent based on the number of staff working in each cost center with the remainder allocated directly to cost centers based on where the services are provided. For example, fixed income analytical services are allocated to fixed income centers and equity analytical services are allocated to public equity centers.

Custodial Bank Fees - Custodial Bank fees are allocated 60.0 percent based on the number of yearly transactions in each center with the remainder allocated based on the asset values within the center. There were more than 87,000 transactions recorded in the custodial bank's accounting system during a 12 month period. The total fees charged are based on a fixed amount in the Custodial Bank contract.

External Manager Fees – External investment manager fees are charged directly to the cost centers in which the services are provided. For example, domestic equity manager fees are charged to the Domestic Equity Pool and international equity manager fees are charged to the International Equity Pool.

The table below shows the total fees charged to each center in Fiscal 2010.

Pool	Board	Custodial Bank	External Managers	Total
Retirement Funds Bond Pool	$ 527,473	$ 141,563	$ 1,078,457	$ 1,747,493
Trust Funds Investment Pool	493,636	118,316	345,658	957,610
Domestic Equity Pool	735,444	567,552	9,605,491	10,908,487
International Equity Pool	729,648	216,660	4,682,131	5,628,439
Private Equity Pool	563,892	73,044	13,360,496	13,997,432
Real Estate Pool	476,317	39,845	7,096,729	7,612,891
Short Term Investment Pool	522,780	215,160	-	737,940
All Other Funds/Loans Mortgages	820,282	181,814	66,627	1,068,723
Total	**$ 4,869,472**	**$ 1,553,954**	**$ 36,235,589**	**$ 42,659,015**

Fees charged to the investment pools are deducted from investment income prior to the distribution of income to the pool participants. The Legislative Auditor reviews the cost allocation procedure annually.

THE BOARD'S THREE MISSIONS

Manage the Unified Investment Program - The Board's original and primary mission is to prudently manage the constitutionally-created Unified Investment Program, which includes all state funds and those local government funds invested in the Program. The Board manages the Program pursuant to constitutional and legal provisions, which restrict equity investments to the nine retirement funds and the State Workers' Compensation Fund. The Program is managed under the "prudent expert principle", which requires the Board to:

- **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;**
- **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**
- **Discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.**

The Program is managed with a mix of Board investment staff and external investment managers.

Manage the Coal Tax Trust Loan Program – The Board manages four distinct loan programs authorized by law and funded from the Coal Tax Trust. The Board has loaned $635.7 million since inception of the first loan program.

State law declares that the purpose of the Coal Tax Trust is to:

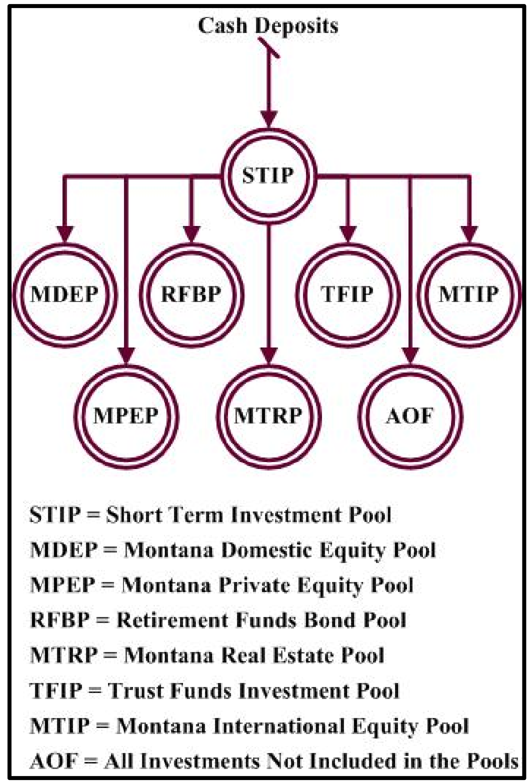
- **Compensate future generations for the loss of a valuable and depletable resource and to meet any economic, social, and environmental impacts caused by coal development not otherwise provided for by other coal tax sources; and**
- **Develop a stable, strong, and diversified economy which meets the needs of Montana residents both now and in the future while maintaining and improving a clean and healthful environment as required by Article IX, section 1, of the Montana constitution.**

All loan programs are limited to Montana businesses and the Program is managed exclusively by Board staff.

Manage the Bond Programs – Under this Program, the Board issues tax-exempt bonds and lends the proceeds to eligible governmental entities for a broad variety of projects (INTERCAP). The Program has been used extensively by local governments due to a user-friendly process and low interest rates. The Board has loaned $325.1 million since the Program's inception. The Board also manages other smaller bond programs authorized by law.

All bond programs are limited to Montana entities and the Program is managed exclusively by Board staff.

THE INVESTMENT STRUCTURE



All funds deposited with the Board are initially invested in the Short Term Investment Pool (STIP). State and local agencies buy and sell STIP units at their discretion with 24-hours notice. The STIP is the only investment option available for local governments and is the primary investment vehicle for most state accounts. The Board has developed other special purpose investment pools that operate similar to mutual funds as depicted in the adjacent chart.

While Board staff exercise no control over local and state agency purchases/sales of STIP units, staff exercises total control over investments in the other pools and the "All Other Funds" portfolio. The transfer of investments from the STIP to other investment pools is conducted monthly by staff based on pre-determined criteria for the account. Most state agency accounts will remain in the STIP due to liquidity or other requirements, but STIP balances are kept to a minimum in retirement and non-expendable trust funds.

The investment pool process simplifies investing and accounting and provides diversification and safety for smaller accounts that would otherwise have to invest in individual securities. The All Other Funds (AOF) is not an investment pool but rather a "bucket" created to hold all investments not held in the investment pools. The largest account in the AOF fund is the State Fund that primarily holds intermediate-term bonds that are better fit for its maturity requirements than the long-term bond investment pools. The Coal Tax Trust loans and retirement fund mortgages are also held in the AOF.

The investment pool creation date and the type of funds eligible to participate are shown below:

Pool/Investments Managed Name	Creation Date	Eligible Participants
Retirement Funds Bond Pool (RFBP)	04/01/95	Nine Retirement Funds Only
Trust Funds Investment Pool (TFIP)	10/01/95	Various State Trust Funds
Montana Domestic Equity Pool (MDEP)	07/01/80	Nine Retirement Funds/Small Trusts
Montana International Equity Pool (MTIP)	06/01/96	Nine Retirement Funds Only
Montana Private Equity Pool (MPEP)	05/01/02	Nine Retirement Funds Only
Montana Real Estate Pool (MTRP)	06/01/06	Nine Retirement Funds Only
Short Term Investment Pool (STIP)	07/01/74	All State Funds and Local Governments
All Other Funds (AOF) Investments Managed	NA	Non-Pool State Agency Investments

<u>Investment Pool Procedures</u> – Net investment income (after fees) is distributed monthly to investment pool participants, while capital gains/losses are retained in the pools and reinvested. Reinvesting net capital gains in the pools is a much more efficient process than distributing the capital gains to participants and then repurchasing units in the pools. Except for the STIP that operates with a $1.00 share value, pool shares must be priced when participants buy or sell pool shares.

THE INVESTMENT PROCESS

The Board has delegated to staff the responsibility to hire, monitor, and terminate all external investment managers. There are two distinct types of external investment managers hired by Board staff - managers who invest in publicly-traded securities and managers who invest in alternative type investments.

Public Security Investment Managers - Investment managers who actively manage the Board's publicly-traded stocks/bonds are selected utilizing the state's "Request for Proposal" (RFP) process that is open to all qualified investment managers. The state Department of Administration supervises and monitors the entire RFP process. The Board's consultant, R.V. Kuhns, provides extensive data-gathering activities and guidance during the selection process, but the ultimate manager selection is made by Board staff. The managers are hired under a standard state contract limited by law to seven years and can be terminated with five days notice with or without cause.

Alternative Investment Managers - The RFP process is not utilized in the selection of alternative investment managers, such as private equity/real estate managers. These funds are structured as Limited Partnerships managed by a General Partner who has the responsibility to raise funds and invest those funds over a specified period of time. Board staff can only invest in these funds when they are in the "fund raising" stage – a process that does not lend itself to the RFP process.

The funds are typically closed-end and structured as Limited Partnership Agreements to which limited partners subscribe and make a "commitment" of funds that are drawn down over a three to five year investment period. The General Partners invest the funds in various types of underlying private investments during the investment period and are expected to return the committed funds and profits over the life of the funds. Because a fund's anticipated life may be as long as 10 to 12 years and there are limited opportunities for Limited Partners to exit the fund during its legal life, these investments are considered illiquid. Because the draw down schedule of these funds cannot be predicted with any accuracy, Board staff must ensure that adequate cash is available at all times to fund commitments on short notice.

The table below shows the percentage of the Unified Investment Program invested by Board staff and external managers as of March 31, 2011.

Pool/Investments Managed Name	Board Staff	External Managers	Portfolio Value
Retirement Funds Bond Pool (RFBP)	71.11%	28.89%	1,883,820,477
Trust Funds Investment Pool (TFIP)	89.72%	10.28%	1,852,183,665
Montana Domestic Equity Pool (MDEP)		100.00%	2,854,652,540
Montana International Equity Pool (MTIP)		100.00%	1,451,802,446
Montana Private Equity Pool (MPEP)		100.00%	911,139,435
Montana Real Estate Pool (MTRP)	2.38%	97.62%	435,603,225
Short Term Investment Pool (STIP)	100.00%		2,195,597,902
All Other Funds (AOF) Investments Managed	91.74%	8.26%	1,663,269,076
Weighted Percentages	**50.82%**	**49.18%**	**13,248,068,768**

Most of the portfolio is actively managed, but there are passive components in the MDEP and MTIP to provide stability and reduce tracking error to the respective benchmarks. The passive components closely track the major domestic and international equity indexes. As of March 31, 2011, 90.0 percent of the total assets were actively managed, while 10.0 percent was passively managed.

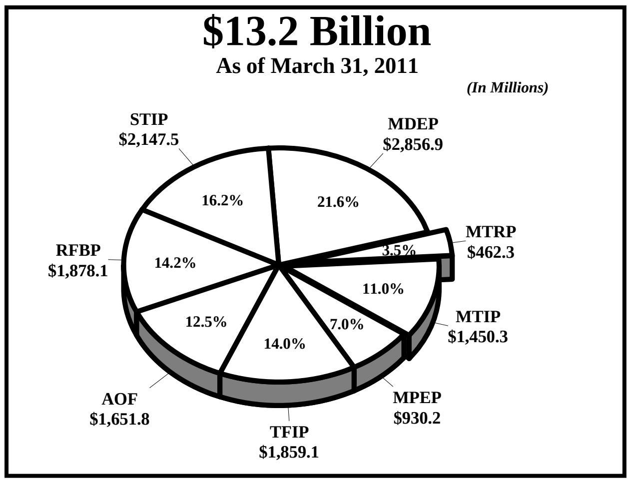
THE UNIFIED INVESTMENT PROGRAM

The table below shows the Unified Investment Program portfolio as of June 30, 2010 by major fund type and asset type. This table has historically been published in the Board's annual report and provides a good snapshot of the Board's total investment portfolio. The trust investment under the Mortgage/Loans asset category represents the in-state loans funded from the Coal Tax Trust. The pension investment under that asset category reflects Montana mortgages held by the Teachers' Retirement System and the Public Employees' Retirement System.

Fund Type	Cash Equivalents	Public Stock	Fixed Income	Mortgage/ Loans	Other (1)	Total
Pensions	118,143,962	3,300,778,543	1,867,210,462	35,527,234	1,226,297,764	6,547,957,966
Trusts	205,670,905	761,159	1,864,093,127	205,427,525		2,275,952,716
Insurance	136,383,310	110,790,189	1,026,600,894			1,273,774,393
Treasurer's	828,267,153		82,427,004			910,694,157
Local Gov.	358,539,815					358,539,815
Agency Cash	374,971,130		17,815,868			392,786,998
Universities	105,592,053	942,076	56,543,391			163,077,519
Debt Service	51,621,780					51,621,780
Total	2,179,190,108	3,413,271,967	4,914,690,745	240,954,759	1,226,297,764	11,974,405,342

(1)Private Equity, and Real Estate

The adjacent chart depicts the Unified Investment Program portfolio by structure as of March 31, 2011. The growth in the portfolio from June 30, 2010 to March 31, 2011 is primarily due to the positive impact of stock market performance on retirement system assets. The Mortgage/Loans investments and the insurance investment under Public Stocks in the top table are included in the AOF in the adjacent table.



Investment Pool Operations – The table below shows the December 31, 2010 status of the investment pools and AOF, including the number of value of securities, the number of securities, the number of transactions in a 12-month period, and the number of participants.

Pool	Security Values	Securities	Transactions *	Participants
Retirement Funds Bond Pool (RFBP)	1,832,973,603	838	8,902	9
Trust Funds Investment Pool (TFIP)	1,828,522,007	245	3,107	34
Montana Domestic Equity Pool (MDEP)	2,730,503,431	1,774	44,299	12
Montana International Equity Pool (MTIP)	1,405,904,879	973	13,279	9
Montana Private Equity Pool (MPEP) **	935,418,920	94	948	9
Montana Real Estate Pool (MTRP) **	417,132,114	27	361	9
Short Term Investment Pool (STIP)	2,130,865,884	84	8,672	489
All Other Funds (AOF)	1,705,520,665	233	8,143	24
Total	12,986,841,505	4,268	87,711	595

* Number of Securities Transaction During 12-month Period - Does Not Include Income Transactions

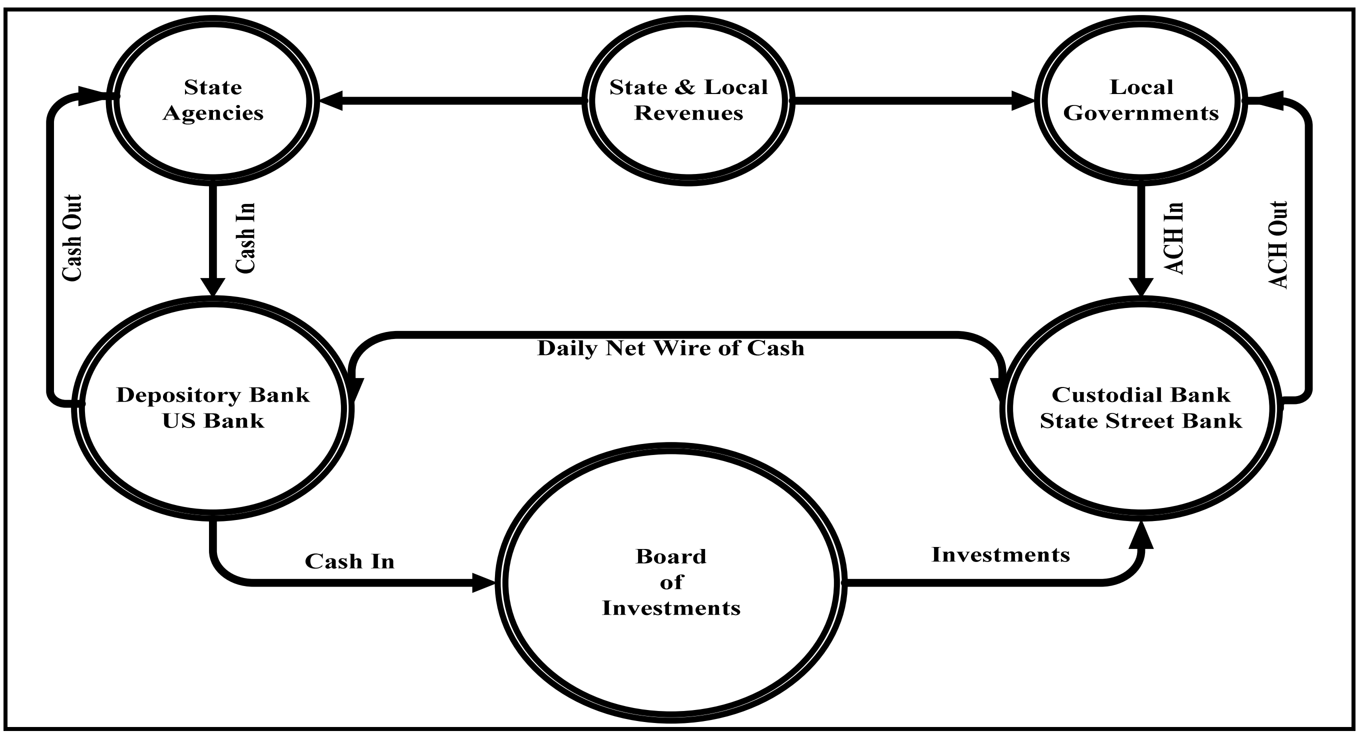
** Individual Fund Partnerships

DOMESTIC/CUSTODIAL BANKS

The Custodial Bank provides the following services for the Board:

- Custody for all publicly-traded securities;
- Complete securities accounting system, including foreign stocks/bonds;
- Participant (mutual fund) accounting system for the investment pools;
- Accounting system for private equity & real estate investments;
- A direct interface from the Board's computer network to the Bank's systems;
- Daily pricing of all publicly-traded securities and foreign currency exchange;
- Automated Clearing House (ACH) function for local government STIP investments;
- Notifies the Board of all corporate actions;
- Receives all proxy notices and distributes to appropriate parties;
- Files on behalf of the Board as a member in all class action securities litigation;
- Calculates total return performance investment pools and major funds;
- Calculates internal rates of return for closed-end private equity & real estate investments;
- Lends Board securities to increase investment income; and
- Sends or receives daily wires to/from Depository Bank to "net" out cash.

The chart below provides a simplified illustration of the daily flow of cash as it is received by the Board; invested by the Board; and then liquidated and sent back to state/local entities.

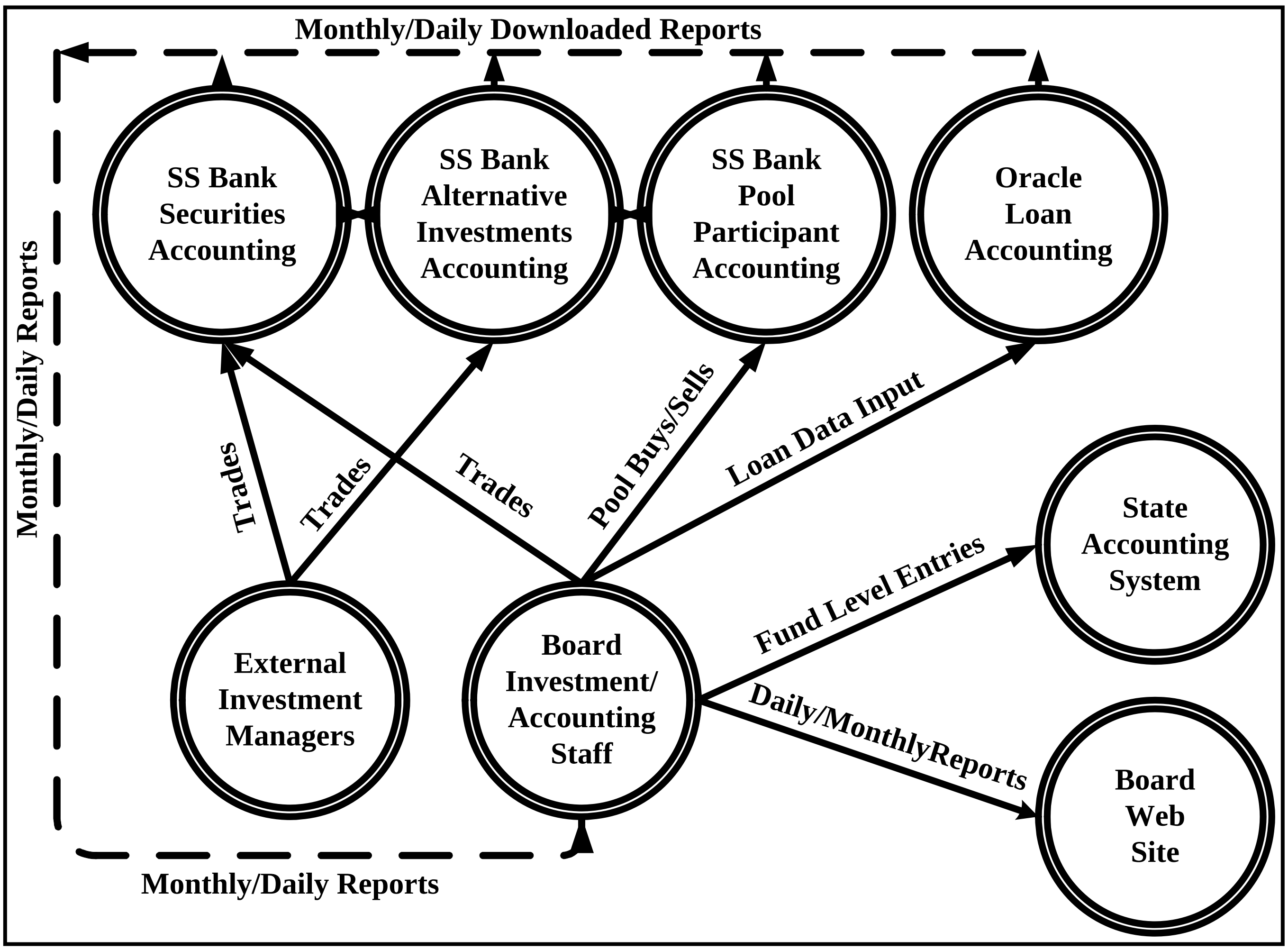


The Depository Bank is the official bank of the state and handles its cash transactions. State/local entities are able to invest and withdraw their cash with 24 hours notice from the Short Term Investment Pool. Depending upon the daily cash flow and daily investment activity there is a "net" daily wire of cash between the banks.

INVESTMENT ACCOUNTING

Board staff interface with five unique accounting systems, three of which are provided by the custodial bank, State Street Bank. The in-state loan and INTERCAP accounting system was custom designed and is housed at the state's computer center. The state accounting system is the "official" book of record for auditing purposes but is not capable of tracking daily security transactions; daily investment pool transactions; or daily loan activity. It is a "fund" level accounting system, which means that Board staff enters end-of-day data into the system reflecting the day's activity at the fund level. A fund is established by the state accounting division to track a specific program or activity, such as a retirement or trust fund.

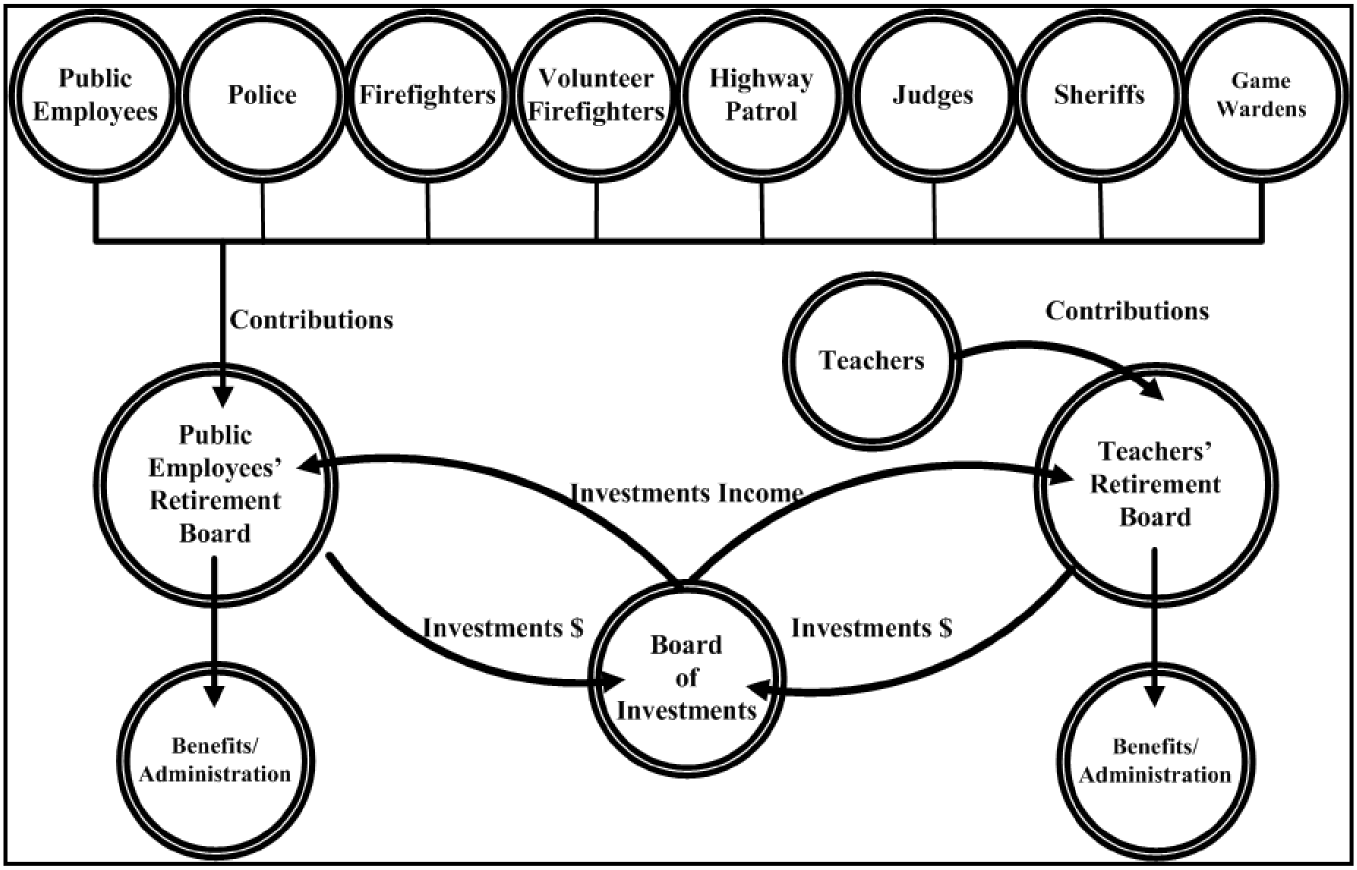
The Board currently records end-of-day data for 493 funds, comprised of 326 state funds and 167 local government funds. Each state fund requires an individual entry in the state's accounting system if there has been investment activity in the fund. Local government funds are rolled up into one state accounting fund. The following chart illustrates a simplified flow chart of the daily investment and accounting activity.



In addition to accounting/portfolio reports downloaded from the custodial bank, the bank also provides investment performance reports for individual funds, the investment pools, and investment managers. Reports are posted to the Board's website daily and monthly.

DEFINED BENEFIT RETIREMENT SYSTEMS

The state's defined benefit retirement plans include all state agencies and most local government entities and school districts. The Board is solely responsible for investing retirement system assets, while two boards appointed by the Governor manage the benefits and liabilities. The chart below depicts the relationship of the two retirement boards and the Board in managing the state's nine pension fund assets and liabilities.



The market values of the nine retirement systems as of March 31, 2011 are shown in the adjacent table. The assets are priced daily by the Custodial Bank and are very sensitive to stock market movements given the large allocation to equities. Depending upon the volatility of the stock markets, the retirement systems comprise between 55.0 percent and 65.0 percent of the Unified Investment Program. Because the Board may invest retirement funds in any type of investment it considers prudent, retirement fund investments are much more complex than are investments of other fund types that have limited investment options. Further, retirement funds have both assets and liabilities, which other state funds do not have. Ideally, retirement system assets should match the liabilities if the systems are to be fully funded.

System	Market Value	%
Public Employees	$ 3,889,873,873	50.43%
Police	215,703,425	2.80%
Game Wardens	91,460,008	1.19%
Sheriffs	207,105,325	2.69%
Judges	62,559,549	0.81%
Highway Patrol	97,370,304	1.26%
Teachers	2,909,731,141	37.72%
Volunteer Firefighters	25,500,009	0.33%
Firefighters	214,071,469	2.78%
Total	$ 7,713,375,103	100.00%

DEFINED BENEFIT RETIREMENT SYSTEMS (CONTINUED)

Defined Benefit Retirement System Liabilities – Liabilities exist in the state's defined benefit retirement systems because a pre-determined "retirement benefit" is promised to employees when they are hired by employers participating in the systems. The benefit formulas are codified in state law as are the contributions required of employees and employers. These systems are distinct from defined contribution retirement systems, which impose no future obligation on the employer. While the employer may make contributions to an employee's defined contribution account during his/her career, when the employee retires the employer's obligation ceases.

Calculating liabilities accurately is difficult because the formulaic benefit is based on years of service and highest average salaries. No one really knows how long an employee will work, what his/her highest average salary will be at retirement, and how long he/she will draw benefits after retirement. An under-calculation of liabilities early in a system's life will have detrimental impacts on the system as it matures.

Defined Benefit Retirement System Assets – Defined benefit retirement system assets are generated by "positive" cash flow – the excess of contributions received over benefits/expenses paid – plus investment income not used to pay benefits. When a defined benefit retirement system is created, the employer and/or employees begin contributing to the system and since there are no retirees drawing benefits in the early years, the contributions accumulate and are invested. Even after the original employees begin to retire there will be positive cash flow because there will be more contributing employees than retirees collecting benefits. The positive cash flow will continue to build the assets into a "nest egg" used to pay benefits when employees retire. As long as contributions exceed benefits paid, the income on the assets are reinvested and add to the growth of the assets.

Normal Cost Concept – The concept behind a defined benefit system is that the cost to fund the benefits should be related to when the benefits are earned, rather than when they are paid. In other words, each generation of employees should fund their retirement benefits during their working careers, rather than depending upon the next generations to fund them. This concept requires that employee/employer contributions are sufficient when invested to pay the employee's benefits upon retirement. The contribution rate calculated to achieve this goal is called the "Normal Cost." The simplest way to explain Normal Cost is to envision an employer creating a new defined benefit system that is limited to only the employees working for the firm at the time the plan is created (a closed system). After the benefit levels are set, the contributions required to fund the benefits are calculated as a percentage of employee salaries that must be set aside each payday and invested to fund future benefits. If the Normal Cost calculation is correct at the outset, after the last benefit payment to the last survivor in the closed system, the invested assets would be completely liquidated.

Normal Cost Calculations - The Normal Cost calculation is complicated by several factors. First, the employer must assume the level of annual investment income the contributions will generate until they are used to pay benefits. Second, an assumption must be made as to how long employees will work before they retire and how long they will draw benefits after retirement. Third, an assumption must be made for salary increases employees will receive during their working career. Salary increases not only impact contributions made during the employee's career but also impact benefit levels since they are based on the highest salary levels prior to retirement.

DEFINED BENEFIT RETIREMENT SYSTEMS (CONTINUED)

The Normal Cost theory falls short of funding benefits when benefit increases are granted midway through an employee's career. The additional Normal Cost required to fund the increased benefit can only be collected during the remainder of the employee's career, when in theory it should have been collected from the date of hire to fully fund the increased benefit. If benefits are increased for employees already retired, the increased benefit costs cannot be funded by the Normal Cost. The Normal Cost contributions made during the retiree's working career will not have paid for the increased benefit costs.

Negative Cash Flow - As defined benefit retirement systems mature, the ratio of retirees to contributing active members increases and the positive cash flow eventually turns "negative" – benefit payments exceed contributions. When this occurs, a portion of investment income must be used to pay benefits and is not available for reinvestment in the pool of assets. Once negative cash flow begins, the only revenue available to "grow" the assets is income generated by the assets. If the negative cash flow continues to grow at a faster rate than investment income, at some point in the future all investment income will be used to pay benefits. Once negative cash flow exceeds investment income, assets will have to be sold to pay benefits and the pool of assets will begin to shrink as will the income generated by the assets.

What is an Unfunded Liability - An unfunded liability exists when a defined benefit retirement system's actuary calculates that the present value of system liabilities exceeds the system's assets available to fund the liabilities. An unfunded liability in and of itself does not make a retirement system actuarially unsound. Under state law, if the unfunded liability can be amortized in 30 years or less by the current contribution stream, the system is actuarially sound. The contribution available to amortize any unfunded liability is that portion of the legislatively-set contribution in excess of the Normal Cost as calculated by the system's actuary. Because the total contribution rate is set by law and does not change, if the Normal Cost rate calculated by the actuary increases, it reduces the level of contributions available to amortize the unfunded liability. Conversely, if the Normal Cost rate decreases, the level of existing contributions available to amortize the unfunded liability increases. As of June 30, 2010, four of the state's nine defined benefit retirement systems were actuarially unsound because their unfunded liabilities could not be amortized in 30 years.

The Investment Return Assumption – The most difficult and important of all assumptions utilized by a system's actuary to value the system is the investment return assumption. Predicting financial market performance year-to-year is difficult if not impossible so assumptions have to be based on very long term investment performance. The assumption is extremely important to the perceived actuarial soundness of the systems because just a small difference in the assumption will increase/decrease system liabilities significantly. In order to derive the "present value" of liabilities so they can be compared to the present value of assets, future liabilities are discounted to the present using the assumed rate of investment return. A higher investment return assumption lowers the present value of liabilities, while a lower investment return assumption increases the present value of liabilities.

Any year, in which the actual performance of the invested assets falls short of the actuarial assumption, an "actuarial" investment loss occurs, even though the assets increased in value. For example, if the annual actuarial investment return assumption is 7.75 percent and the assets earn only 7.0 percent, the system's assets may have earned millions but the system incurred an "actuarial" investment loss.

All nine retirement systems currently utilize a 7.75 percent annual investment return assumption and the Board's current asset allocation of the systems' assets has been structured to meet the assumptions. The table below shows the current asset allocation ranges approved by the Board for all nine retirement systems. The table also shows the asset allocation within each of the investment pools in which the systems participate. The Board has set a range of 60.0 percent to 70.0 percent for total equity investments, which includes domestic/international stock, and private equity. The Board has not authorized investments in Hedge Funds or Commodities.

Pension Fund
Asset Allocations
60 -70% Equities Range

Domestic Equity Pool — 30% - 50%

Investment Type	Range
Large Cap Core (passive)	10% - 30%
Large Cap Enhanced	20% - 30%
Large Cap Style-Based (long-only)	20% - 30%
Partial Long/Short (130/30)	10% - 20%
Total Large Cap	82% - 92%
Mid Cap	5% - 11%
Small Cap	3% - 8%

Real Estate Pool — 4% - 10%

Investment Type	Range
Core/Timberland *	35% - 65%
Value Added	20% - 45%
Opportunistic	10% - 30%

* Timberland may not exceed 2% of total pension assets

International Equity Pool — 15% - 30%

Investment Type	Range
Large Cap Core (active & passive)	50% - 70%
Large Cap Growth	10% - 20%
Large Cap Value	10% - 20%
Small Cap Core	5% - 15%

Private Equity Pool — 9% - 15%

Investment Type	Range
Leveraged Buyouts	40% - 75%
Venture Capital	10% - 50%
Mezzanine Financing	0% - 10%
Distressed Securities	0% - 40%
Special Situtations	0% - 10%

Retirement Funds Bond Pool — 22% - 32%

Investment Type	Range
Domestic High Yield	0% - 15%
International	0% - 10%
Total High Yield/International	0% - 20%
Domestic Core(investment grade)	80% - 100%

Short Term Investment Pool — 1% - 5%

Short-term liquid investments
High-quality Investments
24 Hour Liquidity for Participants

The Board sets the asset allocation ranges and delegates to staff the responsibility of maintaining the assets within the approved ranges. At the end of each month, staff may move assets from one investment pool to another to rebalance the assets and/or to ensure that cash is available to pay benefits and fund draw downs of commitments in the Private Equity and Real Estate Pools.

THE COAL TAX TRUST

Coal Severance Tax Revenues – Fifty percent of coal severance tax revenues are constitutionally dedicated to the Coal Tax Trust. The remaining 50.0 percent is allocated by state law for specific purposes as shown in the adjacent table. The allocations to entities other than the Coal Tax Trust (Trust) are authorized by law and may be changed by the Legislature. The 50.0 percent dedicated to the Trust is required by the state constitution and can only be changed by constitutional amendment approved by the voters.

Coal Tax Trust	**50.00%**
Long-range Building	**12.00%**
Combined Account	**5.46%**
Coal Natural Resource	**5.80%**
State Parks Trust	**1.27%**
Renewable Resources Debt Service	**0.95%**
Cultural Trust	**0.63%**
Coal & Uranium	**$250,000**
General Fund	**The Remainder**

Article IX, Section 5. of the state constitution states:

> **"Severance tax on coal--trust fund. The legislature shall dedicate not less than one-fourth (1/4) of the coal severance tax to a trust fund, the interest and income from which may be appropriated. The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature. After December 31, 1979, at least fifty percent (50%) of the severance tax shall be dedicated to the trust fund."**

While there is a common perception that the Trust is one large account, it has been subdivided over the years for specific purposes. While each of the sub-funds is a part of the Trust and cannot be spent (appropriated) without a ¾ vote of the members of each house, the income from each sub-fund is used for different purposes. Since the Trust was created, it has been referred to as either a "rainy day" fund or an endowment. In practice, it has become more of an endowment because the ¾ vote requirement has prevented it from being used to fill budget shortfalls.

The adjacent table shows the sub-funds; the percentage of dedicated coal tax revenues currently allocated to each sub-fund; and the book value of each sub-fund as of March 31, 2011. Coal severance taxes flowing to the Trust back outstanding severance tax bonds and must first flow through the Severance Tax Bond Fund. The Fund must hold sufficient funds to pay one year's worth of principal and interest on outstanding coal severance tax bonds. After that condition is met, the excess tax revenues are allocated as shown in the table.

Severance Tax Bond Fund	**100%**	**$ 2,289,047**
Treasure State Endowment	**50%**	**193,385,693**
Treasure State Regional Water	**25%**	**55,860,599**
Economic Development Fund	**25%**	**52,068,681**
Permanent Fund	**0%**	**531,310,771**
Total Coal Tax Trust	**100%**	**$ 834,914,790**

All investment income from the Severance Tax Bond Fund and the Permanent Fund are deposited in the state general fund. Investment income from the other three sub-funds is appropriated by the legislature for grant programs. The Severance Tax Bond Fund is invested exclusively in the STIP to ensure liquidity. The Treasure State Endowment, Treasure State Regional Water, and the Economic Development funds are fully invested in the TFIP, except for a small liquid portion in the STIP. All in-state loans are funded from the Permanent Fund. Except for maintaining a STIP balance sufficient to fund loans, the Permanent Fund is invested in the TFIP.

COAL TAX TRUST IN-STATE LOAN PROGRAMS

There are four distinct loan programs authorized by law and funded from the Trust.

Commercial Loans – Any Montana business is eligible to apply for these loans through a Board-approved lender. The loans provide fixed-rate Board financing for terms up to 25 years. The lender services the loans and must participate in at least 20.0 percent of the total loan, unless it is federally-guaranteed. The Board sets the interest rates for these loans.

- Maximum Board participation for individual loans is 10% of the Trust
- Lenders must participate at least 20% if Board share is less than 6% of the Trust
- Lenders must participate at least 30% if Board share is more than 6% percent of the Trust
- Job creation credits may reduce interest rate up to 2.5 percent
- Total outstanding loans limited to 25 percent of the total Trust, including all sub-funds

Value-Added Business Loans – A Montana business that conducts a value-added business as defined by the Board and creates/retains at least 10 jobs is eligible to apply for these loans through a Board-approved lender. The lender services the loans and must participate in 25 percent of the total loan. Interest rates are set by law.

- 15 jobs created/retained qualifies for a loan rate of 2% for the first 5 years
- 10-14 jobs created/retained qualifies for a loan rate of 4% for 5 years
- Interest rate for second five years on all loans is set at 6%
- Interest rate at the Board's posted rate for the final five years of a15-year term
- Minimum Board participation $250,000 – maximum Board participation 1 percent of the Trust
- Total outstanding loans limited to $70.0 million

Infrastructure Loans – A local government entity may apply directly to the Board for a loan to fund infrastructure in their jurisdiction to support a business in the basic sector of the economy. The business must create at least 15 jobs and pay a "user fee" to the local government for the use of the infrastructure. The user fee may be credited against the firm's state income tax. The user fee is pledged to the Board for loan repayment. The definition of "infrastructure" is defined in state law. The Board sets the interest rates for these loans.

- Minimum loan size $250, 000
- Loan size is based on of number of jobs created over a four year period times $16,666
- There is no lender participation and the Board services the loans
- Job creation credits may reduce interest rate up to 2.5percent
- Total outstanding loans limited to $80.0 million

Intermediary Relending Loans – Loans are made directly to Board-approved local economic development organizations. Interest rates are set by law.

- Interest rate at 2% for 30 year term
- Interest only payments for the first 3 years of term
- Maximum individual loan size $500,000
- Borrower must use the loan as matching funds toward other government revolving loan funds
- Total outstanding loans limited to $5.0 million

In certain circumstances a business may be eligible for loans under more than one loan program.

BOND PROGRAMS

The Board administers several bond programs under the Montana Economic Development Bond and the Municipal Finance Consolidation Acts, created as part of the "Build Montana" program in 1984.

INTERCAP – The INTERCAP Program is the most active of the Board's bond programs and is used extensively by local government entities, the University System, and certain eligible state agencies. The Board issues tax-exempt bonds and lends the proceeds to eligible governmental entities for a variety of purposes. Although the bonds are issued as long-term, they are remarketed annually (investors are only required to hold the bonds for a one-year period). Since the Program's inception, the Board has issued $136.0 million in INTERCAP bonds with $96.1 million outstanding at June 30, 2010.

The bonds are backed by the Board in two different ways:

- If for any reason investors do not purchase the bonds when they are remarketed annually, the Board is legally obligated to purchase them.
- The Board guarantees payment of principal and interest to the bond holders.

The Board charges a fee for backing the bonds and since the Program's inception has never been required to purchase the bonds or make principal and interest payments. The Program has never had a borrower default. When the bonds are remarketed annually, the bond interest rates are reset and the Board sets the borrower interest rates based on the reset bond interest rate plus 1.0 percent to 1.5 percent to cover administrative costs. The table below shows the borrower interest rate history.

87	5.625		92	4.950		97	4.750		02	3.150		07	4.850
88	6.625		93	4.350		98	4.850		03	2.850		08	4.250
89	7.950		94	4.500		99	4.300		04	2.700		09	3.250
90	7.500		95	6.400		00	5.600		05	3.800		10	1.950
91	6.350		96	4.850		01	4.750		06	4.750			

Qualified Zone Academy Bond Program – This program allows qualifying school districts to borrow low-cost funds by issuing certain federally-authorized special purpose bonds. Bond proceeds may be used to rehabilitate or repair certain eligible public schools, but may not be used to acquire or construct new public schools. The district must obtain a commitment from a private business to contribute certain equipment, property, services or cash with a value equal to at least 10.0 percent of the principal amount of the bonds. To be eligible, the schools must be located in an empowerment zone; an enterprise community; or have reasonable expectation that at least 35.0 percent of the students attending such school will be eligible for free or reduced cost lunches. Federal law limits the amount of bonds that may be issued each calendar year by state. The Board serves as a facilitator in this process and as of June 30, there was $10.1 million in bonds outstanding.

Qualified School Construction Bonds - This program also allows qualifying school districts to borrow low-cost funds by issuing certain federally-authorized special purpose bonds. Bond proceeds may also be used to rehabilitate or repair certain eligible public schools; but unlike Qualified Zone Academy Bonds, the proceeds may also be used to construct new public schools and acquire the land required for construction. There are no requirements that the district receive private contributions or that the schools be located in an empowerment zone; an enterprise community; or have reasonable expectation that at least 35.0 percent of the students attending the schools will be eligible for free or reduced cost lunches.

BOND PROGRAMS (CONTINUED)

Federal law limits the amount of bonds that may be issued each calendar year by state. The Board serves as a facilitator in this process and has just authorized the first issuance of these bonds.

Economic Development Bond Program - This program that provides qualifying businesses access to tax-exempt funds is no longer very active due to federal law revisions. The Board has issued bonds to finance several projects under this program and acts as a legal funding conduit only and is not pecuniarily liable for the repayment of the bonds. As of June 30, there was $170.1 million in bonds outstanding

Montana Conservation Reserve Payment (CRP) Enhancement Program - This program provides loans to Montana farmers to refinance outstanding loans and/or to purchase additional land and farm equipment. The borrowers assign their remaining federal CRP contract payments to the Board to repay the loans. Although bonds were initially issued to provide funding, the loans are currently funded from the Trust Funds Investment Pool and loan interest rates are typically set 0.50 percent higher than the interest charged by TFIP. A total of 259 loans, totaling $33.5 million have been funded under this program.

Bond Enhancement Program – As described earlier, the Board backs (enhances) the INTERCAP bonds in two different ways – a guarantee to purchase the bonds if other investors do not; and a guarantee of principal and interest payments to the bond holders.

The Board also enhances certain bonds issued by the Montana Finance Facility Authority. The Authority issues tax-exempt bonds and lends the proceeds to non-profit health care facilities and non-profit community correction/treatment facilities. For a fee, the Board guarantees the principal and interest payments to the bond holders. Because these bonds are long-term and not remarketed annually, there is no need for the Board to be a purchaser of last resort.

BOARD MEMBER/STAFF FIDUCIARY RESPONSIBILITIES

Board members and staff are fiduciaries for the funds they manage and invest. Once state and local funds are deposited with the Board, the sole authority for investment of those funds lies with the Board, subject to any legal restrictions imposed by state law or state constitution. In other words, the state/local entities who entrust their funds to the Board lose all control over how the funds are invested.

The website, Investor Word, describes a fiduciary as someone who holds assets for another party with the legal authority and duty to make financial decisions on behalf of the other party. Perhaps the best practical definition of a fiduciary's responsibilities is published by the Federal Department of Labor in its role of administering the Employee Retirement Income Security Act (ERISA) that was enacted to protect the assets of private retirement plans. While public retirement systems are not governed by ERISA, the fiduciary standards would be the same as that for private plans. The following definition is found on the Department's website:

> **"The Employee Retirement Income Security Act (ERISA) protects your plan's assets by requiring that those persons or entities who exercise discretionary control or authority over plan management or plan assets, have discretionary authority or responsibility for the administration of a plan, or provide investment advice to a plan for compensation or have any authority or responsibility to do so are subject to fiduciary responsibilities. Plan fiduciaries include, for example, plan trustees, plan administrators, and members of a plan's investment committee.**
>
> **The primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan's investments in order to minimize the risk of large losses. In addition, they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA. They also must avoid conflicts of interest. In other words, they may not engage in transactions on behalf of the plan that benefit parties related to the plan, such as other fiduciaries, services providers, or the plan sponsor.**
>
> **Fiduciaries who do not follow these principles of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of plan assets. Courts may take whatever action is appropriate against fiduciaries who breach their duties under ERISA including their removal."**

It is clear from this definition that fiduciaries are expected to act prudently and diversify assets as appropriate and "always" act in the best interest of the parties whose assets are totally under the fiduciary's control. State law specifically requires the Board to:

- **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;**
- **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**
- **Discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program**.

It logically follows that a fiduciary's personal opinion and personal investment preference should not bias his/her decision on the prudent investment of funds over which he/she has total control.