

**REGULAR MEETING OF THE
MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE
2401 Colonial Drive, 3rd Floor, Helena, Montana
October 4, 2012
AGENDA**

COMMITTEE MEETING

- A. Human Resource Committee **8:00 AM**
 - 1. Exempt Staff Pay Plan Policy – Decision
 - 2. Public Comment – *Public Comment on Issues with Committee Jurisdiction*

- Tab 1 CALL TO ORDER – Gary Buchanan, Chair** **8:30 AM**
 - A. Roll Call
 - B. Approval of the August 2012 Meeting Minutes
 - C. Public Comment – *Public Comment on Issues with Board Jurisdiction*

- Tab 2 INVESTMENT CONSULTANT FINALIST INTERVIEWS**
 - A. NEPC, LLC (maximum of 70 minutes allowed) **8:40 AM**

 - BREAK** **9:50 AM**

 - B. R.V. Kuhns, Inc. (maximum of 70 minutes allowed) **10:05 AM**

 - INVESTMENT CONSULTANT DISCUSSION** **11:15 AM**

 - LUNCH SERVED** **11:30 PM**

 - INVESTMENT CONSULTANT CONSENSUS SCORING - Decision** **12:00 PM**

 - BREAK** **1:30 PM**

- Tab 3 PRIVATE EQUITY & REAL ESTATE – Cliff Sheets, Ethan Hurley and Dan Zarling** **1:45 PM**

- Tab 4 CASH MANAGEMENT – David Ewer, Gayle Moon, Richard Cooley and Paul Christofferson, Administrator, State Accounting Division** **3:15 PM**

- Tab 5 SECURITIES LITIGATION – David Ewer, Tim House and Greg Gould, Luxan and Murfitt PLLP** **4:00 PM**

- Tab 6**
 - A. Administrative Business **4:30 PM**
 - 1. Human Resource Committee Report – Decision

- Tab 7 EXECUTIVE DIRECTOR REPORTS - David Ewer** **4:45 PM**
 - A. Budget follow up
 - B. Follow up on Fund-of-Funds Underlying Costs

- RECAP OF STAFF TO DO LIST AND ADJOURNMENT – Gary Buchanan** **5:00 PM**

- Tab 8**
 - A. Acronym Index
 - B. Annual Board Meeting Schedule
 - C. 2012 Work Plan

The Board of Investments makes reasonable accommodations for any known disability that may interfere with a person's ability to participate in public meetings. Persons needing an accommodation must notify the Board (call 444-0001 or write to P.O. Box 200126, Helena, Montana 59620) no later than three days prior to the meeting to allow adequate time to make needed arrangements.

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Call to Order

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE
2401 Colonial Drive, 3rd Floor
Helena, Montana**

**MINUTES OF THE MEETING
August 21 - 22, 2012**

BOARD MEMBERS PRESENT:

Gary Buchanan, Chairman
David Ageson – Arrived 8/21/12 11:10 AM
Bob Bugni
Karl Englund
Mark Noennig
Quinton Nyman – Absent 8/22/12
Jack Prothero
Jon Satre
Jim Turcotte

LEGISLATIVE LIAISON PRESENT:

Representative Franke Wilmer

STAFF PRESENT:

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|---|--|
| Jason Brent, CFA, Alternative Investments Analyst | Rande Muffick, CFA, Portfolio Manager, Public Equities |
| Geri Burton, Deputy Director | Chris Phillips DeFranco, CFA, Investment Staff |
| Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP | Jon Putnam, CFA, FRM, Fixed Income Investment Analyst |
| Dana Chapman, Board Secretary | Nancy Rivera, Credit Analyst |
| Frank Cornwell, Deputy Financial Manager | John Romasko, CFA, CPA, Fixed Income Investment Analyst |
| David Ewer, Executive Director | Nathan Sax, CFA, Portfolio Manager, Fixed Income |
| Tim House, Investment Operations Chief | Clifford A. Sheets, CFA, Chief Investment Officer |
| Ethan Hurley, Portfolio Manager, Alternative Investments | Steve Strong, Equity Investment Analyst |
| Ed Kelly, Alternative Investments Analyst | Louise Welsh, Bond Program Officer |
| Herb Kulow, MCMB, Portfolio Manager, In-State Loan Program | Dan Zarling, CFA, Director of Research |

GUESTS:

Jim Voytko, RV Kuhns and Associates
Mark Higgins, RV Kuhns and Associates
Becky Gratsinger, RV Kuhns and Associates
Bill Hoffman, Department of Commerce
Dore Schwinden, Department of Commerce, Director
Roxanne Minnehan, Public Employees' Retirement System
Kris Wilkinson, Legislative Fiscal Division
Angus Maciver, Legislative Audit Division
Michelle Barstad, Montana Facility Finance Authority
Hollie Koehler, Internal Auditor, Teachers' Retirement System
Brad Sanders, Department of Administration, Procurement Bureau

CALL TO ORDER

Board Chairman Gary Buchanan called the regular meeting of the Board of Investments (Board) to order at 11:00 AM in the Board Room on the third floor at 2401 Colonial Drive, Helena, Montana. As noted above, a quorum of Board Members was present. Member David Ageson arrived at 11:10 AM. Representative Franke Wilmer was present.

Board Member Karl Englund made a Motion to approve the Minutes of the May 22 and 23, 2012 Board Meeting; Member Bob Bugni seconded the Motion. The Motion was carried 9-0.

Executive Director David Ewer introduced Frank Cornwell, CPA, the new Deputy Financial Manager. Mr. Cornwell was previously with the Legislative Auditor's Office.

ADMINISTRATIVE BUSINESS

Audit Committee Report

Audit Committee Chair Jim Turcotte reported that the Board's Audit Committee met prior to the Board meeting to review the FY12 Internal Control Review Report performed by Galusha, Higgins & Galusha. Staff concurred with the three recommendations. Where appropriate, and based on the recommendations, staff will make revisions to the Internal Control Policy. The Committee reviewed and approved changes to the Internal Control Policy (the "Policy"). The Policy will be posted on the Board's website and distributed to the Board following final draft.

The Committee also reviewed the Audit Committee Charter (Charter) and had one change. The Charter currently states the Audit Committee is to report "annually" to the Board's constituent groups. Since Audit Committee reports and information are published more often than "annually," the Committee agreed to change the Charter to report "regularly." The change was approved by the Audit Committee.

Jim Turcotte moved that the Board accept the Audit Committee's recommendation to change the Audit Committee Charter to state that the Audit Committee will "Report regularly to the Board's constituent groups, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rule." Quinton Nyman seconded. The motion carried unanimously.

Angus Maciver of the Legislative Audit Division reported that preparations are still underway for the Performance Audit.

Human Resource Committee Report

The Human Resource Committee also met prior to the board meeting. Committee Chair Karl Englund reported on two items that came before the Committee. The first item was the review of the revised Organizational Chart. The chart has been revised to reflect the new Deputy Financial Manager position.

The second item was the Committee's review of the salary disparities for exempt staff which were noted after the hiring of the last Portfolio Manager. The salaries of the Public Equities and Fixed Income/STIP Portfolio Managers, who have been on staff the longest, have fallen behind their counterparts due to salary negotiations for newer staff. The Committee recommends a disparity adjustment which increases the salaries of the two managers by 7.5%, retroactive to January 1, 2012. This will begin the process of salary reviews, which will be ongoing by the Committee.

Karl Englund made a motion to approve the Human Resource Committee's recommendation to increase the salaries of the Public Equity and Fixed Income/STIP Portfolio Managers by 7.5%, retroactive to January 1, 2012. Bob Bugni seconded. The motion carried unanimously.

Loan Committee Report

Loan Committee Chair Jack Prothero reported that the Committee had a conference call meeting on July 24 to address two loans. The Committee approved a \$3 million loan for the Board of Regents (on behalf of the University of Montana) for the Curry Health Center renovations for a term of 15 years. The second loan is for \$2,846,000 to the Town of Sheridan in anticipation of the Rural Development Services (RD) long term financing for a wastewater improvement project. The loan will be in the form of a bond anticipation note (BAN) with a term of one (1) year or less. The Committee approved both loans. No Board action required.

Investment Consultant Committee Report

Committee Chair Karl Englund reported that the Committee met after the last Board meeting to discuss progress on the investment consulting services RFP. Brad Sanders from the Procurement Bureau will come before the Board tomorrow to answer any questions regarding the ongoing process. Six responses were received, one of which was disqualified for failing to meet the requirements which prohibited firms that also offer asset management services from applying as stated in the RFP. The Committee will meet again on September 6th at which time staff will report to the Committee the results of the detailed scoring of the candidates. The final scores and ranking of the applicants will be used to determine which candidates will be interviewed by the entire Board at the October 4th Board meeting.

Public Comment

Chairman Buchanan called for public comment on Board issues. There was no public comment.

EXECUTIVE DIRECTOR'S REPORT

Overall Comments

Director David Ewer noted the work plan was included in the Board handouts and asked if there were any questions. Mr. Ewer then reviewed the revised organizational chart and noted the two changes: the addition of the Deputy Financial Manager; and including the three currently vacant analyst positions to show all legislatively authorized FTEs. Of the vacancies, at least two of the positions are slated to be filled, however no set time line has been determined. The plan is to fill the vacant accountant and bond program specialist vacancies.

Member Jon Satre made a motion to approve the revised Organizational Chart, with the correction showing the Deputy Financial Manager connected to the Financial Manager. Member Englund seconded. The motion passed unanimously.

MONTANA LOAN PROGRAMS

Commercial and Residential Portfolio Reports

Mr. Herb Kulow reported one small loan was approved internally. He will be traveling to Great Falls with Ms. Rivera to look at a Canadian manufacturing firm. The past dues for both commercial and residential are under control. Residential loans continue to pay down. The Montana Veterans' Home Loan Mortgage Program (the "VA Program") is up to almost \$3 million as of the end of July and there are \$3.1 million in reservations, all of which is processed through the Board of Housing (BOH). The total allocation allowed for the VA Program is \$15 million; Mr. Kulow believes there will be a bill before the 2013 Legislature requesting a higher allocation than the current \$15 million.

Mr. Kulow reviewed the VA Program Policy (the "Policy"). State law designates BOH as the Program Administrator. BOH wanted to use their rules; but as the funds are the Board's, the Policy was written using the Board's rules.

While the Coal Tax Trust shows inactivity, staff has processed 64 State Small Business Credit Initiative Program (the "SSBCI Program") loans in the past eight months. Staff has been processing one loan a week.

Member Satre inquired about what kind of businesses are included in the SSBCI Program, and what geographical areas are covered by the loans. Mr. Kulow noted they are done through local economic development groups. Geographically there is \$2.5 million for Missoula, \$2.5 million for Billings and almost \$2 million for Great Falls. The Department of Commerce also has application reservations from a Native American grocery store, and another from the Bakken oil field. Most loans are for expansion of existing small businesses and many create or save jobs. As the loans are repaid, the local economic groups get to keep the money, which assists them in obtaining additional United States Department of Agriculture or Economic Development Administration funding. The Department of Commerce requires that 2% of the \$13 million be granted to the Consolidated Native American Council (the "Council") for equity for their small businesses and requires that the Council match funds, so the funding goes directly to tribal businesses.

Mr. Kulow noted no other states are utilizing the SSBCI Program. Staff is requesting the third draw; there are no other states up to the third draw. The US Treasury is providing the money as part of the Obama 2010 Stimulus program. Executive Director Ewer added that this is money provided through Governor's Economic Development and Department of Commerce who are relying on the expertise of our staff, Mr. Kulow and Ms. Rivera, who have assisted Commerce in taking advantage of this opportunity by vetting these projects.

Member Englund requested clarification as to whether financing for condominiums is allowed under the VA Program.

Mr. Kulow advised the maximum loan amount under the VA Loan Program changes every year; Board of Housing comes up with the maximum loan amount. Because there are too many complications associated with condominiums, they are not allowed under the VA Program.

Jack Prothero made a motion to accept the Veteran's Home Loan Mortgage Policy. Member Englund seconded. Member Bugni inquired what the policy is to allow protection in the event of default. Mr. Kulow advised under our service contract with Board of Housing, all past due loan collections are BOH responsibility. Any past due loan, within the first 180 days could require repurchase by the lenders, which protects BOI interests. Additionally, past due reports will reflect any past due loans on a monthly basis. The motion passed unanimously.

Member Englund requested clarification on what type of business KJR, LLP is; the one staff approved loan. Ms. Rivera explained it's a real estate investment company which purchased the property for a land trust in Missoula.

Bond Program Reports

Activity Report

Ms. Louise Welsh reported no Board actions were needed on INTERCAP loans. Commitments have been skyrocketing as staff is handling a lot of interim financing requests. At the end of fiscal year 2012 we have \$40 million in commitments. The detail report compares the past two

fiscal years showing outstanding loan amounts and geographical information. Geographically, loans are diversified throughout the state.

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|------------------------|-----------------------------|
| Borrower: | Clinton Rural Fire District |
| Purpose: | Used Fire Engine |
| Staff Approval Date: | April 4, 2012 |
| Board Loan Amount: | \$140,000 |
| Other Funding Sources: | \$ 50,000 |
| Total Project Cost: | \$190,000 |
| Term: | 10 years |

| | |
|------------------------|--|
| Borrower: | Missoula County |
| Purpose: | Seeley Lake Refuse District Office Water/Septic Facilities |
| Staff Approval Date: | April 6, 2012 |
| Board Loan Amount: | \$35,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$35,000 |
| Term: | 5 years |

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|------------------------|------------------------|
| Borrower: | City of Thompson Falls |
| Purpose: | Asphalt Grinder |
| Staff Approval Date: | April 11, 2012 |
| Board Loan Amount: | \$65,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$65,000 |
| Term: | 10 years |

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|------------------------|--------------------|
| Borrower: | Town of Alberton |
| Purpose: | Used Sanding Truck |
| Staff Approval Date: | April 13, 2012 |
| Board Loan Amount: | \$20,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$20,000 |
| Term: | 5 years |

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|------------------------|-------------------------------------|
| Borrower: | City of Roundup |
| Purpose: | Sewer Lagoon UV Disinfection System |
| Staff Approval Date: | April 27, 2012 |
| Board Loan Amount: | \$286,000 |
| Other Funding Sources: | \$221,000 |
| Total Project Cost: | \$507,000 |
| Term: | 10 years |

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|------------------------|---------------------|
| Borrower: | Stillwater County |
| Purpose: | New Asphalt Grinder |
| Staff Approval Date: | April 28, 2012 |
| Board Loan Amount: | \$152,990 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$152,990 |
| Term: | 5 years |

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|------------------------|---|
| Borrower: | Target Range School District #23 (Missoula) |
| Purpose: | Various Building Improvements (i.e. heating, cooling, plumbing, flooring, security, etc.) |
| Staff Approval Date: | May 2, 2012 |
| Board Loan Amount: | \$850,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$850,000 |
| Term: | 5 years |

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|------------------------|-------------------------|
| Borrower: | City of Columbia Falls |
| Purpose: | New Sewer Cleaner Truck |
| Staff Approval Date: | May 4, 2012 |
| Board Loan Amount: | \$124,625 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$124,625 |
| Term: | 5 years |

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|------------------------|---|
| Borrower: | Richey Elementary School District #78J |
| Purpose: | School Building Structural Rehabilitation |
| Staff Approval Date: | May 29, 2012 |
| Board Loan Amount: | \$ 850,000 |
| Other Funding Sources: | \$ 200,000 |
| Total Project Cost: | \$1,050,000 |
| Term: | 10 years |

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|------------------------|---|
| Borrower: | City of Belgrade |
| Purpose: | City Library Roof Replacement/Exterior Wall Repairs |
| Staff Approval Date: | June 19, 2012 |
| Board Loan Amount: | \$75,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$75,000 |
| Term: | 15 years |

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|------------------------|---|
| Borrower: | Polson Elementary School District #23 |
| Purpose: | Reroofing High School (Multi-District Agreement 20-3-363 MCA) |
| Staff Approval Date: | June 22, 2012 |
| Board Loan Amount: | \$164,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$164,000 |
| Term: | 3 years |

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|------------------------|------------------------|
| Borrower: | City of Ronan |
| Purpose: | Various Used Equipment |
| Staff Approval Date: | June 26, 2012 |
| Board Loan Amount: | \$150,000 |
| Other Funding Sources: | \$ 30,000 |
| Total Project Cost: | \$180,000 |
| Term: | 7 years |



MONTANA UNIVERSITY SYSTEM

| | |
|------------------------|-----------------------------------|
| Borrower: | UM-Missoula |
| Purpose: | Washington Grizzly Stadium Lights |
| Staff Approval Date | April 4, 2012 |
| Board Loan Amount: | \$1,000,000 |
| Other Funding Sources: | N/A |
| Total Project Cost: | \$1,000,000 |
| Term: | 10 years |

The Loan Committee met via conference call on July 24th and approved the University of Montana and Town of Sheridan loans.

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|------------------------|----------------------------------|
| Borrower: | University of Montana – Missoula |
| Purpose: | Curry Health Center renovations |
| LC Approval Date: | July 24, 2012 |
| Board Loan Amount: | \$3,000,000 |
| Other Funding Sources: | \$1,000,000 |
| Total Project Cost : | \$4,000,000 |
| Term: | 15 years |

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|----------------------------|--|
| Borrower: | Town of Sheridan |
| Purpose: | Interim financing in anticipation of a \$2,846,000 USDA Rural Development Services long-term loan for wastewater improvements. |
| LC Approval Date: | July 24, 2012 |
| Board Interim Loan Amount: | \$2,846,000 |
| Other Funding Sources: | \$6,000,000 |
| Total Project Cost : | \$6,000,000 |
| Term: | 1 year |

Ms. Welsh reported there are no past due loans. It is anticipated that a bond anticipation note may have to be issued in the fall, with additional bonds issued in the spring of 2013 to provide additional funding for the INTERCAP Program.

Member Bugni inquired if we have any concerns on reaching the upper limit of bonds we can issue?

Executive Director Ewer advised no. The work plan reflects discussion on INTERCAP at the November meeting, at which time the INTERCAP Program will be discussed in more detail.

BOARD EDUCATION

Executive Director Ewer reported on the Market Makers Conference in Carlsbad, California, which he and members Jon Satre and Jim Turcotte attended. Topics covered included current issues with pension funds, macroeconomic, micro investment, secular trends, phenomenon of

higher correlations, the outlook for Europe, risk parity investing, stock volatility, higher dividends as an alternative to fixed income, Private Equity and Fixed Income. Hedge Funds were discussed, along with Real Estate and the outlook for Fixed Income, which remains grim. Many pension funds have lowered their assumed target returns. In general, the tone at the conference was serious, earnest and generally somber. Reliance on consultants was also discussed.

Member Turcotte added the conference was one of the better ones he has attended, very well put together. All presenters were from the private sector, but the sales pitch aspect was prevented, as presenters had to stay on topic. The conference was small, with 50 or so attendees. Ontario Municipal Employees Retirement Scheme (OMERS) pension fund has \$50 billion, all in Private Equity, which is unusual, invested in airports, toll roads, etc. They don't invest in any standard vehicles as BOI does. Idaho's plan is in good shape, so they have decreased their risk ratio substantially as they don't need excessive returns to cover costs. Most plans, however, were concerned with their actuarial rate of return.

Member Satre added he thought the conference was beneficial. One benefit was the number of trustees in attendance, and there was a specific trustee session, which was very beneficial. He agreed, the outlook in general was not optimistic. The discussion on actuarial return assumption showed attendees have between 7% and 8% assumed return.

Chairman Buchanan asked for a general take away from the conference. Member Satre noted there was a lot of talk about changing the paradigm of how we rate ourselves, away from peer comparisons and benchmarks, and more on focusing attention to evaluating ourselves in terms of absolute returns to more clearly reflect our actual financial obligations. With maturing pension plans, you can't fund out of returns, you must fund out of contributions.

Executive Director Ewer had previously distributed some conference options to Board members. He noted that Ethan Hurley, Portfolio Manager for Alternative Investments would be traveling to Portland, Oregon to attend a timberland conference and asked if any Board member was interested in joining Mr. Hurley. No member was interested at this time. Mr. Ewer encouraged Board members to keep an eye out for beneficial educational opportunities.

Representative Wilmer asked for classification on the question of higher correlations? How to avoid them?

Executive Director Ewer stated the crash of 2008 was a unique experience in that all asset classes went down. In investments, positive correlations are bad. The notion of trying to protect assets by diversifying into differing classes failed, suggesting diversity is not all it's cracked up to be. We do still need to diversify however. Real Estate is an example of a defensive asset class.

CEM BENCHMARK STUDY

CEM - Mike Heale

Mr. Mike Heale presented the CEM Benchmark Study and summarized the key results in the portfolio for a two year period ending December 31, 2011, and reviewed key trends in the US Universe. Growth of the data base over the past 21 years of its existence now includes 163 US funds with an average fund size of \$11.9 billion. CEM currently includes up to 190 US surveys, some of which were not included because data was not yet received or was not ready in time for inclusion in the BOI report. However, the data of the 163 funds included has critical mass for a comprehensive picture. The returns and value added focus includes a combination of public, corporate and multi employer US funds, so is not dependent on only the public sector.

The cost analysis uses a peer group of 20 US public sponsors ranging in size from \$3.1 to \$13.6 billion with the median hitting close to MBOI. Peer group focus is used for the detailed cost benchmark analysis. Staff does have the names of the peer groups, but names are not included in the formal report. This measures policy return vs. asset mix returns compared to other public funds. Value added is your active management decisions and their contribution to your total returns, and analyzes costs to see if they are reasonable. In effect, does paying more get you more in added value?

The two year total return for the Montana pensions was 8%, which is below the US median of 8.5%, but above peer returns of 7.2%. Median US policy returns are for a mix of public and corporate plans, though we are starting to see public and private sector plans becoming more divergent. Looking at the asset mix position for Montana shows a policy return of 7.3% for the two year period, which is very close to median, and above the peer median policy return of 6.4%. The policy return reflects what you could have earned by investing all assets in a passive manner according to your policy mix.

The drivers in relative return are market performance and asset mix. The two best performing benchmarks were Real Estate (REITS) and Barclay's Long Bonds as interest rates came down, an unusual result over what you'd expect. Private Equity was one of better performing assets, and as BOI policy weights are higher in Private Equity at 12% vs. 7% for peers, this had a positive effect on boosting both the policy return and the actual returns. However this was offset by having no dedicated allocation to long bonds, similar to public peers, while the overall US average is a 12% allocation. Since this was the other best performing class the lack of a dedicated allocation acted to detract from both the policy return and actual returns. The net added value over the 2-year period was 10 basis points: 2010 was not so good, however 2011 was much better in value added. BOI was close to the peer median of 20 basis points. The returns are net of fees which includes all costs.

When compared to the US average returns, the BOI Private Equity and Real Estate portfolios showed positive relative returns over the past two years, while Fixed Income and Public Stocks were below the US average. All of these asset classes posted positive returns, with Real Estate and Private Equity the highest. Two years is not a long enough time period, and total returns will need to be looked at over the long term. In general, active management shows a positive long term trend of net value added, adding 18 basis points over the past 21 year period for US plans.

Investment management costs for 2011 equaled \$50.2 million or 64.9 basis points, with 2.4 basis points attributed to total oversight, custodial and other costs. Mr. Heale noted the default fee cost assumed for diversified Private Equity fund-of-funds is 165 basis points (\$6.5 million) as most funds cannot provide those fees.

Chairman Buchanan asked about accounting for the fund-of-funds fees. As these are real costs, it would be to our advantage to have that information provided by the managers rather than having to estimate them, as it is a hidden cost

Mr. Sheets noted we could probably obtain those costs, although how many we could receive in an explicit way is not known. We are deemphasizing fund-of-funds in general, and use them when they are advantageous in situations where staff doesn't have the practical ability to otherwise attain the desired exposure offered by a fund-of-funds.

Executive Director Ewer advised the costs come out via the state's accounting system with the realized returns and accounting takes what can be determined. We assume that fund-of-funds have costs, however an argument could be made that other asset classes also have additional internal costs that wash out against yields. We aren't paying an additional fee, as we pay the fund-of-funds manager and costs are overlaid.

BOI costs have come down this year vs. last year from 68.7 basis points in 2010 to 64.9 basis points this year, which places BOI slightly above the median of 61.4 basis points for peers. Asset mix and size affect costs and when adjusting for the asset allocation at BOI using median peer costs for similar assets, the BOI is below this benchmark cost by 4 basis points, which represents \$3.1 million in savings.

Mr. Heale continued, regarding style, BOI has 64% external active management vs. 71% for peers, and 72% for U.S. Funds. Since external active management is more expensive generally, BOI has a structural cost advantage vs. peers. This is primarily attributable to having less external active management for Fixed Income. The amount of fund-of-funds also makes a difference, but BOI is comparable to peers. Overall, BOI saved 2.6 basis points relative to peers based on differences in implementation style.

Regarding oversight of custody and other costs, BOI saved 0.9 basis points relative to peers. BOI is paying somewhat more for custodial, but saving on oversight, consulting/performance, audit and other fees.

Executive Director Ewer asked for elaboration on the difference of custodial costs for BOI vs. our peers, noting although we have higher custodial fees, we have a different relationship than many pension funds do as they serve several functions for us.

Mr. Heale advised that among our peers, a broad range of costs are included, and he doesn't believe our higher cost for custodial services is a concern considering all the services they provide. Hiring and retaining good staff to have oversight over assets is vital, and overall we pay less than our peers, showing a two year net added value of 0.1%. Paying more doesn't necessarily give better results. The total cost savings for BOI vs. peers of 4 basis points or \$3,102,000, was due mainly to lower cost implementation style and less cost for investment management and oversight, custodial services and other costs.

Executive Director Ewer inquired how CEM keeps their results accurate, how quality control is assured, as our staff spends a tremendous amount of time providing the information.

Mr. Heale stated the BOI staff does a great job providing CEM with the needed information and they deserve a pat on the back for the quality of information provided. CEM has a 21 year historical data base of costs, and adheres to a screening process where all incoming data is sorted through and examined and anything out of the ordinary is flagged for further scrutiny. Data is compared year to year as well, and any data not up to standard is not entered into the data base. There is difficulty collecting data, but costs should be known as they are an important driver of results. True costs should be known and transparent.

Chairman Buchanan inquired if a fiscal year comparison is possible, and whether our peers report fees on fund of funds?

Mr. Heale stated our peers do not report on fund of funds costs and the default amount is determined using an average of direct costs. At this time, fiscal year reporting is not an option, only a calendar time frame is available.

Member Noennig stated it appears our recent May strategy restructure of the domestic equity pool of transitioning to more passive management will be beneficial regarding reduced costs for fees.

Mr. Sheets agreed that although reduction of fees was not the main factor for the transition, we will realize beneficial savings. While CEM data is for 2011, the changes we made in May and the proposed changes to MTIP at this meeting should result in savings.

Mr. Heale addressed the question of CEM having bias on management implementation style, but as they are not money managers, the goal is to look at the facts and determine the driving factors that affect returns and/or savings.

Member Bugni asked about the custom peer group, why are other funds, especially corporates, included in the peer group? Why not just compare us to public peers only? Corporates are liability and asset driven.

Mr. Heale advised next year the reporting will have a public sector peer group and a public universe comparison as well. Historically they've been included to give robustness to returns, but now that depth is available with both public and corporate separately. The peer group is all public funds. Costs have gone up dramatically, from 37 basis points to 61 basis points, driven in part by alternatives, (Hedge Funds, Real Assets and Private Equity) doubling in the past ten years, and also implementation style as external active management has gone from 64% to 72% in the past ten years. Key US pension funds over the last 21 years have net added value of 18 basis points, which is positive but modest; where you pursue active managers is key. For the best net value large caps are not your best option; small cap, foreign and emerging markets have all had positive value added. Fixed Income and Private Equity perform better with internal management due to the lower cost. Large funds did better than small ones, as in general they do more internal management. Defined Contribution funds have lower returns vs. Defined Benefit funds in part because of asset mix differences. For Example, DB funds have holdings in Private Equity and Real Estate, which have performed well, to which DC plans do not have exposure.

BUDGET

Executive Director David Ewer introduced the Director of the Department of Commerce (Commerce), Dore Schwinden and Bill Hoffman, Budget Manager of Commerce. Director Ewer thanked Mr. Hoffman and Director Schwinden, and Deputy Director Geri Burton for all of their valuable input into the budget process. Mr. Ewer stated it was pertinent to repeat the concept of costs. Costs are broken out four different ways: external investment management costs are paid as authorized under the Unified Investment Act; custodial bank fees which are paid by charges against the Board's investment pools; operations are paid through a biennial maximum charge against the Board's investment pools; and bond program bond interest and issuance expenses are paid through a general statutory authority. Bond program staff is paid from the Board's bond program enterprise fund.

The BOI investment program is an internal service fund; it recovers its costs from the entities that use its services. The maximum amount is set by the legislature, and is currently set at \$4,831,041 a year for both FY 2012 and FY 2013. This maximum fee covers operational costs and a 60 day working capital allowance. To help bring the working capital balance down, no charge against the investment pools was taken for the month of July. The Bond Program is funded through an enterprise fund which charges fees, mostly coming from the INTERCAP program.

The executive budget process is complex. The legislature starts with the base year budget and every penny is voted on. Rules dictate what can go into the base budget. Motions are made to accept the base budget, then add-ons are considered. Allowable adjustments are considered, such as present law adjustments for inflation and new proposals are considered.

The BOI budget is then submitted to the Department of Commerce which submits it to the Governor's Office of Budget and Program Planning. Mr. Hoffman stated Department of Commerce numbers are very close to the BOI estimated budget. Submission of the finalized budget is not due until January 6.

Chairman Buchanan asked how the Fiscal Year 2012 pay increase will affect the budget.

Director Schwinden explained the Broad band market adjustment pay matrix is set after completing a two year salary survey of public, private competitive pay salaries nationwide and includes hundreds of occupational codes. Then the market rate was determined for each code for Montana with a focus on benefiting the lowest paid positions considering the four year pay freeze. According to the salary survey of May 2012, pay bands two through six were moved to the minimum pay zone and payband sevens were given a 7.5% increase. The cost to BOI for the salary increase will total approximately \$86,000 per year.

Chairman Buchanan inquired if we were late getting the budget process started.

Executive Director Ewer noted Commerce submits the budget approximately September 1, so discussion and action at the August meeting is appropriate timing. Director Schwinden confirmed yes, we were right on track. Mr. Hoffman added our year over year budget increases are in line and reasonable.

Mr. Dan Zarling gave an overview of research costs. He explained investment research services are important tools which are essential to have access to, including real time markets, risk portfolios, a system for trade activity, the ability to monitor external managers and a searchable manager data-base. For Fixed Income, effective information is needed for in-house management. Bloomberg and Factset are used to load our portfolios to view characteristics and Wilshire Axiom analyzes our portfolios. An in-house credit service helps to manage portfolios internally. Prices generally go up each year for these services; however Moody's has been decreased due to streamlining and cutting back on subscribed services. Services are constantly monitored and evaluated with adjustments made to discontinue any redundancies. All of the services used have different methodologies, so do not directly overlap one another, they are stand alone with unique features. Mr. Zarling noted he confers with other pension funds to compare which services are customarily used.

Mr. Voytko added the slate of services used by BOI is typical for funds that manage their Fixed Income assets in-house.

Executive Director Ewer recapped staff recommendations for the proposed budget.

Member Satre made a motion to approve the proposed budget amounts for FY 2013 for Investments and the Bond Program as detailed in Table I and Table II of the Board packet. Member Noennig seconded the motion. The motion passed unanimously.

Member Prothero made a motion to approve the preliminary maximum rates presented for FY 2014 and FY 2015 to cover operational expenses and keep working capital amounts within permissible levels; to accept Commerce's final maximum rates; and to direct staff to promptly notify the Board of any significant changes in the rates and explain such changes. Member Noennig seconded. The motion passed unanimously. Member Englund made a motion that the Board reaffirm the current total staffing level as authorized by the legislature and by statute of 8 exempt and 24 classified FTEs. Member Aageson seconded. The motion passed unanimously.

INVESTMENT ACTIVITIES/REPORTS

Montana International Equity Pool Restructuring

Mr. Cliff Sheets and Mr. Rande Muffick presented an overview the proposed restructuring of the International Pool.

Mr. Muffick explained that many of the same factors were considered as with the Montana Domestic Equity Pool restructuring at the May Board Meeting. The public equity market has been difficult. Mr. Sheets noted the goals of the pool restructuring include: achieving better absolute returns; improving relative performance; increasing flexibility when moving assets in and out of the pool; and, being mindful of costs.

Mr. Muffick noted hearing the CEM presentation was very informative and reaffirmed the need to pay for outside managers where they can offer the most benefit, and he reviewed the background of the international pool. Pre-2005 there was a regional approach with two external Asian managers, one European internal and one external manager, Pyrford. It was determined more diversification among managers was needed and in 2006 a move to 100% external managers was made which provided better diversification within market cap categories and better use of internal resources.

Still, international equity performance did not meet expectations. This leads to several changes in structure that have been made over the last three years. Several active managers were terminated with assets going into passive funds. The passive allocation weight has increased to a current level of approximately 50% of the pool. An emerging market index and small cap index fund were added to provide more allocation flexibility. Exposure to quantitative methodologies, which performed particularly poor during the bear market, has been reduced.

Some of the premises behind the changes to date and staff's recommendations include: developed international large caps remain less efficient than domestic large caps; more small cap manager diversification was needed; and active managers are expensive and tend to be more cost effective and liable to beat the benchmarks with non-US small caps and emerging markets than with large caps.

Member Satre inquired if international large caps would benefit from active management?

Mr. Muffick advised in general, international stocks are less efficient than domestic large cap stocks which suggests active management has more potential in international vs. domestic large caps. This can be attributed to less liquidity, Wall Street coverage is not as developed, the political environment, and information on companies is less available.

Mr. Muffick outlined staff's recommendations for the Montana International Pool going forward: decrease reliance on developed market active large cap portfolios: eliminate existing active large cap core reliance but retain some style-based mandates for growth and value, tilting towards value over time (which will decrease the active weight from 49% to 36% of total large caps); and increase the ranges for non-large cap exposure and dedicated emerging markets. In addition, staff recommends the adoption of a new benchmark, the MSCI ACW ex-US IMI, once the transition to the new structure is implemented. Staff also recommends adding 2-3 developed market small cap active managers and 1-2 emerging market active managers to improve manager diversification in these areas where active management is expected to add value over time. The new structure will provide less developed market active large cap management, more diversification in active portfolios within developed market small cap and emerging markets, a more flexible pool infrastructure, more potential for size and value premium effects and increased alpha generation within a similar fee structure. There will be transition costs of implementing the new structure, along with an estimated \$200,000 to \$400,000 increase in annual fees depending on the actual allocation to small cap and emerging markets.

Member Satre asked for clarification on how the new structure will affect risk.

Mr. Muffick stated there will be more risk with a corresponding return assumption increase of 12 basis points.

Mr. Sheets confirmed small cap and emerging markets are more volatile, but it's a net plus overall as higher returns from these markets are expected to continue over the long term.

Representative Wilmer asked if the increase in passive allocation increases risk.

Mr. Sheets stated manager risk will increase as proposed given an assumption of two thirds of small cap and 60% of emerging market exposure would be actively managed; passive does reduce tracking error.

Member Bugni questioned if reducing large cap active from 49% to 36% was enough, as perhaps we should not have any active large caps. He asked Mr. Jim Voytko of R.V. Kuhns to comment on what might be prudent given staff has added value in a lot of areas but can't be expert in all areas.

Mr. Voytko remarked analyzing and evolving is a healthy process regarding the restructuring process and R.V. Kuhns supports the new restructuring plan. The odds are better with large cap active vs. the Montana Domestic Equity Pool, and the asset class is very challenging. Risk is consistent with the evidence.

Ms. Becky Gratsinger added small cap and emerging markets can be daunting, but over the long term it will be worth it, although times of underperformance are likely.

Mr. Muffick advised we are firing only two managers but if the need arises to terminate additional managers it will be done. Picking new managers takes time. Mr. Voytko agreed, picking successful managers is a challenge and it depends on the pot you're picking from.

Chairman Buchanan inquired on savings due to the recent change in strategy for the Montana Domestic Equity Pool and Mr. Sheets reported savings of \$2.6 million is expected from the recent restructuring accomplished during June. As for the international pool, the fees are now estimated at 29 basis points and would increase to 35 basis points if we go to the middle of the target ranges being proposed for the allocation to small cap and emerging markets. Mr. Sheets also advised that significant savings have already been realized for the Montana International Equity Pool due to the historical move to more passive management. Market timing of the transition could be favorable, as both emerging markets and small cap are underperforming large cap developed stocks of late.

Member Turcotte expressed concern making the allocation changes with such a short history to base the changes on, as this seems like a major reversal of policy.

Mr. Muffick noted while the structure is changing, a lot of changes have been made already. While more small cap introduces more risk and the benchmark is being changed, value can be added in inefficient markets and international stocks offer more opportunities.

Member Prothero moved that the Board accept staff recommendation and approve the proposed revised Investment Policy Statement for the Montana International Equity Pool. Member Satre seconded the motion. The motion passed 8-1, Member Turcotte voted nay.

Exhibit A
60 -70% Equities Range

| <u>Domestic Equity Pool</u> | |
|------------------------------------|---------------------|
| <u>Investment Type</u> | <u>Range</u> |
| Large Cap Core (passive) | 45% - 70% |
| Large Cap Enhanced | 8% - 12% |
| Partial Long/Short (130/30) | 8% - 12% |
| Total Large Cap | 72% - 91% |
| Mid Cap | 6% - 17% |
| Small Cap | 3% - 11% |

| <u>Real Estate Pool</u> | |
|--|---------------------|
| <u>Investment Type</u> | <u>Range</u> |
| Core/Timberland * | 35% - 65% |
| Value Added | 20% - 45% |
| Opportunistic | 10% - 30% |
| * Timberland may not exceed 2% of total pension assets | |

| <u>International Equity Pool</u> | |
|--|---------------------------------------|
| <u>Investment Type</u> | <u>Range</u> |
| Large Cap Core (active & Passive) | 50 42% - 70 66% |
| Large Cap Growth Active | 10 22% - 20 32% |
| Large Cap Value | 10 % - 20 % |
| Small Cap Core | 5 10% - 15 16% |
| Dedicated Emerging Markets | 2% - 10% |

| <u>Private Equity Pool</u> | |
|-----------------------------------|---------------------|
| <u>Investment Type</u> | <u>Range</u> |
| Leveraged Buyouts | 40% - 75% |
| Venture Capital | 10% - 50% |
| Mezzanine Financing | 0% - 10% |
| Distressed Securities | 0% - 40% |
| Special Situations | 0% - 10% |

| <u>Retirement Funds Bond Pool</u> | |
|--|---------------------|
| <u>Investment Type</u> | <u>Range</u> |
| Domestic High Yield | 0% - 15% |
| International | 0% - 10% |
| Total High Yield/International | <u>0% - 20%</u> |
| Domestic Core(investment grade) | 80% - 100% |

| <u>Short Term Investment Pool</u> | |
|--|--|
| Short-term liquid investments | |
| High-quality Investments | |
| 24 Hour Liquidity for Participants | |

ADJOURNED

Chairman Buchanan adjourned the Meeting for the day at 4:28 PM.

CALL TO ORDER – Day 2
August 22, 2012

Board Chairman Gary Buchanan reconvened the meeting Wednesday, August 22, 2012 at 8:30 AM with eight members of the Board and Legislative Liaison Representative Franke Wilmer present. Member Quinton Nyman was absent.

Public Comment

Chairman Buchanan called for public comment on Board issues. There was no public comment.

PERS/TRS Board Updates – Executive Director David Ewer, Board Members Jim Turcotte and Bob Bugni

Member Bugni reported PERS reviewed the budget; the 457 Plan and Defined Contribution Plan have surpluses so fees will be reduced for participants.

CONSULTANT REPORT

RV Kuhns & Associates

Mr. Mark Higgins and Mr. Jim Voytko presented an overview of the Investment Performance. Mr. Voytko presented four major themes of the big picture:

1. The outlooks for returns are somber for all of the reasons mentioned during the overview of the summary of the Carlsbad 2012 Market Makers Conference attended by Executive Director Ewer and Board Members Turcotte and Satre.
2. Central banks are forcing investors to make a choice between earning very low real returns and taking more risk. This means investors are tending to push into riskier investments out of desperation for returns.
3. The return for the last 3 fiscal years has exceeded actuarial benchmarks which will provide a tailwind to the funded ratios of most public plans.
4. Over the last 5-7 years the work of the Board is steady and there has been substantial improvement. Most asset classes exceeded the actuarial benchmarks

With cyclical PE ratios and stocks being expensive, riskier investments are being pushed, but restrained expectations are wise. There is the expectation that the Feds will come to the rescue, but as more stimulus is applied, the economic effect is diminished and benefits becomes more short-lived.

Mr. Voytko reviewed the comparative performance of retirement plans over three years. PERS at 12.08% is way above the actuarial benchmark, however is lagging compared to the actual allocation benchmark of 13.27%. The effect of active management has been negative. The underperformance vs. benchmark is due partly to the asset benchmarks being used, in particular the private equity benchmark which is more challenging than most for this asset class. Performance vs. peers is positive, and has improved over time. Asset allocation across peer groups varies widely though, so can be misleading. Additionally, however, returns are also improving considering the amount of risk taken. It's worth noting, one bad year, such as 2008, can ruin returns over the long term. Mr. Higgins added BOI actually outperformed its pension benchmark in 2008.

Mr. Voytko detailed other positives: in comparing the three and five year time periods, plan return is above the median and better than peers, risk efficiency has improved, the standard deviation has declined slightly, leading to a higher Sharpe ratio, or higher return for the risk taken. Mr. Voytko supported the Board's plan to fine tune the MDEP and MTIP pools.

There was discussion of the fact that the performance for the Private Equity and Real Estate pools is inaccurate in the performance data received by the board, and that these returns are currently being revised by State Street. All pension return numbers are correct, however, and will not change when the corrections are made in the investment pools. The pool returns will go up to varying degrees when the pool level returns are corrected. Mr. Sheets noted the mistake was discovered internally by Chris Phillips, who discovered differences in plan level vs. pool level returns, and she subsequently directed SSB to investigate the matter. Mr. Sheets noted that State Street Bank missed some transactions that affected cash flows which were therefore not included in the return calculations. Revised numbers will be distributed as soon as the corrections are completed. State Street reportedly has made the required adjustments to the internal processes to avoid making similar mistakes in the future.

Executive Director Ewer inquired when the mistake was first flagged. Mr. Sheets stated one year ago there were slight differences noticed, but SSB could not track the cause at the time. Executive Director Ewer noted this is a big deal even though total fund performance was unaffected. Performance is difficult to calculate but is vital information. The problem was detected long ago but only recently was the cause discovered. Ms. Phillips is a CFA and offers a unique combination of accounting and financial acumen and her expertise is invaluable.

Mr. Sheets stated that the revisions will have a cumulative effect given the last five years of transaction activity within these pools. Private Equity, and to a lesser degree, Real Estate returns will be revised upward. The preliminary work shows that the one year return for Private Equity will go up from 9.99% to 11.05%. Even the 10 year numbers for Private Equity will be revised slightly upward.

Mr. Voytko noted accuracy of the book of record is important as R.V. Kuhns depends on the numbers for its analysis and it could affect decisions when evaluating the performance of the team. Member Bugni suggested staff follow up with the Audit Committee. Executive Director Ewer explained the reason the discrepancies only showed up on Private Equity and Real Estate is due to distributions of realized gains; and confirmed the Audit Committee will follow up.

Mr. Higgins continued reviewing return data. The shift to more passive management should help; active management has been a drag on returns for the Domestic Equity Pool and for the International Equity Pool, though some of the managers who contributed to poor returns have been terminated already. Regarding RFBP and TFBP, Mr. Higgins praised staff on internal management and good choices of external managers which have contributed to positive returns. STIP returns continue to be paltry with a .30% return for the past year; however, this is attributable to the low rate environment supported by the Federal Reserve. The Real Estate Pool has done well for this calendar year and the Private Equity Pool has been a great asset although recovery for PE always lags the rest of the market.

Chairman Buchanan requested that seven year numbers be included in the performance report; Mr. Higgins responded R.V. Kuhns will include them.

Mr. Higgins advised the structural changes to MDEP and MTIP will make it more difficult to significantly underperform given an increase in the passive focus.

Responding to a question by Member Satre, Mr. Voytko stated composite peer groups are more meaningful when doing comparisons. Public funds over \$3 billion are included but still vary quite a bit, as an example, one fund had no bond investments until recently.

Mr. Sheets added that the different public fund universes are murky at best, as they all are different and none have transparency. State Street Bank has their own public universe which

we also show; the NASIO data base is available for viewing asset allocation but reporting lags. Viewing the different universes over time and triangulating is valuable.

Mr. Higgins reported with the Domestic Equity Pool repositioned at 65% passive, the underperformers are on their way out. The Analytic Investors 130/30 strategy is still trailing although they have improved in the last year. TimesSquare Capital Mgt. has improved and was recently removed from the watch list. For the International Equity Pool watch list, Alliance Bernstein has underperformed, and Martin Currie is a concern due to a regulatory issue that resulted in a \$14 million fine; they have complied and since stabilized. And Hansberger Global Investors, a growth strategy, continues to underperform.

Mr. Higgins reviewed the RFPB and TFBP; there is one manager of concern, Post, a high yield manager.

With respect to fixed income Member Bugni suggested a review and possible change in benchmark may be in order. Mr. Higgins said it would be looked at in November, as that is when the fixed income asset class review is scheduled.

INVESTMENT ACTIVITIES/REPORTS

Retirement System Asset Allocation Report

Mr. Sheets presented the Retirement System Asset Allocation Report for the fiscal year ended June 30, 2012. There is a slight decline in assets, although all assets realized positive gains except MTIP which was -15% for the year. Fixed Income was strong at over 8%; Private Equity and Real Estate were over 11%. Overall assets declined 2.4% due mostly to larger fund benefit payouts, a liquidity drain of approximately \$45 million each month, resulting in a net decline in assets. The Private Equity allocation increased 0.8%, to represent about 13% of total plan assets due to good performance. Even with the sale of \$44 million from MPEP a net gain was realized due to strong returns. In total, equities were down from 67.3% to 66.1% over the year.

In Fixed Income, RFBP had \$60 million in sales for the year which was offset by strong performance. Cash remains low at about 1% during the year. The aim has been to keep cash to a minimum due to low returns.

Comparison to State Street Public Fund Universe

Mr. Sheets began by reviewing asset allocation to the State Street public fund universe. Our public stock allocation is very close to the median weight. Allocation to Real Estate is high when shown vs. the State Street universe though looks more average when compared to a broader state-wide plan composite. The Private Equity allocation is above average at about the 25th percentile. Mr. Sheets then reviewed the return comparison to the universe. Performance is positive vs. peers over one year, as BOI is ranked third overall. BOI held less in international stocks and has more domestic equities vs. many of the bigger plans which accounts in part for outperforming our peers. Looking at the big picture the tendency is for a more worldly view of diversification, but that carries other risks such as currency risk. Historically the BOI public equity allocation has been two to one domestic vs. international.

Fixed Income

Mr. Nathan Sax presented the Fixed Income overview. As of June 30, Fixed Income is down 150 basis points. Continued troubles with the Euro caused a flight to safety. Of the 8.9 million jobs lost in 2008 only half of those have been recovered. Slow job creation, coupled with the slow housing recovery, have affected the market. With fear in the market the quest for income and quality continues.

Fixed Income External Manager Watch List

Mr. Sax presented the manager watch list. Post Advisors remain on the list. While performance rebounded nicely in the first quarter, second quarter returns, although respectable, still lagged. Staff recommendation is to keep them on the watch list until sufficient time has passed with continued improvement.

| Manager | Strategy | Reason | Amount Invested (\$ millions) | Inclusion Date |
|----------------|-------------------|---------------|--|-----------------------|
| Post Advisors | Public High Yield | Performance | \$57 RFBP \$102 TFIP | February, 2012 |

Short Term Investment Pool, State Fund Insurance and Treasurer's Fund Report

Mr. Richard Cooley reported low rates continue although concern over banks in Europe has quieted down. The fund is well diversified and is operating within guidelines. Daily liquidity is at a minimum of \$150 million and weekly minimum is \$250 million. There is a shortage of asset backed commercial paper as a lot of sponsors have rolled them into their own balance sheets. So the trend of commercial paper drying up continues. STIP fund size remains at \$2.3 to \$2.4 billion, just slightly down from last quarter. Daily net yield remains low at just 0.32%.

The Treasurer's Fund total at June 30, 2012 totaled \$1.1 billion; current securities holdings are at \$34 million. The June General Fund balance is \$445 million.

State Fund Insurance portfolio remains underweight in Treasuries and the portfolio has a slightly shorter duration than the benchmark. In the last quarter \$13 million in asset backed securities were added. The total Fixed Income portion of the account outperformed the benchmark by 41 basis points for the quarter ending June 30 and outperformed by 90 basis points over the past year.

Private Asset Pool Reviews

Private Equity (MPEP)

Mr. Ethan Hurley reported the private equity portfolio performed well for the quarter ended March 31, 2012. Exposure remains broadly diversified by manager. Distributions continued to eclipse capital calls during the quarter resulting in net positive cash flow. He then reviewed the standard exhibits included in the private equity report.

Chairman Buchanan asked about the option of asking our fund-of-funds for their underlying fund costs, the question that was raised when discussing the CEM Report.

Mr. Hurley remarked that we could request the information of the managers. Staff is researching how BOI can get the needed exposure in direct ways without using fund of funds. All asset classes have costs to keep us fully exposed; going direct is a good option but we need to have the required information. Our strategy is to reduce the use of fund-of-funds where feasible over the long term, therefore reducing the associated costs.

Mr. Hurley reported three new commitments were added. The Tenex Capital Partners commitment was via a secondary purchase from another LP who had over-committed to the fund. We committed \$20 million towards this buyout/operational turnaround strategy. Dover Street VIII is a fund which focuses on buying secondary interests to which we committed \$10 million. A commitment of \$15 million was made to Catalyst Fund Limited Partnership, IV, LP, which is a fund that focuses on distressed-for-control investments in the Canadian debt markets.

| Fund Name | Vintage | Subclass | Sector | Amount | Date |
|--|----------------|---------------------------------|---------------|---------------|-------------|
| Tenex Capital Partners SG, LP – Secondary Interest | 2011 | Buyout – Operational Turnaround | Diverse | \$20M | 6/30/12 |
| The Catalyst Fund Limited Partnership IV, LP | 2012 | Distressed Debt for Control | Diverse | \$15M | 6/30/12 |
| Dover Street VIII, LP | 2012 | Secondaries | Diverse | \$10M | 6/12/12 |

Real Estate (MTRP)

Mr. Ethan Hurley presented an overview of the real estate reports for the quarter ending March 31, 2012. The real estate pool is still experiencing net negative cash flows, due in part to large draw downs from Molpus and other recent commitments while distributions remain subdued. Our exposure remains diversified across the risk spectrum. Mr. Hurley will attend a timberland conference in Oregon next month, giving him additional exposure to a new asset class within the pool. Real Estate returns continue to plug along and were the best performing asset class for us during the fiscal year.

Three new commitments were made since the last Board meeting with the ABR commitment representing an addition to a prior \$17 million commitment to the same fund:

| Fund Name | Vintage | Subclass | Property Type | Amount | Date |
|----------------------------|----------------|-----------------|----------------------|---------------|-------------|
| Stockbridge Value Fund, LP | 2011 | Value – Add | Diverse | \$25M | 6/15/12 |
| ABR Chesapeake Fund IV, LP | 2011 | Value – Add | Diverse | \$13M | 6/30/12 |
| ORM Timber Fund III, LLC | 2012 | Timberland | Pacific Northwest | \$30M | 7/31/12 |

Partnership Focus List

There were no changes to the MPEP Focus list, and one change to the MTRP Partnership Focus List since the May 2012 Board Meeting. Responding to a question from Member Prothero, Mr. Hurley confirmed Beacon Capital Strategic Partners has been added to the watch list. While the manager has done a good job of trying to preserve value, suffering from the impact the recession has had on office properties, the fund is not expected to recover our cost.

Investment Consultant RFP

Investment Consultant RFP – Executive Director David Ewer and Brad Sanders, Procurement Bureau

By consensus of the Board, Public Asset Pool Review was moved to follow the Investment Consultant RFP discussion.

Executive Director Ewer stated there were six respondents to the RFP for consulting services which was issued on June 25 and closed on July 23, 2012:

- NEPC, LLC, Cambridge, MA
- Pension Consulting Alliance, Inc., Portland, OR
- R.V. Kuhns & Associates, Inc., Portland, OR
- Strategic Investment Solutions, Inc., San Francisco, CA
- Summit Strategies Group, St. Louis, MO
- Wilshire Associates, Inc., Santa Monica, CA

One applicant, Wilshire Associates, Inc., was disqualified for not meeting the requirements set out in the RFP. Wilshire also is a money manager which is expressly prohibited in the terms of the RFP.

Executive Director Ewer, Deputy Director Geri Burton and Chief Investment Officer Cliff Sheets will meet tomorrow, August 23, 2012, to jointly score the remaining applicants. Brad Sanders from the Procurement Bureau will also attend the meeting.

The Investment Consultant Committee will meet on Thursday, September 6, 2012 to hear staff recommendations and determine which applicants will be brought before the full Board for interview presentations. Of the total possible earned points of 1000, 250 are determined at the interview process. Fee scores are worth 200 points and the remaining 550 points will be scored at the staff meeting occurring tomorrow.

Member Noennig asked Mr. Sanders if the high scorer is awarded the contract. Mr. Sanders confirmed, yes, the high scorer is awarded the contract.

Mr. Sanders gave an overview of the RFP scoring process. The three staff members have each independently reviewed the five application packets submitted and have scored the applicants for each scoring section. At the meeting, which is a public meeting and has been noticed to the public, staff will go through the process of consensus scoring. The consensus scoring process works well as all staff participants have input and after discussion, they come to a consensus score for each participant for each scored section. Staff from the Procurement Bureau will also attend the meeting. Staff will present the results of the scoring process to the Investment Consultant Committee at the September 6, 2012 committee meeting.

Executive Director Ewer advised the Investment Consultant Committee can accept the staff scoring and decide how many finalists to bring in before the full Board for the presentation/interviews.

Member Noennig asked if the Committee has the option of rejecting staff scoring and starting the RFP process again from scratch. Mr. Sanders stated that was an option and there is no time limit, therefore reposting of the RFP could happen immediately.

PERS/TRS Relationship – Board Member Jim Turcotte

Member Turcotte had an addition to the earlier report. TRS is working on bills for the upcoming legislature. Actuarial changes in assumptions will be done in the off year.

Public Asset Pool Reviews

Domestic Equity (MDEP)

Mr. Rande Muffick reported on the Montana Domestic Equity Pool as of June 30, 2012. The changes in MDEP implemented at the May Board meeting have been completed. Alliance Bernstein small cap was a good addition back in April. He noted that growth stocks have outperformed value stocks for 2012 year-to-date. In discussing the transition done in June pursuant to the restructuring decision, four managers were reduced and four were terminated. A total of \$865 million of large cap active exposure was moved to large cap passive. The market moved against us during the day of transition increasing the cost to 19.6 basis points; however BlackRock did a good job trading to mitigate the market impact.

International Equity (MTIP)

Mr. Muffick presented the Montana International Equity Pool Report for the period ending June 30, 2012 and reviewed market trends during the quarter. MTIP is down about 15% this fiscal year.

[Return to Agenda](#)

Investment Consultant

Public Equity External Manager Watch List

The watch list has dwindled down to two managers. Columbus Circle was terminated as part of the MDEP restructuring. Alliance Bernstein, an international value manager, is a new addition due to performance concerns with their deep value strategy. Times Square was removed from the watch list as they've had four consecutive outperforming quarters. Martin Currie had an issue with regulators which has settled down, though remains on the list for now.

PUBLIC EQUITIES MANAGER WATCH LIST

August 2012

| Manager | Style Bucket | Reason | \$ Invested (mil) | Inclusion Date |
|--------------------|---------------------------|----------------------------|--------------------------|-----------------------|
| Martin Currie | International – LC Growth | Performance, Risk Controls | \$95 | February 2009 |
| Alliance Bernstein | International – LC Value | Performance | \$88 | August 2012 |

To Do List

Chairman Buchanan called for items to add to the to do list. The Investment Consultant Committee will meet starting at 9:00 AM, Thursday, September 6, 2012. The meeting could last all day. The October 4th Board Meeting will be a one day meeting and will include the interviews/presentations of the RFP finalists. The regular Board meeting will begin in the afternoon after the interviews. Executive Director Ewer added R.V. Kuhns will add seven year numbers to their reporting; the Audit Committee will further review the performance calculation process at State Street Bank which allowed the error in certain pool performance numbers; the Human Resource Committee will be reviewing the policy on exempt positions; and Mr. Ethan Hurley will inquire regarding underlying fee costs from the fund-of-funds managers.

ADJOURNMENT

There being no further business, Chairman Buchanan adjourned the meeting at 12:25 PM.

Next Meeting

The next regular meeting of the Board will be Thursday, October 4, 2012 in Helena, Montana.

Complete copies of all reports presented to the Board are on file with the Board of Investments.

BOARD OF INVESTMENTS

APPROVE: _____
Gary Buchanan, Chairman

ATTEST: _____
David Ewer, Executive Director

DATE: _____

MBOI:drc
9/21/12

| Investment Consulting Services Interviews | | |
|--|------------|---|
| Thursday, October 4, 2012 | | |
| Interview #1 | | |
| NEPC, LLC | | |
| 8:40 a.m. | 5 minutes | Introduction |
| 8:45 a.m. | 20 minutes | Standard & Customized Questions (sent in advance) |
| 9:05 a.m. | 45 minutes | Open Questions & Answers |
| 9:50 a.m. | | Conclude |
| | 70 minutes | |
| Interview #2 | | |
| R.V. Kuhns, Inc. | | |
| 10:05 a.m. | 5 minutes | Introduction |
| 10:10 a.m. | 20 minutes | Standard & Customized Questions (sent in advance) |
| 10:30 a.m. | 45 minutes | Open Questions & Answers |
| 11:15 a.m. | | Conclude |
| | 70 minutes | |
| All above times are Mountain Standard Time. | | |

6.3 STEP TWO EVALUATION CRITERIA

Based on a **maximum possible value of 250 points** for **Part Two**, the finalists will be required to participate in an in-person presentation/oral interview before either the evaluation committee or the full Board at a public meeting. The presentation will be an opportunity for the finalists to further define their offer based on the topics of Section 4.2.2, Resumes/Company Profile and Experience and Section 4.2.4, Method of Providing Services. Audio-visual presentation aids will be allowed. The oral interview will be an opportunity for the evaluation committee and/or Board Members to ask questions of the finalists to allow further elucidation on these topics. The presentation/oral interview will be evaluated based on the criteria set forth below. One of the individuals participating in the Step Two presentation/oral interview must be the person designated in the proposal as the project manager.

| Presentation/Oral Interview | | 25.0% of points for a possible 250 |
|------------------------------------|---|---|
| Category | | Point Value |
| A. | Thoroughness of the presentation | 100 |
| B. | Ability to articulate the offeror's capabilities | 75 |
| C. | Ability to address evaluation committee questions | 75 |

[Return to Meeting Agenda](#)

Private Equity & Real Estate



Overview of Private Equity and Real Estate Pools

Cliff Sheets, CFA
Chief Investment Officer

Ethan Hurley
Portfolio Manager

Dan Zarling, CFA
Director of Research

Table of Contents

- What We Have
 - Characteristics
 - Objectives and Results
- Strategic Priorities and Rationale
- 2012 – Year in Review
- Liquidity
- Implementation
- Private Equity and Real Estate Fund Commitment Pacing
- Investment Policy Statements

What We Have



Private Equity - Attributes

- Economic value-add
 - Based on underlying company fundamentals (revenue, EBITDA growth)
 - Business basics
 - Professionalization of management and reporting systems
 - Augment sales and marketing
 - New products, new markets
 - Upgrade corporate governance
 - Establish a Board of Directors
 - M&A function
 - Manufacturing efficiency gains
 - Financing strategies
 - Business rationalization
 - Reduce headcount
 - Exit non-core, unprofitable markets/products
 - Balance sheet restructuring
 - Multiple expansion – buy low, sell high
 - Debt funds – capital structure-focused
 - Debt-to-equity conversion for influence/control

Private Equity - Attributes

- Risks

- Financial – “leverage”
- Operating, execution
- Valuation
- Structure, liquidity
- Country, Manager, Strategy
- Vintage year
- Technology
- Industry

- Costs

- Higher than traditional asset types; strategy dependent, high-end is generally 2% management fee and 20% carry (i.e., profit participation)
- However, CEM Benchmarking survey results show MBOI average management fee of 1.29% for our direct fund commitments vs. peers at 1.65%
- Majority of our managers have a minimum return hurdle (e.g., 8%)
 - Must return our fees, expenses and capital plus meet minimum before profit participation

Private Equity - Attributes

- **Program Structure** (% of holdings)
 - **Venture Capital (22.6%)**
 - Typical IT related company investments, early-stage, pre-revenue
 - **Buyout - Broadly (66.1%)**
 - Growth capital to smaller, growing companies, lower leverage, often minority ownership
 - Investments in larger, more established companies, higher leverage, control
 - Leverage a key component of a company's capital structure, value creation
 - Special Situations – Energy-focused funds
 - **Distressed (9.7%)**
 - Financial – companies with poorly organized capital structures
 - Operational – need for operational restructuring
 - Includes trading strategies or those focused on significant influence and control positions
 - **Mezzanine (1.6%)**
 - Subordinated debt investments senior to equity and junior to senior debt
 - Investments targeted at financing acquisitions, recapitalizations, financing growth
- **Relationships**
 - **Key relationships**
 - Largest exposures, multiple funds, those that have performed
 - Future consideration
 - **Legacy relationships**
 - Organizational/structural issues, those that have not performed
 - Mega/large buyouts, generally
 - Will not make future commitments

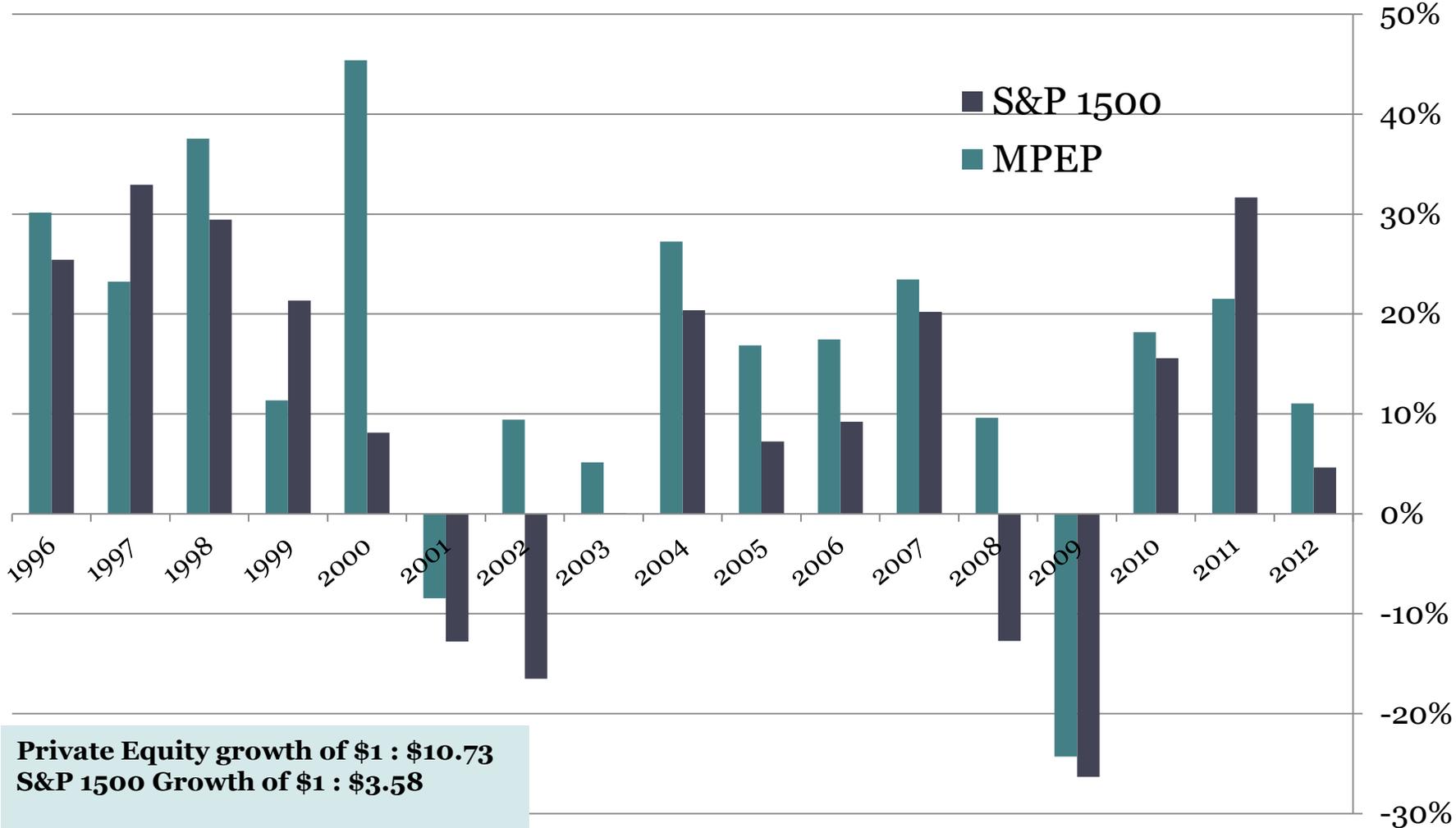
Private Equity - Objectives and Results

- Objectives
 - High returns
 - Diversification vs. public equities
 - Access to unique strategies not otherwise available (e.g., distressed debt)

- Return Results
 - Returns have been high over time; much higher than public equities
 - Volatility of actual returns not as high as assumed (FY96 – FY12)
 - Actual standard deviation of annual returns, PE 13.02% vs. S&P 1500 18.14%
 - Correlation coefficient < 1.0 , so some diversification benefit
 - Actual correlation of returns, PE vs. S&P 1500 = .74

MPEP vs. S&P 1500

FY1996 - FY2012 (17 years)



Real Estate - Attributes

- **Economic value-add**
 - Based on underlying property fundamentals (occupancy, net operating income)
 - Real Estate basics
 - Entitlements
 - Permitting raw land for specific commercial real estate development purposes
 - Ground-up development
 - Property management
 - Marketing and leasing
 - Asset management (CAPEX related decisions)
 - Efficiency upgrades to lower operating expenses
 - Repositioning a “tired” asset
 - Financing strategies
 - Encumbered vs. unencumbered debt
 - Cap rate compression – buy high, sell low
 - Discount rate applied to net operating income to determine market value

Real Estate - Attributes

- Risks

- Financial – “leverage”
- Operating, execution
- Valuation
- Structure, liquidity
- Country, Manager, Strategy
- Vintage year
- Property type, geographic

- Costs

- Higher than traditional asset types; strategy dependent
- Core funds ~100bps management fee annually with no profit participation
- Non-core generally 1.5% management fee and 20% carry (i.e., profit participation), some have higher fees
- CEM Benchmarking survey results show MBOI average management fee of 1.07% for our direct, non-core fund commitments vs. 1.03% peer median
- All of our non-core managers have a minimum return hurdle (e.g., 9%)
 - Must return our fees, expenses and capital plus meet minimum before profit participation

Real Estate - Attributes

- **Program Structure** (% of holdings)
 - **Core**
 - **Open-end funds (42.3%)**
 - Access to existing, substantially leased, diversified portfolio of assets
 - Potential for increased liquidity
 - Lower leverage
 - **Timberland (5.8%)**
 - Raw land with harvestable, merchantable timber, or intended for such use
 - Ancillary revenues generated through the sale of conservation easements, recreational leases, Higher and Better Use Sales
 - **Non-Core**
 - **Value-add (30.7%)**
 - Assets requiring rehab, redevelopment, lease-up or repositioning
 - Higher leverage
 - **Opportunistic (21.2%)**
 - May include investments in non-traditional real estate, for example, operating companies
 - Highest leverage
- **Relationships**
 - **Key relationships**
 - Largest exposures, multiple funds, those that have performed
 - Future consideration
 - **Legacy relationships**
 - Organizational/structural issues, those that have not performed
 - Will not make future commitments

Real Estate - Objectives and Results

- Objectives

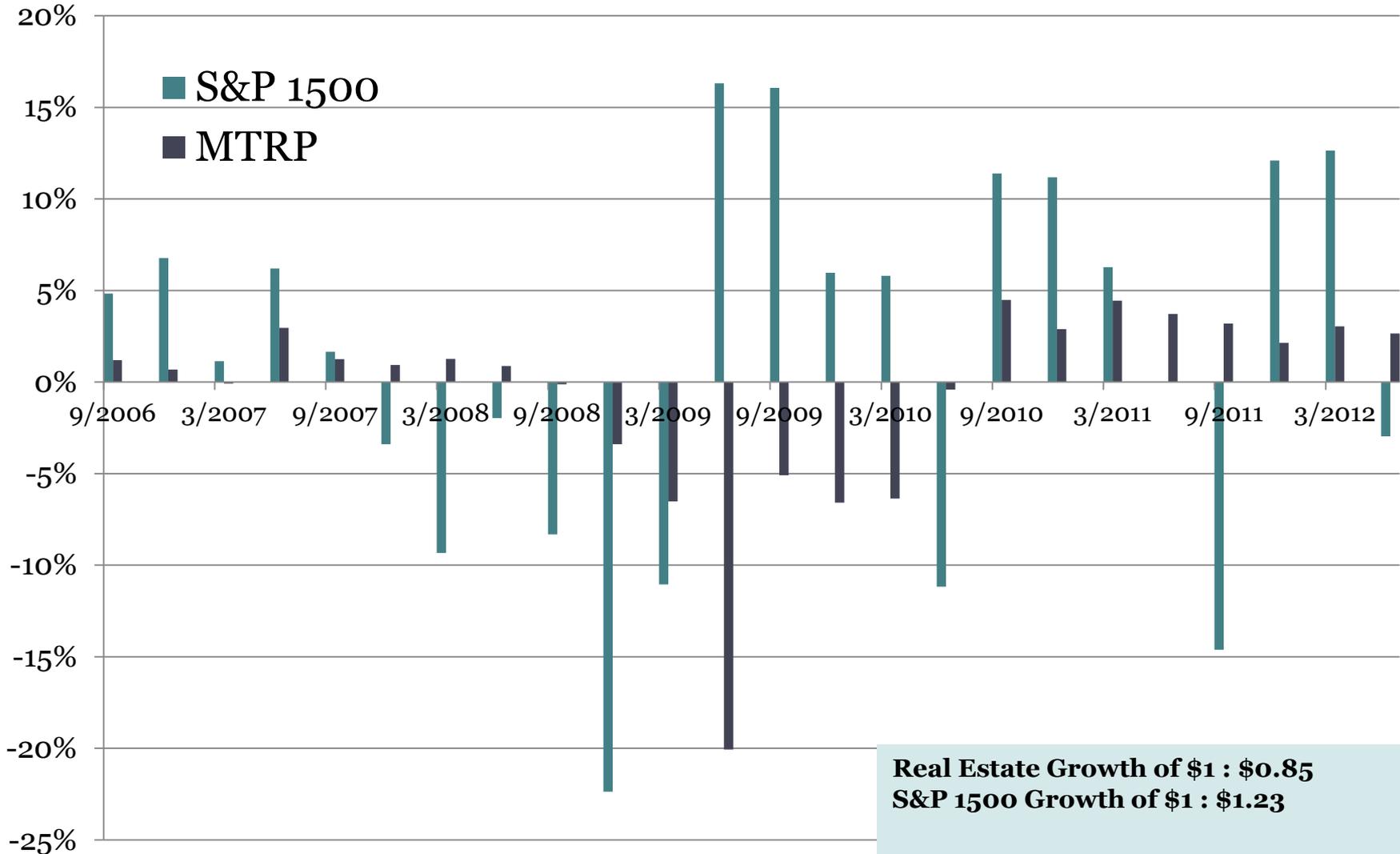
- Diversification vs. traditional assets (stocks & bonds)
- Long-term returns competitive vs. actuarial return needs

- Return Results

- Our actual returns since inception in '06 have been weak due to market conditions
 - Initial investments near peak of market, and “J-curve” effect
 - Signs of improvement last 2 years
- Volatility of actual returns low (FY07 – FY12)
 - Actual standard deviation of returns: RE 10.80% vs. S&P 1500 20.43%
- Correlation coefficient near zero, so significant diversification benefit
 - Actual correlation of quarterly returns: RE vs. S&P 1500 = (.14) (assumed = 0.24-.29)

MTRP vs. S&P 1500

FY2007 - FY2012 (6 years, quarterly data)

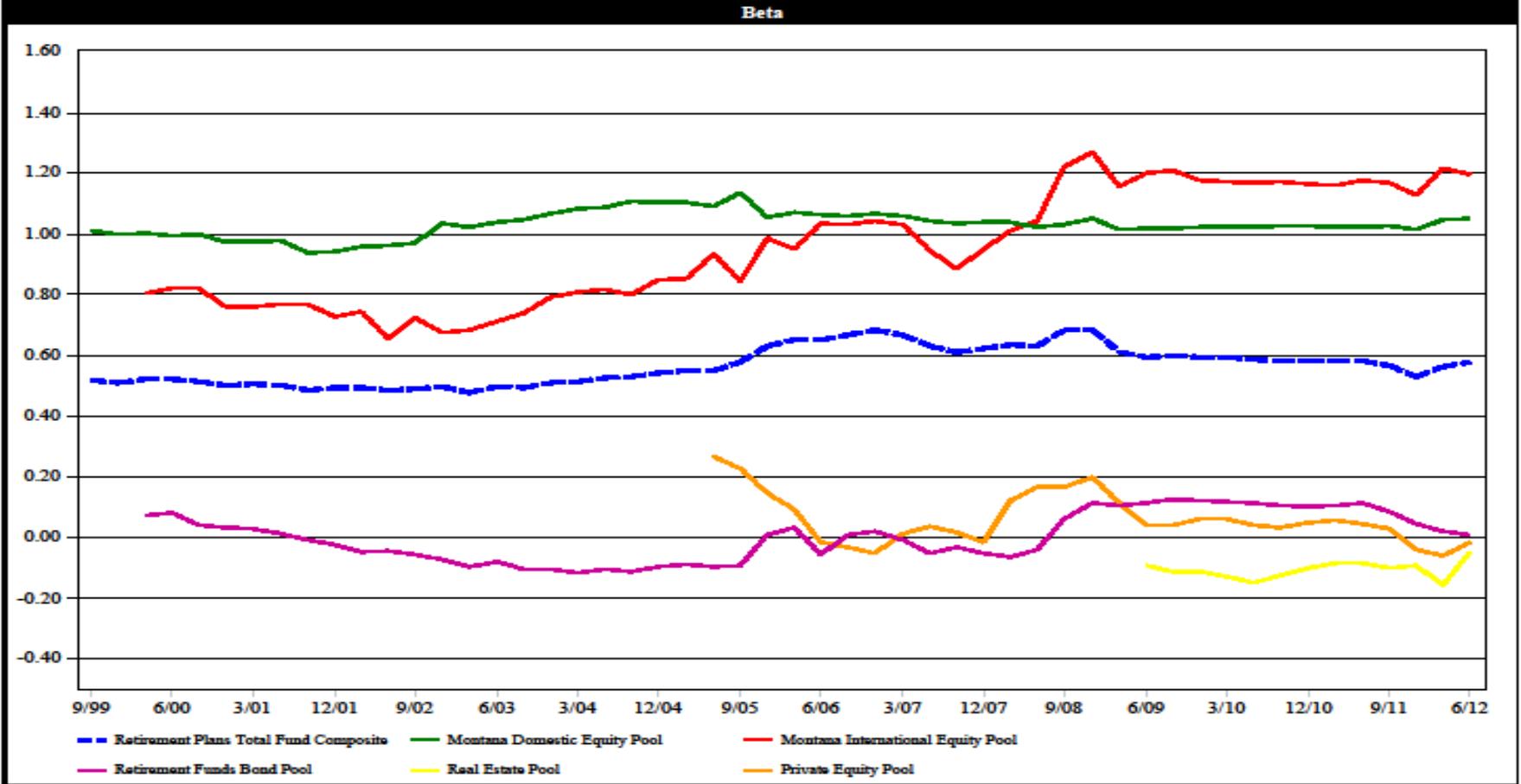


Objectives & Results - Summary

- Private Equity
 - Long-term program
 - Excellent results
 - Experience suggests less risk than assumed
- Real Estate
 - Relatively new program for MBOI, with long-term promise
 - Yet to fulfill absolute return expectations since inception, but moving in the right direction
- Both offer diversification vs. public equity beta (systematic risk), our single largest risk

MBOI Investment Pools - Beta vs. S&P 500

Montana State Board of Investment
 Versus. S&P 500 Index (Cap Wtd)
 36 Months Rolling Periods As of June 30, 2012



The objective of the Total Fund Beta is to measure the aggregate level of non-diversifiable or systematic equity risk exposure of the Montana Retirement Plans. The Total Fund Beta is calculated using the S&P 500 as the benchmark and is based on monthly periodicity. It represents a measure of the sensitivity of the total fund to movements of the S&P 500 over the preceding three year period.

Strategic Priorities and Rationale



MPEP- Strategy and Rationale

What

- Begin to move the program toward smaller market cap strategies
- Be selective with large/mega cap re-ups
- Maintain some venture exposure; selective fund-of-fund re-ups; make targeted direct commitments
- Maintain secondaries exposure; be selective with re-ups

Why

- More value creation levers, alignment of interest, lower leverage/entry multiples
- Fewer value creation levers. Do not totally disregard but focus on our key relationships, best managers
- Focus on the right access, long-term return profile
- J-curve mitigation considerations

MPEP- Strategy and Rationale (cont'd)

What

- Monitor Europe, consider non-control oriented debt strategies
- Target US lower-middle market debt-for-control
- Look for a diversified global emerging market manager
- Sector-focused funds – focus on energy
- Deemphasize fund-of-funds generally in favor of direct fund commitments

Why

- Significant distress, cyclical, slow to unfold
- Limited capital solutions, no access to high yield
- Growth story, augment pool exposure
- Barbell approach; stable income-oriented strategies balanced with higher risk E&P strategies
- If comparable to a fund-of-funds, a direct strategy should outperform due to a reduced fee burden

MTRP- Strategy and Rationale

What

- Focus on augmenting our timberland exposure
- Add to our value-add exposure with a focus on traditional “bricks-and-sticks” value creation strategies employed by those managers focusing on the four major property types (office, retail, industrial and multifamily)
- Deemphasize the more eclectic strategies in CMBS, debt origination and other public security-related strategies

Why

- Proxy for core, behavior relative to inflation, diversification, potential recovery in housing
- Significant market opportunity persists within the US real estate market post Global Financial Crisis
 - Lagging “risk asset”
 - Many “distressed” properties: good RE but poor capital structures that need to be fixed outside banking system
- Prefer more direct exposure to real estate without the accompanying securities market-related noise

MPEP and MTRP - 2012 Year in Review

- **MPEP Commitments**

- Total committed capital of \$210m
- 5 re-ups with current managers
 - Asia-focused FoF
 - Distressed credit manager
 - Venture capital-focused FoF
 - Secondaries manager
 - Co-investment manager
- 6 new managers added
 - Mid/late-stage direct venture capital manager
 - Emerging markets-focused manager
 - 2 operationally-oriented debt-for-control/turnaround managers
 - 2 lower middle market oriented managers

- **MTRP Commitments**

- Total committed capital of approximately \$138m
 - 2 re-ups with current value-add managers
 - 2 new managers added including 1 timberland commitment and 1 value-add commitment
 - Potential for 2 more new managers before year-end

MPEP and MTRP Liquidity

Liquidity - simple definition: “the ability to generate cash”

Two kinds:

- Transaction-based: ability to sell the asset (fund units)
 - By definition, generally illiquid (private contractual fund interests)
 - Limited to “open-end” core RE funds, under the right conditions/timing
 - Secondary sales of LP interests more problematic
- “Natural” liquidity: cash flow from the asset (income, profits, return of capital)
 - MPEP
 - Strong over last two years: cash flow **positive** (not typical, but reflects maturity of program and market conditions)
 - YTD through August - \$139M in distributions vs. \$104M in capital calls
 - CY 2011 - \$230M in distributions vs. \$157M in capital calls
 - MTRP
 - Distributions remain low: maturity of program; market still in recovery mode
 - Cash flow negative YTD through August - \$13M in distributions vs. \$57M in capital calls
 - CY 2011 - \$17M in distributions vs. \$59M in capital calls

Implementation



How We Implement MPEP and MTRP

- Deal sourcing
 - Other limited partners, general partners, intermediaries, periodicals
 - Filter the “noise” (does it fit with current strategy?)
- Due diligence and investment underwriting
 - Checklists to ensure the process is repeatable and disciplined

How We Implement MPEP and MTRP

- MBOI Due Diligence Checklist includes a review of:
 - **Standard Documents**
 - Private Placement Memorandum
 - Due Diligence Questionnaire
 - Limited Partnership Agreement
 - GP's Valuation Policy
 - Form ADV Part II
 - Quarterly and Annual reports and financial statements
 - **Other Documents**
 - Investment memos, fund advisory board minutes, investment term sheets, quarterly partners meeting materials
 - Industry studies, investor rights agreements, stock purchase agreements, opinions of counsel, certificates of incorporation, voter's rights agreements
 - Company specific diligence request list, financial diligence questions list

How We Implement MPEP and MTRP

- MBOI Due Diligence Checklist (cont'd):
 - Placement Agent Disclosure
 - On list and off list reference checks
 - Search and review recent publicly available news
 - Review all transactions of GP's prior funds; GP's cash distribution policy
 - Review GP's practices regarding fees, financing strategies
 - Understand circumstances around past secondary transactions in GP's prior funds
 - Review potential threats that may jeopardize the "going-concern" nature of the GP
 - Check that adequate insurance policies are in-place to further indemnify and limit an LP's liability
 - Document all interactions with the GP throughout the process

How We Implement MPEP and MTRP

- Ongoing monitoring
 - Full quarterly review of all funds
 - Attend annual meetings, selectively
 - LPAC membership participation, selectively
 - In-person, on-site updates by GP
- Resources employed
 - Internal Staff (“Alternatives Team”)
 - State Street Private Edge
 - Legal review – Luxan & Murfitt
 - Costs

Private Equity and Real Estate Fund Commitment Pacing

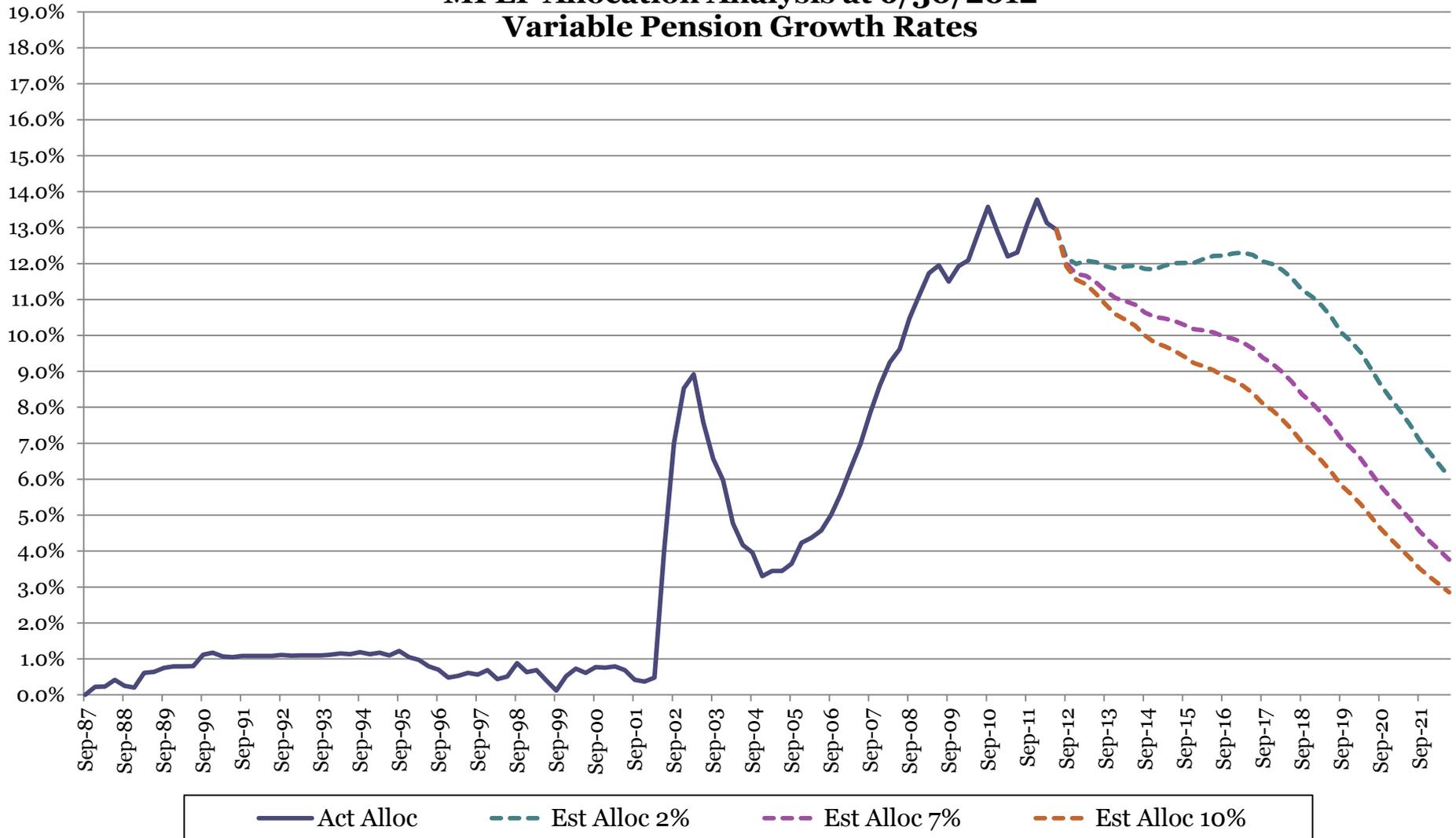


Pacing - Private Equity & Real Estate

- Purpose – General monitor of projected values and impact of weighting relative to pension assets
 - Scenario-based (pension growth and commitment levels)
 - Helps to address the impact of outstanding commitments and expected new commitments
 - Mix of art and science
 - Highly uncertain and highly subject to capital market conditions (real estate, M&A, public equities)
 - Denominator effect

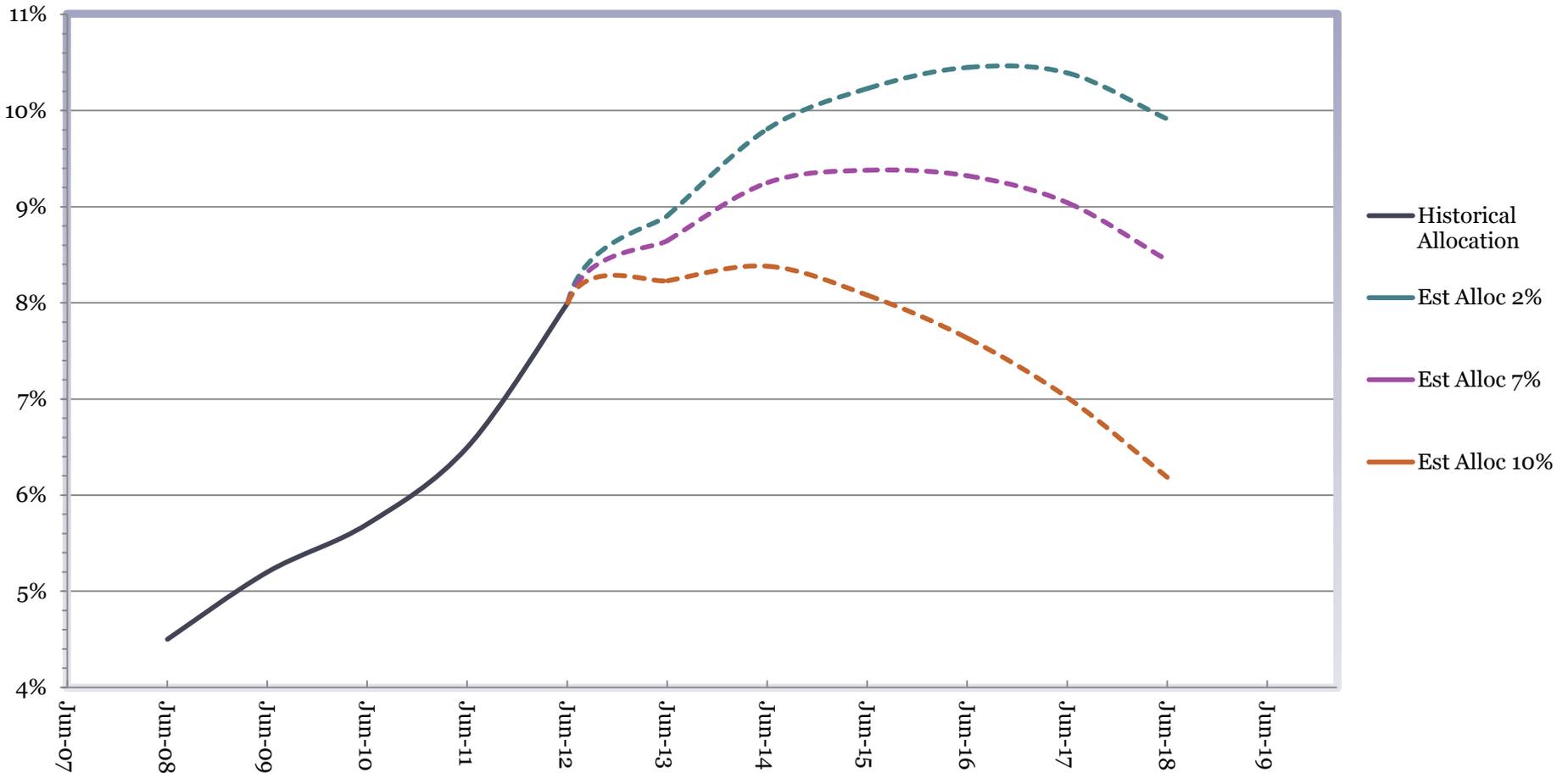
Private Equity Pacing

MPEP Allocation Analysis at 6/30/2012
Variable Pension Growth Rates

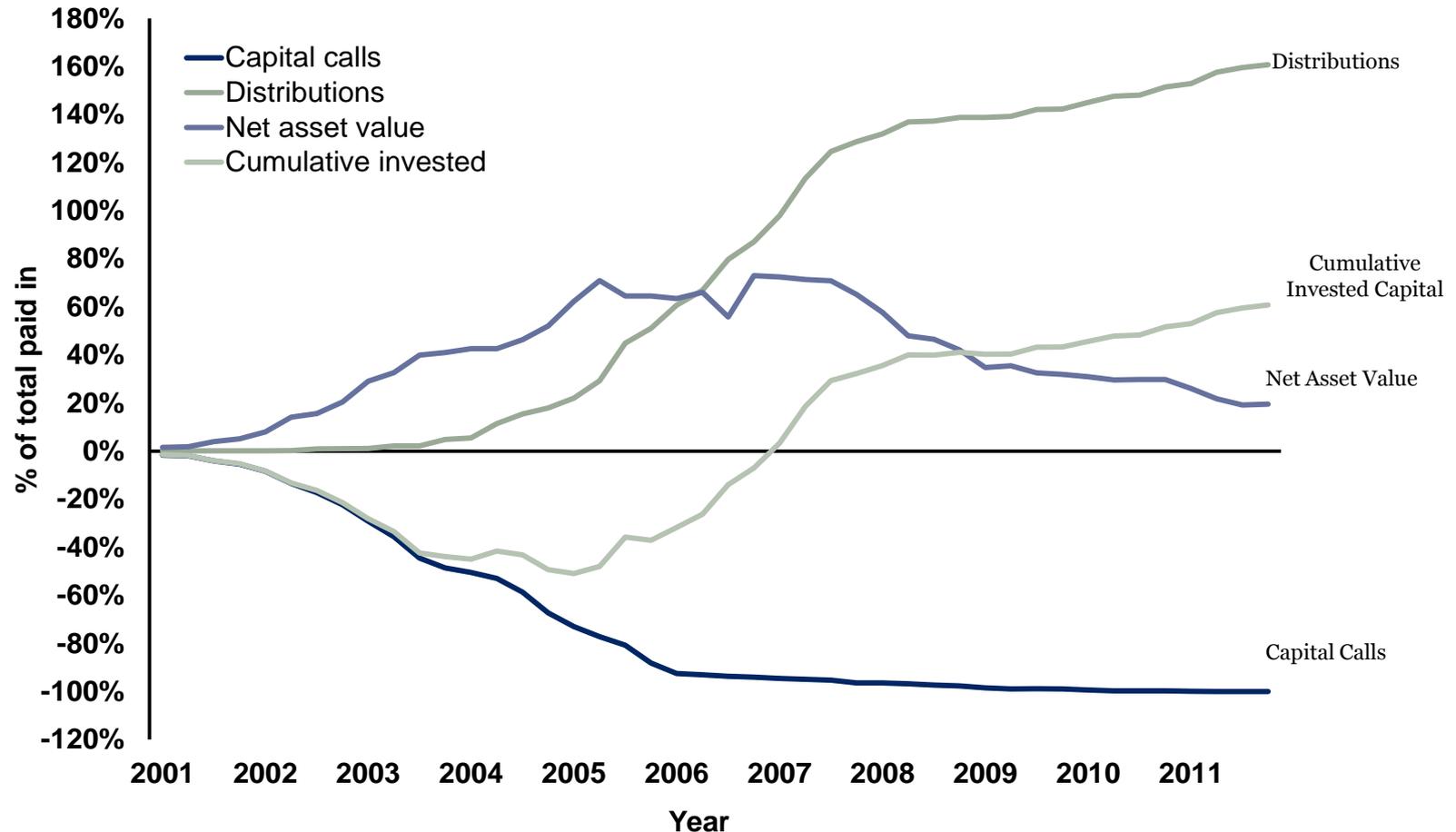


Real Estate Pacing

Real Estate Allocation Scenario Analysis Variable Pension Growth Rates



Pacing - Lifecycle of a Typical Fund



Data source: Thomson Reuters (cash flow summary report) as of 12/31/11

MPEP and MTRP Investment Policy Statements

- For 2013 – Staff to review and advise of any recommended changes

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Cash Management

MEMORANDUM

Montana Board of Investments

Department of Commerce

2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board

From: David Ewer, Executive Director
(With input from Rich Cooley, Gayle Moon and Paul Christofferson)

Date: October 4, 2012

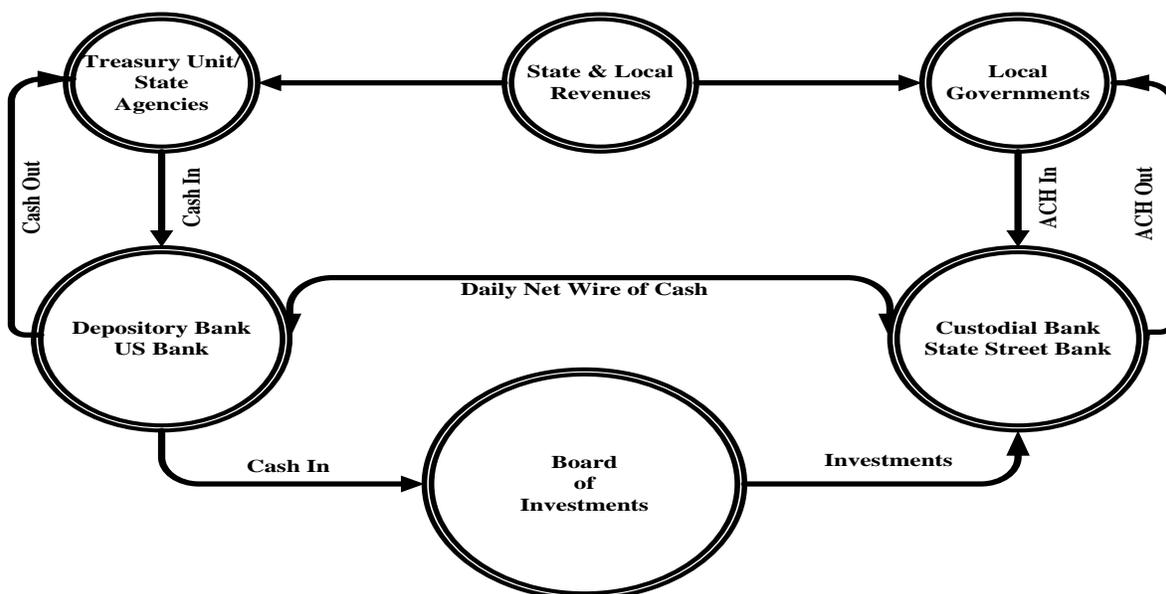
Subject: Cash Management of State Monies

Background

For forty years, the Board of Investments (the “Board”) has been responsible for administering the Unified Investment Program, which is constitutionally-mandated. With only a few exceptions, this program mandates that all state money, regardless of source or use, flows into or out of the Board of Investments. The yearly velocity is in the billions of dollars, the number of transactions is in the tens of thousands. The Board serves as a vital utility, but rather than delivering gas or electricity, the Board delivers cash for the entire campus of state government.

Along with the Board of Investments, there are three other key entities at the highest level that are responsible for the state’s cash movement: the Department of Administration’s Treasury Unit, the state’s depository bank, US Bank in Helena, and the state’s custodial bank, State Street Bank, in Boston.

The chart below shows the daily cash flow possibilities among the various entities:



Montana's State Treasurer, *ex officio*, is Janet Kelly, Director of the Department of Administration. The Department's State Accounting Division assists the Board of Investments in administering the treasury function and overall cash management. The Division Administrator annually prepares General Fund cash projections which estimate monthly cash availability and potential cash deficits possibly necessitating the State to issue Tax and Revenue Anticipation Notes (TRANS).

The Treasury Unit deposits the agency collections not deposited directly at US Bank, reconciles all bank accounts, provides a collateralization report on a monthly basis, reconciles all Electronic Funds Transfer, provides prior notification to the Board of Investments of large outgoing wires, and reports all payment and receipt activity to the Board. Additionally the Department works with US Bank on all payment and collection issues and works with the Board in establishing and maintaining all external depository bank accounts and reviewing and approving deposit exceptions as allowed under State law.

The Board's involvement with cash management is closely related to managing the STIP portfolio. In general, STIP provides the liquidity for all aspects of the cash management function, including the pension funds, various state agencies, the State's General Fund, and local governments choosing to participate in STIP.

Cash Flow Types Occurring Throughout the Year

- Inflows: Income from income and property taxes, oil and gas taxes, investment earnings and US government payments.
- Outflows: Vender payments, pension benefits, State of Montana payroll, FICA, school payments (OPI).
- Settlements: Security purchases, sales and maturities for STIP, TFIP, State Fund, MTRP and pool participant unit purchases and sales. These transactions are included in the State Street/US Bank daily net wire.

Daily Cash Flow Types to US Bank, the Depository Bank

- Deposits by the Department of Revenue and Treasury Unit
- ACH (Automated Clearing House) deposits/withdrawals
- Wires in/out including State Street Bank net wire
- Warrants cashed
- Sweep investment purchase at end of the day in excess of a \$3 million balance
- Sweep maturity from previous day

Appendix A

As a reference tool, Appendix A accompanying this memo includes specific Board policy, governance or orientation material directly relating to cash management and the general duties of the State Treasurer.

Senior Staff Involving Cash Management

While literally scores of state and private sector employees are part of the State's cash management, three state employees have principal responsibilities and will make brief presentations during the Board's October meeting relating to their respective areas.

Paul Christofferson, CPA, Division Administrator, State Accounting Division. Paul is responsible for the state's accounting, budget control and treasury functions. He is also responsible for the state's Comprehensive Annual Financial Report (CAFR). Paul will provide an overview of the state's characteristics of its cash flow, its biggest components as to in and out flow and the general stability (or instability) of these flows.

Richard Cooley, CFA, Portfolio Manager. Rich is the Board's principal staff person who oversees bulk cash movement to and from the depository bank, in Helena and the custodial bank, State Street Bank in Boston. Rich monitors and assures sufficient liquidity, and invests idle monies.

Gayle Moon, CPA, Financial Manager. Gayle is the principal overseer of specific cash movement from the 'customer' perspective, i.e., all the STIP customers, primarily state agencies, but many Montana local governments as well, who may use STIP. She is also responsible for accounting for the "bulk" cash transactions with respect to the STIP money pool; hers is a dual role.

Questions and Answers (Q and A)

In anticipation of some likely questions, Staff has compiled our responses in the following Q and A:

1. How does the state pay its bills?
Bills are paid through the Department of Administration by issuing checks (called 'warrants') drawn against funds at US Bank in Helena. The Board of Investments administers the daily movement of cash between US Bank (the 'Depository bank') and State Street Bank (the 'Custodial bank').
2. How does the state track, account, and invest or expend its monies?
State agencies remit the cash they collect to the state's Treasury Unit. Agencies must use SABHRS (Statewide Accounting Budgeting and Human Resource System) to track their cash and other funds. The Unified Investment Program mandates that the Board of Investments is in charge of where and how the money is invested. State agencies use the Treasurer's Fund or separate STIP accounts for holding their cash. The Treasurer's Fund has its own STIP account.
3. What is STIP? How big is it? Who governs it?
STIP is the Board's Short Term Investment Pool, which operates similarly to a money market fund. Its current size is \$2.4 billion. Its governance is entirely under the Board of Investments; however, state agencies that must revert earnings to the State's General Fund must use the Treasurer's Fund and may not have a separate STIP account.
4. How much available cash does STIP maintain?
STIP maintains \$150 million in daily liquidity and \$250 million weekly.
5. How many STIP customers are there?
As of June 2012 there were a total of 498 accounts: 329 state accounts and 169 local government accounts.
6. Can anyone use STIP?
No. State agencies must be authorized by law to have their own STIP account; otherwise they must use the Treasurer's Fund. Montana local governments may choose to invest in STIP.
7. What is the difference between the State's Depository bank and its Custodial bank? Who is responsible for hiring them?
The Depository bank, US Bank, assigns a bank account in the State of Montana's name. This account is used to deposit daily cash receipts and pay the State's warrants. The Department of Administration is responsible for hiring the Depository bank. The Custodial bank, as the name

implies, holds (has 'custody' of) the securities within the Board's seven investment pools and the All Other Funds investments. The Custodial bank provides an investment accounting system. The Custodial bank is hired by the Board of Investments and the Department of Administration.

8. How are these banks paid?

Both banks are paid by a permanent law (a 'statutory' appropriation) rather than the biennial appropriation process. Both vendor functions must be bid out under the State's procurement laws.

9. What safeguards are in place to protect the state's money?

a. Compartmentalization with separate functions between the Treasury Unit and the BOI. No single individual has the authority to direct the entire cash management.

b. User access and dollar limitations are controlled by US Bank's security module and Board internal control policies.

c. Daily reconciliation of STIP and Treasurer's cash.

d. There are numerous internal controls.

e. Audits are done annually.

Appendix A

Cash Management Authorization

From the Board's Governance Manual:

The Unified Investment Program - The Montana Constitution requires that the Legislature provide for a Unified Investment Program for public funds. Section 17-6-201, MCA, established the Unified Investment Program, created the Montana Board of Investments (the "Board") and gave the Board sole authority to invest state funds in accordance with state law and the state constitution. State law requires that the Board operate under the "prudent expert principle," defined as: 1) discharging its duties with the care, skill, prudence, and diligence 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; 2) diversifying the holdings of each fund to minimize the risk of loss and maximize the rate of return; and 3) discharging its duties solely in the interest of and for the beneficiaries of the funds managed.

Selection of Custodial Bank and Retainer Consultant – While this Governance Policy delegates general contracting authority to the Executive Director, the Board reserves the right and the authority to make the final selection of the Custodial Bank and the Retainer Consultant after which the Executive Director shall negotiate a contract.

From Montana Code Annotated:

17-6-101. Deposit of funds in hands of state treasurer. (1) Under the direction of the board of investments, the state treasurer shall deposit public money in the treasurer's possession and under the treasurer's control in solvent banks, building and loan associations, savings and loan associations, and credit unions located in the state, except as otherwise provided by law, subject to national supervision or state examination.

(2) If needed financial services are not available through solvent banks, building and loan associations, savings and loan associations, and credit unions located in the state, the state treasurer may deposit public money in out-of-state financial institutions subject to national supervision.

(3) The state treasurer shall deposit funds in banks, building and loan associations, savings and loan associations, and credit unions in amounts that may be designated by the board of investments and shall withdraw deposits when instructed to by the board of investments.

(4) When money has been deposited under the board of investments and in accordance with the law, the state treasurer is not liable for loss on account of any deposit occurring from any cause other than the treasurer's own neglect or fraud.

(5) The state treasurer shall withdraw all deposits or any part of the deposits from time to time to pay and discharge the legal obligations of the state presented to the treasurer in accordance with the law.

(6) The state treasurer may contract with a financial institution to provide general depository banking services. The cost of contracting for banking services is statutorily appropriated, as provided in [17-7-502](#), from the general fund.

17-1-111. General fiscal duties of state treasurer. (1) The state treasurer is the custodian of all money and securities of the state unless otherwise expressly provided by law.

(2) It is the duty of the state treasurer to:

(a) receive and account for all money belonging to the state, not expressly required by law to be received and kept by some other person;

(b) pay warrants out of the funds upon which they are drawn;

(c) upon payment of any warrant, record the receipt of the person to whom it is paid;

(d) keep an account of all money received and disbursed;

(e) at the request of either house of the legislature or of any legislative committee, give information in writing as to the condition of the treasury or on any subject relating to the duties of the office of state treasurer;

(f) superintend the fiscal concerns of the state;

(g) suggest plans for the improvement and management of the public revenue;

(h) keep an account of all warrants drawn upon the treasury and of other appropriation records that the treasurer determines to be essential for the support of the accounting records maintained in the department;

(i) keep a register of warrants, showing the fund upon which each warrant is drawn, each warrant's number, who received the warrant, and the date issued;

(j) require all persons who have received money belonging to the state but who have not accounted for it to settle their accounts;

(k) draw warrants on the state treasury for the payment of money directed by law to be paid out of the treasury, except that a warrant may not be drawn unless authorized by law;

(l) authenticate with the official seal of the state all warrants drawn and all copies of papers issued from the office of state treasurer;

(m) collect and pay into the state treasury all fees received;

(n) discharge other duties as may be imposed upon the state treasurer by law; and

(o) provide information through the state's official internet website detailing how donations can be made to the state general fund or to any function of state government.

Cash Management Funds from the Board's 2011 Annual Report

TREASURER'S FUND

The Treasurer's Fund (Fund) is comprised of surplus cash in all state accounts that do not retain their investment earnings. All earnings are deposited in the State General Fund. State law authorizes the Board to determine the amount of surplus cash in the Fund to be invested and the type of investments to be made. Invested balances at book value vary widely due to varying levels of excess cash in the State's General Fund and other accounts comprising the Fund. The Fund is managed by the Board to maximize income, rather than for total rate of return. This Fund has been a major investor in STIP since 1974.

| <u>Treasurer's Fund Annual Change</u> | | | | | | |
|--|---------------------------------|-----------------------|---------------------------------|-----------------------|----------------------|------------------------|
| Investment Type | 6/30/2011 Book Value | % of Total | 6/30/2010 Book Value | % of Total | \$ Change | % of Change |
| US Bank Sweep Repo | 15,077,839 | 1.5 | 11,659,113 | 1.3 | 3,418,725 | 29.3 |
| US Agency Bonds | 30,969,504 | 3.0 | 50,538,642 | 5.6 | (19,569,138) | (38.7) |
| US Treasury Bills/Bonds | 0 | 0.0 | 4,992,673 | 0.5 | (4,992,673) | (100.0) |
| Corporate Bonds | 0 | 0.0 | 15,066,906 | 1.7 | (15,066,906) | (100.0) |
| Cash Equivalents (STIP) | 976,647,515 | 95.5 | 828,267,153 | 91.0 | 148,380,362 | 17.9 |
| Total | 1,022,694,858 | 100.0 | 910,524,487 | 100.0 | 112,170,371 | 12.3 |
| <hr/> | | | | | | |
| Income | 2,535,104 | | 2,692,285 | | (157,181) | (5.8) |

| <u>Treasurer's Fund 2011 Total Rates of Return</u> | | | | |
|---|---------------------|-------------------|-------------------------------|---------------------------------|
| Asset Type | % Return | Benchmarks | Benchmark % Return | Return +/- Benchmark |
| Cash Equivalents | 0.30 | 3 Month Treasury | 0.14 | 0.16 |
| All Assets | 0.33 | | | |

SHORT TERM INVESTMENT POOL

The Short Term Investment Pool (STIP), created in 1974, provides participants access to a short-term money market fund. Shares are fixed at \$1.00, fractional shares may be purchased, and participants may buy or sell shares with one business day's notice. Income is distributed on the first day of the month. Pool investments are managed by Board staff. There were 497 accounts invested in STIP during the year, consisting of 329 state accounts and 168 local government accounts. All investments are made by Board staff and all income is distributed to participants. The table below shows the annual change in the value of shares by major participant type.

| STIP Annual Change by Major Participant Type | | | | | | |
|---|---------------------------------|-----------------------|---------------------------------|-----------------------|----------------------|---------------------|
| Participant | 6/30/2011 Book Value | % of Total | 6/30/2010 Book Value | % of Total | \$ Change | % Change |
| Trust Funds | 201,460,349 | 8.3 | 205,670,905 | 9.1 | (4,210,556) | (2.0) |
| Insurance Funds | 134,884,032 | 5.6 | 136,383,310 | 6.1 | (1,499,278) | (1.1) |
| University Funds | 152,251,238 | 6.3 | 105,592,053 | 4.7 | 46,659,185 | 44.2 |
| Debt Service Funds | 26,906,460 | 1.1 | 51,621,780 | 2.3 | (24,715,320) | (47.9) |
| State Agencies Operating | 342,015,686 | 14.1 | 374,971,130 | 16.7 | (32,955,444) | (8.8) |
| Board Investment Pools | 60,035,775 | 2.5 | 68,987,480 | 3.1 | (8,951,705) | (13.0) |
| Treasurer's Fund | 976,647,515 | 40.3 | 828,267,153 | 36.8 | 148,380,362 | 17.9 |
| Pension Funds | 115,651,022 | 4.8 | 118,143,962 | 5.3 | (2,492,940) | (2.1) |
| Local Governments | 415,221,685 | 17.1 | 358,539,815 | 15.9 | 56,681,870 | 15.8 |
| Total | 2,425,073,762 | 100.0 | 2,248,177,588 | 100.0 | 176,896,174 | 7.9 |
| Income Distributed | | | | | | |
| | 6,595,801 | | 6,999,570 | | (403,770) | (5.8) |

The table below shows the historical yield, by year, since 1974 to 2011, to STIP participants net of all fees.

| | | | | | | | | | | | | | | | |
|-----------|------------|-----------|-------------|-----------|-------------|-----------|------------|-----------|------------|-----------|------------|-----------|------------|-----------|------------|
| 74 | 8.8 | 79 | 8.1 | 84 | 10.6 | 89 | 8.6 | 94 | 3.4 | 99 | 5.4 | 04 | 1.1 | 09 | 1.7 |
| 75 | 9.0 | 80 | 10.2 | 85 | 10.1 | 90 | 8.7 | 95 | 5.8 | 00 | 6.0 | 05 | 2.3 | 10 | 0.3 |
| 76 | 7.0 | 81 | 12.0 | 86 | 8.3 | 91 | 7.9 | 96 | 5.8 | 01 | 6.6 | 06 | 4.2 | 11 | 0.3 |
| 77 | 6.8 | 82 | 13.8 | 87 | 6.3 | 92 | 5.4 | 97 | 5.7 | 02 | 2.8 | 07 | 5.3 | | |
| 78 | 7.2 | 83 | 11.3 | 88 | 7.1 | 93 | 3.7 | 98 | 5.9 | 03 | 1.5 | 08 | 4.2 | | |

| STIP Total Rates of Returns Versus Benchmark | | | | |
|---|---------------------|----------------------|-------------------------------|---------------------------------|
| Year | % Return | Benchmark | Benchmark % Return | Return +/- Benchmark |
| 2011 | 0.31 | LIBOR 1 Month | 0.25 | 0.06 |
| 3 Year Annualized Average | 0.76 | LIBOR 1 Month | 0.62 | 0.14 |
| 5 Year Annualized Average | 2.40 | LIBOR 1 Month | 2.25 | 0.15 |
| 10 Year Annualized Average | 2.40 | LIBOR 1 Month | 2.31 | 0.09 |

[Return to Agenda](#)

Securities Litigation

MEMORANDUM

Montana Board of Investments

Department of Commerce

2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board
From: David Ewer, Executive Director
Date: October 4, 2012
Subject: Securities Litigation

Background

Litigation with respect to investment securities is an unavoidable phenomenon for large investors. The Board recognizes this and has taken various steps to deal with it. The purpose of this memorandum is to review Board policy, directives and current implementation status on this topic.

Tim House, one of our key staff monitors on this matter, will join in the presentation. Also present will be attorney Greg Gould with Luxan and Murfitt who is also involved with litigation matters.

Amounts Recently Received

Settlement amounts from securities litigation are sporadic and in some years, nominal.

| | <u>FY 2012</u> | <u>FY 2011</u> |
|------------------------------|----------------|----------------|
| Montana Domestic Equity | \$149,429 | \$617,009 |
| Montana International Equity | \$ 64 | \$233,840 |
| Trust Fund Bond Pool | \$ 8,564 | \$118,449 |
| State Fund | \$ 9,665 | \$149,643 |
| Total | \$167,722 | \$1,118,941 |

Board Policy, Governance and Implementation

Appendix A accompanying this memorandum has the Board's governance and policies specific to securities litigation. In general, the executive director is responsible for overseeing the **process** involving securities litigation matters, which generally fall into two possible subsets: class actions and actions where the Board takes a lead. The Board directs how its staff, attorneys and other agents are to operate depending on class action or lead plaintiff status.

Board policy states, in part: "The Board will delegate to qualified service providers the responsibility to take steps to identify, analyze, pursue and collect upon securities law claims. The duties of each service provider shall be clearly articulated as a matter of contract and the Board shall adopt prudent, documented procedures to monitor the implementation of its policies."

In meeting this requirement, the Board's contract with State Street Bank requires: "Contractor will track all necessary Board transaction data that will permit the Board to participate in class action litigation and will file as appropriate on behalf of the Board to participate in class action litigation. Contractor will also be required to feed such data to the Board's litigation monitoring providers."

State Street Bank files on the Board's behalf the necessary documentation to join a class action lawsuit. It provides litigation information updated daily through its web portal. A sample of a partial litigation status report is in Exhibit A (the full report is many pages).

For larger claims and as a cross check on securities litigation matters, the Board has two securities class action monitoring firms (as Board policy describes these law firms) to identify and evaluate potential claims that may merit commencing separate litigation or filing motions as lead or co-lead plaintiff, or opting out of a class action settlement. The Board has selected two such "Monitoring Firms," Barrack, Rodos & Bacine and Bernstein, Litowitz, Berger & Grossmann LLP. A copy of Barrack's monthly report accompanies this memorandum.

The Board requires that "The Executive Director, the Chief Investment Officer, the Board's General Legal Counsel, and the Board's Investment Consultant shall receive reports from the Monitoring Legal Firm, regarding the status of all securities class action litigation matters in which the Board is or could be a member. The Executive Director shall receive such reports at least monthly and upon each filing of proofs of claim."

Both law firms provide reports to the Executive Director monthly and will recommend higher involvement than just joining in a blanket class action in certain cases. The most recent example was in regards to a Pfizer lawsuit, where the Board is exploring larger damages *before* deciding upon entering into a class action.

Conclusion

The Board's security litigation process appears on its face to be working as the Board has directed, however, this review will help assess Board satisfaction or further instructions in this area.

Appendix A

From the Board's Governance Manual:

8. **Legal Action** - When the Board is named as a defendant in a legal action the Executive Director is authorized to act on behalf of the Board with the advice of legal counsel and shall notify the Chairperson in a timely manner. The Executive Director may only initiate legal action with Board approval.

9. **Class Action Litigation** - The Executive Director is authorized to join class action lawsuits on behalf of the Board so that the Board may share in any distribution from the settlement, unless it is determined that legal action by the Board, independent of a class action lawsuit, is advisable as per the Class Action Litigation Policy (**Appendix F**). The Executive Director may consult with legal counsel and Audit Committee members as necessary and shall report to the Board, at its next meeting, any decisions regarding class action suits.

APPENDIX F

I. **Principles**

1. The Board of Investments manages the assets entrusted to it “in accordance with the prudent expert principle” which requires that the Board act “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 and with like aims.” Montana Code Sec. 17-6-201. See also, Montana Constitution, Art. VIII, Sec. 13.
2. Claims under state and federal securities laws arising out of losses on securities under the Board's management are assets subject to the Board's fiduciary duty of prudent management. Accordingly, the Board should take reasonable steps to identify and recover on such claims. Such steps may include:
 - Participating as passive class member in class actions brought by others, and filing a proof of claim when action is settled/resolved.
 - Enhanced participation as class member in class actions brought and led by others, by considering objections or comments on settlements
 - Active participation in class action litigation, including serving as a “lead plaintiff” or “co-lead plaintiff” pursuant to the Private Securities Litigation Reform Act
 - Separate litigation on behalf of the Board
3. The Board will delegate to qualified service providers the responsibility to take steps to identify, analyze, pursue and collect upon securities law claims. The duties of each service provider shall be clearly articulated as a matter of contract and the Board shall adopt prudent, documented procedures to monitor the implementation of its policies.

II. **Policies**

1. The Board shall take reasonable, cost-effective steps to identify, pursue and collect upon claims under state and federal securities laws for losses suffered by the Board on its investments because of alleged or proven violations of securities laws.

2. A proof of claim should be filed on behalf of the Board in connection with every securities class action litigation settlement or judgment in which the Board is a member of the plaintiff class.
3. Because pursuing securities litigation as an active plaintiff, either by separate lawsuit or by serving as a lead plaintiff in a class action, imposes on the Board a separate fiduciary responsibility to other class members (in the case of lead plaintiff status), administrative, legal and other burdens and possibly out-of-pocket expense, the Board will not consider separate litigation or lead plaintiff status with respect to any claim unless the losses suffered with respect to the particular securities are at least \$1,000,000. When losses exceed that amount, the Board may commence separate litigation or apply for lead or co-lead plaintiff status, after receiving advice from the Board's General Counsel that it is in the interest of the Board to do so. The criteria to be considered in deciding whether to commence separate litigation or apply for lead plaintiff status are set forth on Attachment 1.
4. If the Board has suffered losses of \$500,000 or more, and the Board is not pursuing separate litigation or acting as lead or co-lead plaintiff in a class action, the Board may play an enhanced role, which may include review of the terms of any settlement, including applications for legal fees, to determine if the Board should file a comment or objection with respect to the settlement, or opt out of the class. The criteria for deciding whether to opt out are set forth on Attachment 1. The Board is authorized to direct the filing of a comment or objection
5. The Board will act only as a passive class member with respect to any claim in which the losses suffered are less than \$500,000. Proofs of claim will be filed on behalf of the Board upon a settlement or final judgment awarding damages in relevant class actions.
6. The Board delegates to its Audit Committee the decision to seek lead or co-lead plaintiff status or to play an enhanced role in a class action under Paragraphs 3 and 4.
7. The Executive Director, the Chief Investment Officer, the Board's General Legal Counsel, and the Board's Investment Consultant shall receive reports from the Monitoring Legal Firm, regarding the status of all securities class action litigation matters in which the Board is or could be a member. The Executive Director shall receive such reports at least monthly and upon each filing of proofs of claim.

III. Roles and Authority

1. *Board Role and Authority:*

- Review staff reports regarding securities litigation matters
- Periodically review and, as appropriate, modify this Policy
- Establish, periodically review and, as appropriate, modify Protocols for implementation of this Policy
- Select a securities class action "Monitoring Firm" to identify and evaluate potential claims and oversee the process for selecting such firm
- Approve, modify or terminate agreements with service providers responsible for implementation of this Policy

2. *Audit Committee Role and Authority:*

- Authorize commencement of separate litigation or filing of motion for lead plaintiff or co-lead plaintiff status or support for another's application for lead plaintiff status, consistent with this Policy

- Approve settlement of separate litigation or class action in which the Board is lead plaintiff or co-lead plaintiff, consistent with Board Policy
- Authorize opting out of a class settlement, consistent with this Policy
- Authorize filing of objections and comments on settlements, consistent with Board Policy.
- Receive and review staff reports on the status of matters other than passive claim filings.

3. *Staff Role and Authority*

- Circulate to Board members, Board General Legal Counsel, and Investment Consultant the reports from the Custodian and Monitoring Firm showing status of all securities litigation matters in which the Board may have an interest (e.g. date case filed, date of settlement, due date for claim filing, date Board's claim filed, date of recovery).
- Approve, circulate, and review responses to requests for proposals for Monitoring Firm services for and make recommendations to Board regarding selection
- Monitor, with assistance from the Board's General Counsel, performance of the Monitoring firm and report deficiencies to the Board
- As appropriate, recommend to the Board modifications to this Policy and Implementation Protocols

4. *Board General Counsel Role and Authority:*

- Assist in the preparation of Requests for Proposals for a Monitoring Firm, review responses and make recommendation to Board members and staff regarding candidates.
- Assist in negotiations of terms and agreements with Monitoring Firm, with assistance from the Board's Investment Consultant.
- Review, prior to submission to the Audit Committee, all recommendations from the Monitoring Firm regarding whether to commence separate litigation or seek lead plaintiff or co-lead plaintiff designation, or to opt out of or object to class settlements.
- Review, prior to submission to the Audit Committee, all recommendations from Monitoring Firm regarding proposed settlements of separate actions brought by the Board or class actions in which the Board is lead or co-lead plaintiff
- Review, prior to submission to the Audit Committee, all recommendations from Monitoring Firm regarding whether to file objections to or comments upon settlements.
- Supervise and monitor outside Legal Counsel's conduct of litigation when Board pursues separate litigation or acts as lead or co-lead plaintiff

5. *Custodian Role and Authority*

- Maintain and communicate data necessary to identify the Board's securities holdings and transactions in order to determine if the Board is a class member and calculate losses
- Collect and distribute to the Monitoring Firm all notices regarding the commencement, class certification and settlement of class action lawsuits in which the Board has an interest as an actual or potential class member
- Collect, record on the Board's custody statements and deposit into appropriate accounts for investment, proceeds from the Board's claims

6. *Custodian/Class Action Role and Authority*

- Establish and implement procedures to identify all securities class actions filed by others in which the Board is or may be a class member

- Collect and distribute to Monitoring all official notices of pendency of class actions in which the Board, according to this Policy, may consider applying for lead plaintiff status or pursuing separate litigation
- Timely file accurate proofs of claim on behalf of the Board in all class actions in which the Board may participate as class member and notify the Monitoring Firm.
- Provide necessary custody data to the Monitoring Firm.

7. Monitoring Firm Role and Authority

- Ensure by written communication that the Custodian has filed the appropriate documents for Board participation in pending class action litigation.
- Identify circumstances in which the Board may have incurred investment losses in excess of the minimum threshold which give rise to potentially meritorious claims for the Board which are not yet the subject of litigation.
- Evaluate claims over \$1,000,000 and recommend whether the Board should pursue separate litigation or lead or co-lead plaintiff designation
- Evaluate settlements of actions in which Board is not lead plaintiff where losses exceed \$500,000 and recommend whether Board should object to, comment upon or opt out of settlement
- File objections to and comments upon settlements as authorized

Implementation

These Policies shall be implemented in accordance with a written statement of procedures to be adopted by the Board incorporated as Attachment 1.

ATTACHMENT 1

Considerations Relevant to Deciding Whether to Pursue Separate Litigation or Lead or Co-Lead Plaintiff Status

Will the Board add value by volunteering to lead or co-lead litigation in view of the fiduciary responsibilities (as class action lead or co-lead plaintiff), administrative burdens and costs that are associated with separate litigation and acting as lead or co-lead plaintiff?

1. Size of the Board's damages measured by standards applicable to securities litigation
2. Strength of claims, including evaluation of defenses
3. Special circumstances which render the Board's claims different from, stronger or weaker than claims of typical class members such that it would be in the interest of the Board to act as lead or co-lead plaintiff
4. Venue of litigation
5. Resources available to pay a significant judgment (e.g. financial condition of potential defendants, availability of insurance, potential for bankruptcy)
6. Qualifications of other lead plaintiff candidates and their counsel, and likelihood that the Board would be selected a lead or co-lead plaintiff
7. Relation of claims to other corporate governance issues of special interest to the Board, and impact on other Board holdings
8. Potential for non-monetary remedies of special importance to the Board which other class members/lead plaintiffs may not pursue
9. Costs to the Board of separate litigation/lead or co-lead plaintiff status such as discovery, legal fees and Board staff time and resources needed to monitor litigation more actively
10. Potential exposure to counterclaims/court costs, and willingness of litigation counsel to indemnify the Board against such exposure.

Considerations Relevant to Deciding Whether to Opt Out, Object to or Comment on Settlements

Is the Board receiving fair value for its claims? Does the likely gain to the Board to be achieved by objecting to or commenting on a settlement outweigh the costs of engaging counsel to file the objection/comment? Should the Board risk losing the certain recovery the settlement provides in order to opt out of the class and pursue separate claims independently?

1. Financial value of settlement to class as a whole and the Board in particular
2. Non-monetary (e.g. corporate governance) aspects of settlement, or the lack thereof
3. Amount of attorneys fees sought and merits of attorneys fee claim
4. Expense and risk (including value which might be lost if settlement is disrupted or rejected) associated with opting out, commenting or objecting in relation to expected benefits of doing so.

Class Action Status Report as of 9-21-12

| Docket # | Event Name | Class Period Start Date | Class Period End Date | Event Status | Expiration Date | Claims Administrator |
|---------------------------|--------------------------------|-------------------------|-----------------------|-------------------|-----------------|------------------------------|
| 04 CIV. 8141 (DAB) (AJP) | AIG SUNAMERICA GLOBAL FING IV | 10/28/1999 | 04/01/2005 | PROOF OF CLAIM | 01/23/2012 | RUST CONSULTING INC |
| 08-CV-264-KMK | MBIA INC WART | 07/02/2007 | 01/09/2008 | PROOF OF CLAIM | 02/09/2012 | GARDEN CITY GROUP INC |
| 1:11-CV-00412-CMA-MEH | EMERGENCY MEDICAL SERVICES A | 12/13/2010 | 05/25/2011 | OBJECTION | 02/16/2012 | ALLIANCE ADVISORS |
| CV-08-01821-PHX-GMS | MEDICIS PHARMACEUTICAL CL A | 10/30/2003 | 09/23/2008 | PROOF OF CLAIM | 02/18/2012 | GARDEN CITY GROUP INC |
| 2:09-CV-00104-RDP-WC | COLONIAL BANCGROUP INC | 04/18/2007 | 08/06/2009 | PROOF OF CLAIM | 02/29/2012 | STRATEGIC CLAIMS SERVICES |
| C-08-4966 SC | CADENCE DESIGN SYS INC | 04/23/2008 | 12/10/2008 | PROOF OF CLAIM | 03/01/2012 | GILARDI AND CO LLC |
| 1:08-NC-70004 | NATIONAL CITY CORP | 04/30/2007 | 04/21/2008 | PROOF OF CLAIM | 03/09/2012 | BMC GROUP |
| 07-CV-8851 (LAP) | NORTEL NETWORKS CORP | 10/24/2000 | 04/27/2004 | PROOF OF CLAIM | 03/16/2012 | GARDEN CITY GROUP INC |
| 11-4211 (DMC) (MF) | MEDCO HEALTH SOLUTIONS | 07/21/2011 | 01/13/2012 | OBJECTION | 04/02/2012 | BERDON CLAIMS ADMINISTRATION |
| 07 CIV. 10617 (LTS)(GWG) | FOCUS MEDIA HOLDING ADR | 09/27/2007 | 11/19/2007 | PROOF OF CLAIM | 04/05/2012 | GILARDI AND CO LLC |
| 8:10-CV-1327-JST (RNBX) | BECKMAN COULTER INC | 07/31/2009 | 07/22/2010 | PROOF OF CLAIM | 04/12/2012 | A B DATA LTD |
| CV 10-2496-PHX-RCJ | NEW VY CORP | 01/01/2003 | 12/31/2007 | DERIVATIVE ACTION | 05/01/2012 | RIGRODSKY & LONG, P.A. |
| CV 10-2496-PHX-RCJ 2 | WESTERN UNION CO | 01/01/2003 | 12/31/2007 | DERIVATIVE ACTION | 05/01/2012 | RIGRODSKY & LONG, P.A. |
| 09 MD 2058 (PKC) | BANK OF AMERICA CO | 09/18/2008 | 01/21/2009 | EXCLUSION | 05/07/2012 | GARDEN CITY GROUP INC |
| 08-CV-5523-LAK (S.D.N.Y.) | LEHMAN BROTHERS HLDGS INC | 06/12/2007 | 09/15/2008 | PROOF OF CLAIM | 05/17/2012 | GARDEN CITY GROUP INC |
| PANDORA A/S | PANDORA A/S | 01/01/2011 | 08/01/2011 | SEEKING INTEREST | 05/20/2012 | DEMIMOR |
| 1:07-CV-04507 | MOTOROLA SOLUTIONS INC | 07/19/2006 | 01/04/2007 | PROOF OF CLAIM | 05/28/2012 | GILARDI AND CO LLC |
| 5958-VCL | WILMINGTON TR- AA COMMON STOCK | 10/31/2010 | 05/16/2011 | OBJECTION | 05/28/2012 | KURTZMAN CARSON CONSULTANTS |
| 10CV021273 | MARSHALL + ILSLEY CORP | 12/16/2010 | 07/05/2011 | OBJECTION | 05/29/2012 | GARDEN CITY GROUP INC |
| OLYMPUS CORP DRRT | OLYMPUS CORP | 06/29/2001 | 03/31/2012 | SEEKING INTEREST | 05/30/2012 | DRRT |
| 24-C-11-003015 | CONSTELLATION ENERGY GROUP | 04/27/2011 | 03/12/2012 | OBJECTION | 06/01/2012 | RIGRODSKY & LONG, P.A. |
| 1:10-CV-180413 | MCAFFEE COM CORP | 02/28/2011 | 03/04/2011 | EXCLUSION | 06/01/2012 | GILARDI AND COMPANY LLC |
| 4:08-CV-02348-TLW-SVH | SONOCO PRODUCTS CO | 02/07/2007 | 09/18/2007 | EXCLUSION | 06/05/2012 | ROBBINS GELLER RUDMAN & DOWD |
| 2:08-CV-00419-JRG | PILGRIMS PRIDE CORP | 05/05/2008 | 10/28/2008 | PROOF OF CLAIM | 06/09/2012 | RUST CONSULTING INC |
| OLYMPUS CORPORATION | OLYMPUS CORP | 01/01/2006 | 10/13/2012 | SEEKING INTEREST | 06/10/2012 | DEMIMOR |
| 1:09-CV-00799-MMB | R H DONNELLEY CORP | 10/26/2006 | 05/29/2009 | PROOF OF CLAIM | 06/19/2012 | RSM MCGLADREY |
| 08 CIV. 6171 (RJS) | WACHOVIA CP TIER 1 PFD | 05/08/2006 | 09/29/2008 | PROOF OF CLAIM | 06/27/2012 | RUST CONSULTING INC |
| C04-1599-JCC | WASHINGTON MUTU PP | 04/15/2003 | 09/24/2004 | PROOF OF CLAIM | 07/02/2012 | RUST CONSULTING INC |
| 1:08-CV-06613-BSJ-THK | CIT GROUP HLDGS INC | 12/12/2006 | 03/05/2008 | PROOF OF CLAIM | 07/05/2012 | GILARDI AND CO LLC |
| 8:09-CV-00005-PJM | AMERICAN CAP HLDGS | 10/31/2007 | 11/07/2008 | PROOF OF CLAIM | 07/20/2012 | GARDEN CITY GROUP INC |
| 3:09-CV-00419-ECR-WGC | INTL GAME TECHNOLOGY | 11/01/2007 | 10/30/2008 | PROOF OF CLAIM | 08/06/2012 | GILARDI AND CO LLC |
| CV-11-431153-00CP | SINO FOREST CORP | 03/19/2007 | 06/02/2011 | OBJECTION | 08/21/2012 | SISKINDS LLP |
| 4:08-CV-02348-TLW-KDW | SONOCO PRODUCTS CO | 02/07/2007 | 09/18/2007 | PROOF OF CLAIM | 08/30/2012 | RSM MCGLADREY |
| VESTAS WIND SYSTEMS A/S | VESTA WIND SYSTEMS | 10/27/2009 | 10/25/2010 | SEEKING INTEREST | 08/30/2012 | STICHTING |
| BP, PLC EUROPE | BRITISH PETROLEUM + EX L | 06/30/2005 | 06/01/2010 | SEEKING INTEREST | 08/31/2012 | SRKW |
| 08-CIV-1029 (WHP) | SLM CORP FLT | 01/18/2007 | 01/23/2008 | PROOF OF CLAIM | 08/31/2012 | A B DATA LTD |
| 04-CV-9866 | PFIZER INC | 10/31/2000 | 10/19/2005 | EXCLUSION | 09/09/2012 | EPIQ |
| 3:10-CV-00132-ECR-WGC | ORMAT TECHNOLOGIES INC | 05/07/2008 | 02/24/2010 | PROOF OF CLAIM | 09/24/2012 | GARDEN CITY GROUP INC |
| 1-11-CV-215076 | NOVELLUS SYSTEMS INC | 12/13/2011 | 06/04/2012 | OBJECTION | 10/12/2012 | GILARDI AND COMPANY LLC |
| 08 MDL NO. 1963 (RWS) | BEAR STEARNS COS INC | 12/14/2006 | 03/14/2008 | PROOF OF CLAIM | 10/25/2012 | GARDEN CITY GROUP INC |
| 07 CIV. 8538 (JPO) (MHD) | E TRADE FINANCIAL CORP | 04/19/2006 | 11/09/2007 | PROOF OF CLAIM | 10/31/2012 | GARDEN CITY GROUP INC |
| CIV 07-815JB/WDS | THORNBURG MTG INC | 04/19/2007 | 03/19/2008 | PROOF OF CLAIM | 11/19/2012 | STRATEGIC CLAIMS SERVICES |
| 3:10-CV-00463 | BANCORPSOUTH INC | 04/23/2009 | 07/22/2010 | PROOF OF CLAIM | 11/20/2012 | GILARDI AND CO LLC |
| CV 09-3994 JFW (MANX) | COUNTRYWIDE FINL CORP | 03/01/2005 | 04/24/2008 | PROOF OF CLAIM | 12/09/2012 | RUST CONSULTING INC |
| 08-6324 (PAM/AJB) | MEDTRONIC INC | 11/20/2006 | 11/17/2008 | PROOF OF CLAIM | 12/11/2012 | RUST CONSULTING INC |
| 2:07-CV-1635-GW (VBK) | INDYMAC BANCORP INC | 03/01/2006 | 03/01/2007 | PROOF OF CLAIM | 12/28/2012 | RUST CONSULTING INC |



Barrack, Rodos & Bacine
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Philadelphia
San Diego
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New Jersey
Conshohocken

Leslie Bornstein Molder
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August 3, 2012

Ms. Paula Troy
State Street Corporation
1001 Marina Village Parkway
3rd Floor
Alameda, CA 94501

**Re: Securities Class Action Settlements:
Claim Filing Deadlines (09/01/2012 – 09/30/2012)**

Dear Ms. Troy:

I am writing to you on behalf of our mutual client, Montana Board of Investments (the "Fund"), regarding upcoming claim filing deadlines in certain settled securities class actions.

As you know, the Fund has asked us to monitor its claim filings in order to ensure that it is filing claims in all settlements in which it is entitled to participate. To that end, we have enclosed a spreadsheet that identifies all securities class action settlements with upcoming claim filing deadlines. Also enclosed is a glossary of terms used in the spreadsheet. The spreadsheet includes, but is not limited to, those settlements for which we believe the Fund is entitled to file a claim, based upon the transaction information available to us. As the Fund's custodian, the information you have available to you may lead you to a different conclusion. Please let us know if the Fund has made a claim in each of the listed settlements and, if so, the dates that you submitted each claim to the claims administrator. You may reach me at lmolder@barrack.com.

If you do not have a claim form for a particular case, please contact Patti Hamer at phamer@barrack.com and she will forward a copy to you. If you have any questions about any of the settlements, please feel free to contact me.

Sincerely,

Leslie Bornstein Molder

LBM:kal
Enclosure

cc: Carroll V. South, Executive Director (Montana Board of Investments)

BOARD OF INVESTMENTS

AUG 13 2012

RECEIVED

Montana Board of Investments

Claim Deadlines from 9/1/2012 through 9/30/2012

| Company/Case Name (Ticker) | Cusip | Class Period Start | Class Period End | Claim File Deadline Date | Claims Admin | Custodian | Trade Status | Claim Status |
|--|-----------|-----------------------|---------------------|-----------------------------|---|--------------------------|--------------|--------------|
| Allwaste, Inc. Debentures (JPMorgan Chase) () | 020047AA4 | 7/30/1997 | 6/25/1999 | 9/10/2012 | Rust Consulting, Inc. | State Street Corporation | DINCN | TBF |
| Arctic Glacier Income Fund Securities Litigation (AG.UN) | 39675103 | 3/13/2002 | 9/16/2008 | 9/11/2012 | NPT RicePoint Class Action Services Inc. | State Street Corporation | NACT | N/A |
| Omat Technologies, Inc. (ORA) | 686688102 | 5/7/2008 | 2/24/2010 | 9/24/2012 | Garden City Group, Inc. | State Street Corporation | NACT | N/A |
| Sturm, Ruger & Company (RGR) | 864159108 | 4/23/2007 | 10/24/2007 | 9/24/2012 | Gilardi & Co. LLC | State Street Corporation | NACT | N/A |



Barrack, Rodos & Bacine

Glossary

Trade Status and Claim Status Terms

ACT — *Transaction Activity in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund had transactions in the securities that are the subject of the lawsuit.

ACTFGN — *Activity in Foreign Stock Only*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund had transactions in stock traded on a non-U.S. exchange. Following the U.S. Supreme Court's decision in *Morrison v. National Bank of Australia Ltd.*, ___ U.S. ___, 130 S.Ct. 2869 (2010), courts have dismissed investor claims under the federal securities that are based on purchases of stock on non-U.S. exchanges. We therefore believe that the court in this case will reject claims based on such purchases. Nonetheless, as a courtesy, we have calculated your fund's losses on its investments made through a non-U.S. exchange. The losses are reported in U.S. dollars, even though the transactions were recorded by your fund's custodian in the local currency where the investment occurred. For the purposes of this calculation, we converted each transaction price to U.S. dollars on the date of the transaction.

ACTPFT — *Transaction Activity in Class Period with a Profit*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund's transactions in the securities that are the subject of the class action resulted in a profit.

ACTMBS — *Activity - Mortgage-Backed Securities.*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund had transactions in one or more of the derivative securities that are the subject of the lawsuit. For derivative securities that continued to make principal and interest payments through the end of the class period, BR&B has not calculated your fund's losses.

ARS — *Auction Rate Securities.*

This term means that this case involves auction rate securities ("ARS") underwritten or sold by a sponsoring investment firm, but does not identify the particular securities to which it applies. When the ARS market froze in February 2008, holders who wished to sell their ARS were unable to do so. But most ARS continued to perform. And many ARS were eventually repurchased by the sponsoring investment firm. We do not have sufficient information to identify the particular securities covered by the action or to calculate investment losses, if any."

CF — *Claim has been Filed*

This term means that BR&B has received information that the settlement/claims administrator has received a proof of claim on behalf of your fund.

CFNR — *Claim has been Filed/Ineligible for Recovery*

This term means that BR&B has received information that, while a proof of claim has been filed on your fund's behalf, your fund is not eligible to receive a distribution under the allocation formula contained in the settlement.

CN — *Custodian and/or Client Notified of Upcoming Claim Deadline.* This term means that BR&B has notified your fund and/or its custodian of the upcoming deadline for filing proofs of claim.

CUSTCF — *Custodian has Filed Claim*

This term means that BR&B has received information from your custodian that a proof of claim was filed on behalf of your fund.

D/N/A — *Data Not Available*

This term means that BR&B cannot electronically retrieve information about your fund's transactions in the securities that are the subject of the class action from your fund's custodian for the period covered by the lawsuit because BR&B's access to your fund's historical transaction data is limited by the terms of BR&B's contract with your fund.



Barrack, Rodos & Bacine

DINCA — *Data Incomplete/Data Shows Transaction Activity in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian does not include data for the entire period covered by the class action because BR&B's access to your fund's transaction data for that period is limited by the terms of BR&B's contract with your fund. To the extent BR&B has access to transaction data within that period, the information BR&B has retrieved shows that, during the period covered by the lawsuit, your fund had transactions in the securities that are the subject of the case.

DINCN — *Data Incomplete/Data Shows No Transaction Activity in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian does not include data for the entire period covered by the class action because BR&B's access to your fund's transaction data for that period is limited by the terms of BR&B's contract with your fund. To the extent BR&B has access to transaction data within that period, the information BR&B has retrieved shows that, during the period covered by the lawsuit, your fund had no transactions in the securities that are the subject of the case.

DINCP — *Data Incomplete/Data Shows a Profit on Transactions in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian does not include data for the entire period covered by the class action because BR&B's access to your fund's transaction data for that period is limited by the terms of BR&B's contract with your fund. To the extent BR&B has access to transaction data within that period, the information BR&B has retrieved shows that, during the period covered by the lawsuit, your fund appears to have had a profit on transactions in the securities that are the subject of the lawsuit.

DINCS — *Data Incomplete/Data Shows only Sales Transactions in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian does not include data for the entire period covered by the class action because BR&B's access to your fund's transaction data for that period is limited by the terms of BR&B's contract with your fund. To the extent BR&B has access to transaction data within that period, the information BR&B has retrieved shows only sales of the securities that are the subject of the lawsuit during that period.

HOLD — *Hold Stock During Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund held stock in the securities that are the subject of the lawsuit.

NACT — *No Transaction Activity during Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian does not show any transactions in the securities that are the subject of the class action for the period covered by the lawsuit.

NC — *No Claim*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund's transactions in the securities that are the subject of the class action resulted in no claim under the settlement allocation formula approved by the court in the action.

NCF — *None/Claim Filed*

This term means that, because a claim has been filed on behalf of your fund with the administrator handling the settlement of the class action lawsuit, your fund need take no further action in this case.

NCOF — *No Claim on File*

This term means that there is no claim on file with the claims administration on your fund's behalf.

NPRCHS — *No Purchases in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian does not show any purchases of securities that are the subject of the class action during the period covered by the lawsuit.

SACT — *Only Sales Transaction Activity in Class Period*

This term means that the information BR&B has electronically retrieved from your fund's custodian shows that, during the period covered by the class action, your fund only sold the securities that are the subject of the lawsuit.

TBF — *Claim Filed*

This term means that BR&B believes that your custodian should file a proof of claim on behalf of your fund by the deadline set by the court. In accordance with BR&B's procedures, unless instructed otherwise by your fund, BR&B has notified (or will notify) your fund's custodian of the upcoming deadline three weeks in advance of the deadline.

**MONTANA BOARD OF INVESTMENTS
EXEMPT STAFF PAY PLAN**

Last Revised November 13, 2008 Pending Approval: October 4, 2012

LEGAL AUTHORITY:

Eight positions in the Board of Investments are exempt from the requirements of Montana's job classification and pay system pursuant to ~~of~~ Section 2-18-103 M.C.A. The positions include:

Chief Investment Officer
Executive Director
Six Professional Staff Designated by the Board

The salaries for exempt positions are established by the Board. The remaining positions at the Board are “non-exempt” employees of the Department of Commerce. The pay rates for these positions are established through a combination of legislative action and classification actions ~~recommended~~ by the Department of Commerce and the State Personnel Division.

The Board may revise the Exempt Pay Plan at its discretion for any reason.

Pursuant to Section 2-15-1808 M.C.A., the Board adopts the following procedure for establishing the pay of its exempt staff.

ESTABLISHMENT OF PAY RANGES

A ~~complete~~ salary ~~and benefits~~-survey of ~~peer~~ organizations similar to the Board should be conducted periodically to assist the Board in establishing ~~obtain the~~ “market” pay rates for comparable positions. ~~For comparison purposes, the information should be solicited from internally managed public agencies that have approximately the same total of assets under management. The Board may contract with an appropriate outside entity to provide such information.~~ Additional information ~~may be is~~ available from surveys conducted annually by the National Association of State Investment Officers (NASIO) and other industry groups.

The Board at its sole discretion will use the survey results to establish the “market” rates to be used to set salary ranges. The salary ranges are calculated as follows:

Six Designated Staff:

The range width is 55% of the market rate established by the Board after the survey is completed. With the market rate in the middle of the range the bottom of the range is 72.5% of market and the top of the range is 127.5% of market.

Chief Investment Officer and Executive Director:

The range width is 75% of the market rate established by the Board after the survey is completed. With the market rate in the middle of the range the bottom of the range is 62.5% of market and the top of the range is 137.5% of market.

~~After the range is established for each position, the range is divided into five equal performance ranges.~~

**MONTANA BOARD OF INVESTMENTS
EXEMPT STAFF PAY PLAN**

Last Revised November 13, 2008 Pending Approval: October 4, 2012

ESTABLISHMENT OF INDIVIDUAL PAY RATES AND PAY ADJUSTMENTS, GENERALLY

Once pay ranges ~~and performance ranges~~ have been established by the Board, the salary of each exempt employee may be set ~~by granting an appropriate amount of credit for each of the following after considering the additional factors listed below, including salary survey data. The Board, in its sole discretion, may choose to decide what weights each factor may have for pay adjustments. Some factors may be permanent and others may be temporary. Permanent factors are permanently added to the employee's base pay. Temporary additives are for a specified length of time. Under certain circumstances, the Board may at its discretion set salaries, grant raises, bonuses, or make other adjustments using other procedures.~~

The Board will review each exempt employee's performance and salary at least annually, however, the Board, in its sole discretion, may decide if and when a pay or other compensation adjustment is to be made. The Board retains full discretion on pay adjustments including, but not limited to, making such adjustments for some exempt employees, but not for all, to make retroactive adjustments, or to make temporary, lump sum or conditional pay adjustments.

While the Board has the statutory ability to unilaterally set all exempt salaries, it recognizes it may also consider the general compensation or pay adjustments received (or not received) by other state employees in its consideration for exempt employee pay.

Factors Generally, but Not Exclusively, to be Considered:

A. Performance:

Individual Performance is the primary determinate of "base pay". Each employee is given an annual performance rating by his or /her supervisor based on an evaluation of how well each employee met the goals and objectives assigned to the position.

~~In addition to the base pay established by the Individual Performance Factor described above, employees may receive permanent or temporary pay additives for any or all of the following factors:~~

B. Professional Credentials:

Employees who earn the Chartered Financial Analyst (CFA) designation or an equivalent professional certification (including Masters of Business Administration (MBA) or Masters of Public Administration (MPA) for the Executive Director position) may, at the Board's discretion, earn a permanent salary additive. ~~The Professional Credential will be shown as a separate item on the pay calculation sheet for each employee.~~

**MONTANA BOARD OF INVESTMENTS
EXEMPT STAFF PAY PLAN**

~~Last Revised November 13, 2008~~ Pending Approval: October 4, 2012

C. Experience and Skill:

This ~~is a temporary~~ factor ~~which~~ measures the job related experience and skill ~~either~~ brought to the job by a new employee or demonstrated on the job by an existing employee. ~~—The Board Management~~ may grant credit for experience, special training or other job related knowledge or ability. ~~Following the initial performance appraisal period of up to one year, the employee's salary will be set as per the procedures for factors A, B and D. Notwithstanding the above, w~~When recruiting nationally for a position where competitive salaries must be offered, a new employee may be hired at any salary approved by the Board.

~~**D. Fund Performance:**~~

~~A bonus may be granted to individual employees at the discretion of the Board in recognition of the overall achievement of Board objectives and investment performance compared to appropriate external benchmarks and Board peers. Bonuses may not exceed 20.0 percent of an incumbent's current salary.~~

E. Pay Equity:

In considering a salary adjustment for any individual exempt staff, the Board may consider the salaries paid to other exempt staff and the non-exempt staff.

**MONTANA BOARD OF INVESTMENTS
EXEMPT STAFF PAY PLAN**

Last Revised November 13, 2008 Pending Approval: October 4, 2012

EFFECTIVE PAY RANGES AS OF NOVEMBER 13, 2008

(this will be updated to 2011 data and the column "Research Director" eliminated) – see below

| Total Range | <u>Executive Director</u> | <u>Chief Investment Officer</u> | <u>Senior Portfolio Manager II</u> | <u>Research Director</u> | <u>Loan Portfolio Manager</u> |
|---------------------------|----------------------------------|--|---|---------------------------------|--------------------------------------|
| Market From Survey | 190,900 | 205,000 | 125,000 | 155,200 | 103,690 |
| Bottom of Range | 119,313 | 128,125 | 90,625 | 112,520 | 75,175 |
| Top of Range | 262,488 | 281,875 | 159,375 | 197,880 | 132,205 |

Chief Investment Officer & Executive Director Ranges are 75% of Market

Other Staff Ranges are 55% of Market

**MONTANA BOARD OF INVESTMENTS
EXEMPT STAFF PAY PLAN**

Based on 2012 McLagan Salary Survey and 2011 Bank Salary Survey (Montana/Wyoming)

| <u>Total Range</u> | Based on 2012 Survey | | | Based on 2011 Survey |
|---------------------------|---------------------------|---------------------------------|------------------------------------|-------------------------------|
| | <u>Executive Director</u> | <u>Chief Investment Officer</u> | <u>Senior Portfolio Manager II</u> | <u>Loan Portfolio Manager</u> |
| Market From Survey | 217,300 | 245,000 | 125,000 | 90,150 |
| Bottom of Range | 135,813 | 153,125 | 90,625 | 65,359 |
| Top of Range | 298,788 | 336,875 | 159,375 | 114,941 |

Chief Investment Officer & Executive Director Ranges are 75% of Market
Other Staff Ranges are 55% of Market

DRAFT

[Return to Meeting Agenda](#)

Executive Director Reports

MEMORANDUM

Montana Board of Investments

Department of Commerce

2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board
From: David Ewer, Executive Director
Date: October 4, 2012
Subject: Update regarding Board's Budget Submission

The Department of Commerce completed its budget submission process in late August. One of its final steps was to estimate its overhead charge for administrative support against all of its divisions, including the Board of Investments. The final rates proposed to the legislature for the internal service and enterprise fund are shown below. As a reminder, these numbers will need to be approved by the Governor's budget office, and are the starting point in the entire legislative appropriation process.

| | Requested <u>FY 14</u> | Requested <u>FY 15</u> |
|--|---------------------------|---------------------------|
| BOI Administrative Fee, Investments | | |
| Amount originally in Board August packet | \$5,056,440 | \$5,292,523 |
| Amount submitted by Commerce | \$5,109,144 | \$5,234,796 |
| Difference | 52,704 | 57,727 |
| BOI Enterprise Fee, (Intercept et al) | | |
| Amount originally in Board August Packet | \$1,676,269 | \$1,939,249 |
| Amount submitted by Commerce | \$1,658,269 | \$1,921,249 |
| Difference | (\$18,000) | (\$18,000) |

MEMORANDUM

Montana Board of Investments

Department of Commerce

2401 Colonial Drive, 3rd Floor

Helena, MT 59601 (406) 444-0001

To: Members of the Board
From: David Ewer, Executive Director
Date: October 4, 2012
Subject: Private Equity Fund of Funds Underlying Management Fees

The chart below summarizes the actual underlying management fees relating to all active Fund of Funds in 2011. The total underlying management fee is significantly lower than the \$6.5 million that CEM Benchmark estimated.

| Fund of Funds Underlying Management Fees - Calendar Year 2011 | | |
|--|---------------------|-----------------------------|
| Manager | Fees Paid | Fee as % of Holdings |
| Adams Street Partners - Funds in Aggregate | \$ 1,601,068 | 92 |
| Axiom Asia Private Capital | \$ 277,104 | 139 |
| HarbourVest International | \$ 81,386 | 106 |
| Northgate Capital | \$ 402,580 | 210 |
| Performance Equity Management - Venture Capital | \$ 341,708 | 180 |
| Portfolio Advisors - Funds in Aggregate | \$ 900,996 | 164 |
| Siguler Guff & Company | \$ 343,140 | 137 |
| Total | \$ 3,947,982 | 98 |

**MONTANA BOARD OF INVESTMENTS
ACRONYM INDEX**

| | |
|------------|---|
| ADR..... | American Depository Receipts |
| AOF..... | All Other Funds |
| BOI..... | Board of Investments |
| CFA..... | Chartered Financial Analyst |
| EM..... | Emerging Market |
| FOIA..... | Freedom of Information Act |
| FWP..... | Fish Wildlife and Parks |
| IPS..... | Investment Policy Statement |
| MBOH..... | Montana Board of Housing |
| MBOI..... | Montana Board of Investments |
| MDEP..... | Montana Domestic Equity Pool |
| MFFA..... | Montana Facility Finance Authority |
| MPEP..... | Montana Private Equity Pool |
| MPT..... | Modern Portfolio Theory |
| MSTA..... | Montana Science and Technology Alliance |
| MTIP..... | Montana International Pool |
| MTRP..... | Montana Real Estate Pool |
| MTSBA..... | Montana School Boards Association |
| MVO..... | Mean-Variance Optimization |
| NAV..... | Net Asset Value |
| PERS..... | Public Employees' Retirement System |
| PFL..... | Partnership Focus List |
| QZAB..... | Qualified Zone Academy Bonds |
| QSCB..... | Qualified School Construction Bonds |

**MONTANA BOARD OF INVESTMENTS
ACRONYM INDEX**

RFBP..... Retirement Funds Bond Pool
RFP.....Request for Proposal
SSBCI State Small Business Credit Initiative
STIPShort Term Investment Pool
TFBPTrust Funds Bond Pool
TFIPTrust Funds Investment Pool
TIF..... Tax Increment Financing
TIFD Tax Increment Financing District
TRS..... Teachers' Retirement System
VIX Volatility Index

Montana Board of Investments 2012 Meeting Schedule

| 2012 | M | T | W | T | F | S | S |
|--------------------------|----|----|----|----|----|----|----|
| | 26 | 27 | 28 | 29 | 30 | 31 | 1 |
| Jan 2012 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
| | 16 | 17 | 18 | 19 | 20 | 21 | 22 |
| | 23 | 24 | 25 | 26 | 27 | 28 | 29 |
| | 30 | 31 | 1 | 2 | 3 | 4 | 5 |
| Feb 2012 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| | 13 | 14 | 15 | 16 | 17 | 18 | 19 |
| | 20 | 21 | 22 | 23 | 24 | 25 | 26 |
| | 27 | 28 | 29 | 1 | 2 | 3 | 4 |
| Mar 2012 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| | 12 | 13 | 14 | 15 | 16 | 17 | 18 |
| | 19 | 20 | 21 | 22 | 23 | 24 | 25 |
| | 26 | 27 | 28 | 29 | 30 | 31 | 1 |
| Apr 2012 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
| | 16 | 17 | 18 | 19 | 20 | 21 | 22 |
| | 23 | 24 | 25 | 26 | 27 | 28 | 29 |
| | 30 | 1 | 2 | 3 | 4 | 5 | 6 |
| May 2012 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| | 14 | 15 | 16 | 17 | 18 | 19 | 20 |
| | 21 | 22 | 23 | 24 | 25 | 26 | 27 |
| Jun 2012 | 28 | 29 | 30 | 31 | 1 | 2 | 3 |
| | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
| Jul 2012 | 18 | 19 | 20 | 21 | 22 | 23 | 24 |
| | 25 | 26 | 27 | 28 | 29 | 30 | 1 |
| | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
| | 16 | 17 | 18 | 19 | 20 | 21 | 22 |
| Aug 2012 | 23 | 24 | 25 | 26 | 27 | 28 | 29 |
| | 30 | 31 | 1 | 2 | 3 | 4 | 5 |
| | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| | 13 | 14 | 15 | 16 | 17 | 18 | 19 |
| Sep 2012 | 20 | 21 | 22 | 23 | 24 | 25 | 26 |
| | 27 | 28 | 29 | 30 | 31 | 1 | 2 |
| | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
| Oct 2012 | 17 | 18 | 19 | 20 | 21 | 22 | 23 |
| | 24 | 25 | 26 | 27 | 28 | 29 | 30 |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| | 8 | 9 | 10 | 11 | 12 | 13 | 14 |
| | 15 | 16 | 17 | 18 | 19 | 20 | 21 |
| Nov 2012 | 22 | 23 | 24 | 25 | 26 | 27 | 28 |
| | 29 | 30 | 31 | 1 | 2 | 3 | 4 |
| | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| | 12 | 13 | 14 | 15 | 16 | 17 | 18 |
| Dec 2012 | 19 | 20 | 21 | 22 | 23 | 24 | 25 |
| | 26 | 27 | 28 | 29 | 30 | 1 | 2 |
| | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
| | 17 | 18 | 19 | 20 | 21 | 22 | 23 |
| | 24 | 25 | 26 | 27 | 28 | 29 | 30 |
| | 31 | 1 | 2 | 3 | 4 | 5 | |

February 21-22
(February 20th: State Holiday - Lincoln's & Washington's Birthday)

April 3

May 22-23 (possibly an out of town meeting)
(May 28th: State Holiday - Memorial Day)

August 21-22

October 4
(October 8th: State Holiday - Columbus Day)

November 13-14
(November 6th: State Holiday - General Election Day)
(November 12th: State Holiday - Veteran's Day)

Montana Board of Investments Meetings

All meetings

- Are public and duly noticed in advance
- Public comments invited at every meeting
- Minutes taken and previous ones approved

Quarterly meetings - February, May, August, and November

- Standard business
 - Performance
 - Activity
 - Investment consultant
- Committees
 - Loans: Commercial, INTERCAP, MSTA
 - Audit
 - Human Resource
 - Other Committees, as appointed by the Chairman
- Systematic review of Topics, as scheduled for 24-month rotation

Semi-Annual meetings - April and October

- In depth coverage on certain (to be determined) topics
- April - Asset Allocation at a strategic level
- October - updated Actuarial Status & Asset Allocation implications
- Additional systematic review of topics to complete 24-month rotation
- Subcommittees meet only as needed

Additional Board Topics for 24-month Systematic Review, either (A) annually or at least (B) biennially

- Investment Policy Statements (A)
- Accounting and internal data systems (A)
- Annual report and financial statements (A)
- Staffing levels and compensation (A)
- Accounting, GAAP, audits and internal control standards, compliance and execution (A)
- PERS and TRS relationship (A)
- Ethics policy – affirmations (typically May) (A)
- Resolution 217 update (typically November) (A)
- General operations (e.g. day to day, landlord, disaster recovery, vendor review) (A/B)
- BOI website (B)
- Custodial bank relationship, performance, continuity (B)
- Board member training and staying current efforts (B)
- Customer relationships especially large customers such as State Fund (B)
- Legislative session and interim matters (B)
- Outreach, especially commercial and municipal missions (B)
- The Board as a rated investment credit, and as a bond issuer and a credit enhancer (B)
- Securities Lending (A)
- Securities Litigation (A)

Proposed Work Plan 2012

(Meetings shown below do NOT reflect all likely agenda items. Quarterly meetings will always include standard quarterly business. All meetings will include a combination of topics that will be reviewed within a 24-month systematic basis)

| | |
|----------|---|
| February | Quarterly Meeting Securities Lending |
| April | Semi-annual meeting BOI's Hierarchy of Responsibilities Asset Allocation - Strategic Work plan for remaining calendar 2012 Staff report on new public and private equity managers Proposed checklist for public manager due diligence Announcements, next meeting, logistics |
| May | Quarterly Meeting Public equity - MDEP Proposed restructuring of domestic public equities Training, staff/ board ideas and recommendations, discussion, and logistics TRS and PERS board-to-board relationship |
| August | Quarterly Meeting Costs (including reviewing CEM Benchmarking Inc. results) MBOI Budget Fiscal Year performance through June 30 th Public Equity - MTIP |
| October | Semi-annual Meeting Private Real Estate Private Equity Operations (broadly)/Unified Investment Mission (focus on cash management and daily process issues) Investment Consultant Selection Securities Litigation |
| November | Quarterly Meeting Fixed Income Actuarial Status & Asset Allocation Implications Legislative Session Investment Consultant Selection (depending if done in Oct.) Coal Severance/Enhancement/Commercial Loan/INTERCAP et al Exempt Staff Annual Performance |