MONTANA
BOARD OF INVESTMENTS

BOARD ADOPTED POLICY

POLICY NUMBER: 40.200

EFFECTIVE DATE: November 30, 2021

TITLE: Consolidated Asset Pension Pool Investment Policy Statement

SUPERSEDES: November 19, 2020

BOARD ADOPTION: November 30, 2021

REVIEWED:

I. Introduction

A. Montana Public Retirement Plan assets are commingled for investment purposes into a Consolidated Asset Pension Pool (CAPP) created by the Board.

B. The use of a commingled pool allows for simplified investing and accounting, broader diversification and thus less risk than would otherwise be available for the smaller Plans and provides additional opportunities for fee savings.

C. CAPP invests directly in the underlying Asset Classes.

1. Each Asset Class has an underlying set of investment objectives and investment guidelines.

2. Each of the nine Plans, CAPP, and each of the Asset Classes are separately identified for accounting and record keeping purposes.

D. This policy is effective upon adoption and supersedes all previous Investment Policy Statement (IPS) related to the investment management of the Montana Public Retirement Plans.

II. Purpose

A. The purpose of this policy statement is to provide a broad strategic framework for the Montana Public Retirement Plans' investments under the guidance of the Montana Board of Investments.

III. Legal and Constitutional Authority

A. Article VIII, Section 13, of the Montana Constitution requires that the Legislature provide for a Unified Investment Program for public funds.

1. Section 17-6-201, MCA:

a) Established the Unified Investment Program.

b) Created the Board.

c) Gave the Board sole authority to invest state funds, including the public retirement plans (Plans) in accordance with state law and the state constitution.

B. Section 17-6-201(1), MCA, requires the Board to operate under the "prudent expert principle," defined as:

1. Discharging its duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of like character with like aims.

2. Diversifying the holdings of each fund to minimize the risk of loss and maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.

3. Discharging its duties solely in the interest of and for the beneficiaries of the funds managed.

C. Section 17-6-201 (2) (a), MCA, states "Retirement funds may be invested in common stocks of any corporation."

D. Section 17-6-201 (3) (b), MCA, states "The Board is urged under the prudent expert principle to invest up to three percent (3%) of retirement funds in Venture Capital companies. Whenever possible, preferences should be given to investments in those Venture Capital companies which demonstrate an interest in making investments in Montana."

E. Section 17-6-201 (3) (c), MCA, states "In discharging its duties, the board shall consider the preservation of purchasing power of capital during periods of high monetary inflation."

F. The Board, as the investment fiduciary of the Plans, is responsible for establishing the investment parameters for the Plans.

1. The Board has the authority to allocate portfolios to any previously board-approved asset class in the proportions it considers prudent, under the prudent expert rule.

2. There are currently no statutory or constitutional restrictions on the investment of the Plans.

3. Asset allocation decisions made by the Board must be made in a public meeting.

IV. Strategic Investment Objectives

A. The Board's overall objective is to achieve the highest level of investment performance that is compatible with its risk tolerance and prudent investment practices.

B. Because of the long-term nature of the state's various pension liabilities, the Board maintains a long-term perspective in formulating and implementing its investment policies, and in evaluating its investment performance.

V. Time Horizon

A. The Board expects to meet or exceed these objectives over a long-term investment horizon.

B. Over shorter periods, the anticipated market volatility, and specific actions, including risk mitigation efforts of the Board, may lead to unfavorable but expected deviation from these objectives.

VI. Performance Measurement

A. Investment performance is measured by three integrated long-term return objectives:

1. Actuarial Target Rate of Return

a) The actuarial target rate of return is the key actuarial assumption affecting future funding rates and liabilities.

b) Investment performance that exceeds or underperforms the target rate may materially impact future funding rates and liabilities.

c) The Board seeks to generate long-term investment performance that will exceed the maximum actuarial annual target rate of return of seven and sixty-five hundredths' percent (7.65%), as determined by:

(1) The governing boards of the public retirement systems.

(2) Net of all investment and administrative expenses.

d) There may be years, or a period of years, when the Plans do not achieve this goal followed by years when the goal is exceeded.

e) Over a long period, the Board seeks to achieve an average net rate of return of seven and sixty-five hundredths' percent (7.65%), as determined by the governing boards of the public retirement systems, at risk levels (measured by expected volatility) broadly consistent with other public fund peers.

2. Investment Policy Benchmark

    a) For the Retirement Plans is calculated by applying the investment performance of the benchmarks to any of the underlying asset classes to the Plans' actual allocation to these investments during the measurement period.

    b) The investment policy benchmark represents the return that would be achieved if the Plan implemented a passively managed portfolio.

    c) Deviations from the policy benchmark measure the contribution of active management, rebalancing policy and its execution, and investment implementation generally.

3. Public Plan Sponsor Universes

    a) The Board also compares each Plan's total performance, before all fees, to appropriate public plan sponsor universes.

    b) This process permits the Board to compare its total performance to other public pension plans.

    c) While the Board seeks to rank consistently in the top half of comparable public pension plans, the Board recognizes that other plans may have investment objectives and risk tolerances that differ substantially from the Board's.

VII. Roles and Responsibilities

A. Board of Investments

1. The Board is responsible for approving the IPS for the Montana Public Retirement Plans and has the authority to allocate portfolios to any asset class in the proportions it considers prudent, subject to such limitations as contained in law and the Constitution.

2. The Board reviews this document periodically and as needed, approves any changes to the policy.

3. As described in the Board of Investments Governance Manual, the Board delegates authority to the Executive Director, Chief Investment Officer (CIO), and other Staff to execute the day-to-day duties required to carry out the Board's mission.

B. Executive Director

1. The Executive Director is empowered by the Board to sign all documents required to conduct Board business.

    a) Unless there are specific written policies or instructions from the Board to the contrary.

2. The Executive Director and the CIO are authorized jointly to contract for investment manager services and if deemed appropriate, terminate them.

C. Chief Investment Officer

1. The CIO is empowered by the Board to serve as the principal staff person responsible for overseeing the investment activities under the Board's jurisdiction in compliance with the Board's policies.

2. The CIO, with the support of other staff, is responsible for recommending IPS changes for Board approval.

D. Staff

1. The staff is responsible for:

    a) Managing day-to-day operations and delegating work to external resources as appropriate.

    b) Monitoring allocations and overseeing all investment manager due diligence activities and recommending changes to the CIO.

    c) Monitoring and reporting to the Board the performance of each asset class and the individual managers' performance.

    d) Informing the Board of any new managers or terminations.

    e) Reporting any deviations from the IPS Policy to the Board.

E. Investment Consultant

1. The investment consultant assists the CIO and staff with policy recommendations and provides advice to the Board.

2. The investment consultant also assists staff in monitoring all external managers and reports to the Board independently.

F. External Managers

1. Managers are responsible for all aspects of portfolio management as set forth in the contract specific to each manager.

2. Managers must communicate with staff as needed, regarding investment strategies and results.

3. Managers must also cooperate fully with staff regarding administrative, accounting, and reconciliation issues as well as any requests from the investment consultant and the master custodian.

VIII. Strategic Asset Allocation

A. The Board finds that it is in the best interest of the state's nine retirement Plans to set out investment policies for the Plans in one comprehensive document.

1. Nine Public Retirement Plans

    a) Public Employees Retirement System.

    b) Teachers Retirement System.

    c) Police Officers Retirement.

    d) Firefighters Retirement.

    e) Sheriffs Retirement.

    f) Highway Patrol Retirement.

    g) Game Wardens Retirement.

    h) Judges Retirement.

    i) Volunteer Firefighters Retirement.

2. The current asset allocation ranges for the Plans are in Policy 40.201 of the Governance Manual.

    a) The asset allocation ranges are subject to change as modifications are adopted by the Board, at which time Policy 40.201 of the Governance Manual will be revised to reflect these changes.

b) The Board will formally affirm or revise the asset allocation ranges for the Plans at least annually.

IX. Rebalancing

A. The actual asset allocation mix may deviate from time to time from the approved asset allocation ranges due to financial market performance, cash flows, and manager performance.

B. Material deviations from the asset allocation ranges can alter the expected return and risk of the Plans.

C. Rebalancing the Plans' assets to remain within the Board-approved allocation ranges is delegated to the CIO, in consultation with the Executive Director.

D. Any necessary rebalancing will be made in a timely manner and will take into consideration associated costs and current market conditions.

E. In addition to maintaining actual allocations within the ranges, the CIO will also consider:

1. Contractual investment commitments to private investments.

2. Liquidity necessary to meet benefit payments and administrative costs for the Plans.

3. Current market conditions.

F. This may prompt asset rebalancing when asset allocations fall within the established ranges.

G. The CIO shall inform the Board of rebalancing activity at the Board's next regularly scheduled quarterly meeting.

X. Risk Management

A. Evaluation of Investment Managers.

1. The Investment Manager Evaluation Policy is a distinct policy that is regularly reviewed and updated separate from the Retirement Plans Investment Policy because staff utilizes the Investment Manager Evaluation Policy to oversee and manage other assets in addition to the retirement plan assets.

B. Liquidity

1. Based on the percentage of total plan assets necessary for ongoing benefit payments and other plan expenses, the liquidity needs for the Retirement Plans are generally low and participant capital is not expected to change dramatically on short notice.

2. Illiquidity risk still needs to be monitored and managed by staff on a regular basis to ensure that assets are not required to be sold too quickly, or at an unfavorable time, and potentially at a discount to fair value to meet the cash needs of the Retirement Plans.

a) A significant percentage of the investments in the Real Estate, Real Assets and Private Investments Asset Classes are considered illiquid. Due to the limited liquidity of these assets, it will typically be impractical to fund plan cash needs or correct deviations from policy ranges through the purchase or sale of these assets.

3. The investments held in the Domestic Equity, International Equity, Core Fixed Income, and Non-Core Fixed Income Asset Classes are categorized as publicly traded securities.

a) In "normal market" conditions many of the underlying assets from these Asset Classes can be liquidated in a relatively short period to accommodate both expected and unexpected withdrawals as well as any repositioning of the asset allocation to stay within approved ranges.

4. To improve liquidity and manage both the expected and unexpected Retirement Plans need for cash, this IPS specifies a strategic allocation to the Cash Asset Class, which invests in approved investments including the Short-Term Investment Pool (STIP).

C. Monitoring/Reporting - Transparency

1. Managers shall submit periodic reports to facilitate Staff's monitoring of the Managers' conformance to investment restrictions and performance objectives.
2. Staff shall provide regular reporting to the Board regarding the asset allocation and performance of the pension plans as well as the characteristics and performance of the Asset Classes to confirm these items are known and adhere to all IPS requirements and expectations.
3. Staff will discuss and communicate any key information discovered due to the ongoing Manager monitoring process that might assist the Board in understanding the underlying investment manager structure or risks embedded in the investment characteristics of the Retirement Plan asset allocations.

D. Leverage

1. Leverage is a significant risk factor.
   a) Investment managers may utilize leverage only when permitted in the manager's investment guidelines approved by Staff.
   b) Staff shall monitor the use of leverage and its impact on risk and return.
2. The use of derivative securities can generate additional leverage even if the derivative is being used to reduce the risk in other investments.
   a) Investment managers may only use derivatives when permitted in the manager's investment guidelines approved by Staff.

E. Cash Investments

1. Cash investments held at the Retirement Plan, CAPP level, or any managed account within it, entail an element of credit risk.
2. Only approved cash investment vehicles are permitted. These include:
   a) Any cash vehicle at the Custodial Bank.
   b) STIP.
   c) Any SEC-registered money market fund approved by the CIO for internally managed funds or employed by an external asset manager which specifically address credit risk in their respective investment guidelines.

XI. Securities Lending

A. Section 17-1-113, MCA, authorizes the Board to lend securities held by the state.

1. The Board may lend its publicly traded securities through an agent, to other market participants in return for compensation.
2. Currently, through an explicit contract, the state's Custodial Bank manages the state's securities lending program.
   a) The Board seeks to assess counterparty and reinvestment risk, associated with each aspect of its securities lending program.
   b) The Board requires borrowers to maintain collateral at one-hundred and two percent (102%) for domestic securities and one-hundred and five percent (105%) for international securities.
   c) To ensure that the collateral ratio is maintained, securities on loan are marked to market daily and the borrower must provide additional collateral if the value of the collateral falls below the agreed-upon ratio of over-collateralization.

d) In addition to the strict collateral requirements imposed by the Board, the credit quality of approved borrowers is monitored continuously by the contractor.

e) Staff or the investment manager may restrict a security from the loan program upon notification to the Custodial Bank.

f) Staff will monitor the securities lending program and will periodically report to the Board on the status of the program.

g) The Board's participation in securities lending may change over time given Plan activity, market conditions, and the agent agreement.

XII. Exercise of Shareholders Rights

A. The Board recognizes that publicly traded securities and other assets of the Plans include certain ancillary rights, such as the right to vote on shareholder resolutions at companies' annual shareholders' meetings, and the right to assert claims in securities class action lawsuits or other litigation.

1. The Board will prudently manage these assets of the Plans for the exclusive purpose of enhancing the value of the Plans for its participating systems' members and beneficiaries through such means as:

a) Adopting and implementing a proxy voting policy.

b) Undertaking productive, cost-effective action to exercise its rights as shareholders or claimants in litigation.

B. Proxy Voting

1. Active voting of proxies is an important part of the Board's investment program.

a) Under the contractual arrangements between the Board and its investment managers, the responsibility for voting proxies on the investments is delegated to the managers.

(1) Managers are contractually required to establish a proxy voting program in coordination with Board Staff and are required to vote proxies, excluding shares on loan under the Board's securities lending program, in the interest of the Plans' beneficiaries.

(2) Records of proxy votes shall be maintained by the Managers, and/or its third-party designee, and submitted to Staff and/or an external service provider annually.

(3) Staff will monitor the proxy voting practices of the Board's external investment managers.

(a) External service providers may be retained by either the Board or the Managers to assist in monitoring efforts.

(b) This monitoring will be coordinated with each manager to reasonably assure the Staff that Managers are fulfilling their fiduciary responsibilities with respect to proxy voting.

C. Class Action Litigation

1. 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.

(a) The Board shall take reasonable, cost-effective steps to identify, pursue, and collect upon claims under securities laws for losses suffered by the Board on its investment.

(b) Accordingly, the Board maintains a detailed litigation policy, including process steps, outlined in Policy 10.250 of the Governance Manual.

XIII. Investment Policy Statement Review

A. Per the Board's Governance Policy, "the Board shall create, maintain, and revise as necessary Investment Policy Statements (IPS) for each separate account it manages. The IPS shall cite the law establishing the account if such law exists, the permissible investments authorized by law, and establish an investment range for each of the permissible investments. The Board shall review such policies at least annually or more frequently at the request of Board staff. IPS may only be revised in a public meeting. All IPS shall be posted on the Board's website for review by the public."