

# MONTANA

## BOARD OF INVESTMENTS

### BOARD ADOPTED POLICY

POLICY NUMBER: 40.500

EFFECTIVE DATE: May 24, 2023

TITLE: Trust Funds Investment Pool  
Investment Policy Statement

SUPERSEDES: November 30, 2021

BOARD ADOPTION: November 30, 2021

REVIEWED: May 24, 2023

#### I. Introduction

- A. The Trust Funds Investment Pool (TFIP) was created by the Board on October 1, 1995.
1. The pool is designed to provide participants exposure to a portfolio of income-producing assets.
  2. The use of a commingled pool allows for simplified investing and accounting, broader diversification and thus less risk than would otherwise be available for individual participants.
  3. The TFIP invests directly in the underlying Asset Classes.
  4. Each Asset Class has an underlying set of investment objectives and investment guidelines. Each account participating in the TFIP is separately identified for accounting and record keeping purposes.
- B. This policy is effective upon adoption and supersedes all previous Investment Policy Statement (IPS) related to the investment management of the TFIP.

#### II. Purpose

- A. The purpose of this policy statement is to provide a broad strategic framework for the TFIP investments under the guidance of the Board.

#### 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 and gave the Board sole authority to invest state funds, 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. The Board, as the investment fiduciary, is responsible for establishing the investment parameters for the TFIP.

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1. The Board has the authority to allocate to any previously Board-approved asset class in the proportions it considers prudent, under the prudent expert rule.
2. Asset allocation decisions made by the Board must be made in a public meeting.

#### IV. Strategic Investment Objectives

- A. The Board's primary objective is to provide investment income to participants.
- B. The Board's secondary objective is to achieve the highest level of investment performance.
- C. Both objectives must be compatible with the Board's risk tolerance and prudent investment practices.
- D. The Board seeks to maintain a long-term perspective in formulating and implementing investment policies and evaluating 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 the objectives.

#### VI. Performance Measurement

- A. Success in achieving these objectives will be measured by comparing the risk and return of the account to the:
  1. Bloomberg/Barclays U.S. Aggregate Bond Index (IG fixed income).
  2. NCREIF ODCE Index (real estate).
  3. Bloomberg Barclays US High Yield – two percent (2%) Issuer Cap Index (Non-Core fixed income).
  4. Fifty percent (50%) MSCI ACWI Commodity Producers Index / fifty percent (50%) MSCI ACWI Infrastructure Index (real assets).
- B. Each weighted proportionately to the portfolio's holdings.
- C. Performance results will be monitored and evaluated quarterly.
- D. Success in achieving the objective will be measured on a three (3) year, five (5) year, and ten (10) year annualized basis.

#### VII. Roles and Responsibilities

##### A. Board of Investments

1. The Board is responsible for approving the IPS for the TFIP and has the authority to manage the TFIP as it considers prudent, subject to such limitations as contained in law and the Constitution.
2. The Board reviews this document periodically and approves any changes to the policy as needed.
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 any and 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. The Executive Director is responsible for establishing the financial reporting procedures as well as collection and reporting of all income.

#### 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 investment policy 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 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 shall provide assistance to staff as requested in conjunction with the management of the TFIP.

#### 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 current asset allocation ranges for the TFIP are in Policy 40.501 of the Governance Manual.
  1. The asset allocation ranges are subject to change as modifications are adopted by the Board, at which time Policy 40.501 of the Governance Manual will be revised to reflect these changes.
  2. The Board will formally affirm or revise the asset allocation ranges for the TFIP 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 TFIP.
- C. Rebalancing 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. The CIO shall inform the Board of rebalancing activity at the Board's next regularly scheduled quarterly meeting only if rebalancing causes deviations from the Board approved ranges.
- X. Risk Management
- A. Evaluation of Investment Managers
    - 1. Board staff have detailed processes for investing in new managers and overseeing existing manager relationships in each asset class. These processes shall include, but are not limited to, an ongoing examination of manager investment strategy, philosophy & process, team/staffing, operations & compliance, risk management & legal functions. These processes will be regularly evaluated to comport with industry best practices.
  - B. Liquidity
    - 1. Many participants in the TFIP spend the income generated from their holdings.
    - 2. The total liquidity needs for the TFIP are generally low and participant capital is not expected to change dramatically on short notice.
    - 3. Illiquidity risk still needs to be monitored and managed by staff on a regular basis to ensure that:
      - a) 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 pool participants.
        - (1) A significant percentage of the investment in Core Real Estate is considered illiquid.
        - (2) Due to the limited liquidity of these assets, it will typically be impractical to fund participant cash needs or correct deviations from policy ranges through the purchase or sale of these assets.
    - 4. The investments held in Investment Grade and High Yield Fixed Income are categorized as publicly traded securities.
      - a) In "normal market" conditions many of the underlying assets 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.
  - 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 TFIP 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 TFIP asset allocation.
  - 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 within the TFIP 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) Short-term Investment Pool (STIP).
  - c) Any SEC-registered money market funds 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 acceptable and adequate collateral per the terms of the securities lending authorization agreement.
  - 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 account activity, market conditions and the agent agreement.

#### XII. Exercise of Shareholder Rights

##### A. Proxy Voting

1. Article VIII, Section 13 of the Montana Constitution requires that "no public funds shall be invested in private corporate capital stock" with the exception of public retirement system and state compensation insurance fund assets. Therefore, the TFIP does not participate in proxy voting.

##### B. 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 the 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. The authority to approve IPS may not be delegated to staff".

Authority: Montana Constitution, Article VIII, Section 13  
Section 2-15-1808, MCA  
Section 17-1-113, MCA  
Section 17-6-201, MCA  
Sections 17-6-204 and -205, MCA  
Section 19-2-504, MCA