



**MONTANA**  
BOARD OF INVESTMENTS

# **Short Term Investment Pool Financial Statements**

**(Unaudited)**

**For the Fiscal Year Ending June 30, 2018**

**SHORT TERM INVESTMENT POOL**

*Prepared by the Staff and Management of  
The Montana Board of Investments*

STATE OF MONTANA BOARD OF INVESTMENTS  
SHORT TERM INVESTMENT POOL (UNAUDITED STATEMENTS)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

STATEMENT OF FIDUCIARY NET POSITION		
SHORT TERM INVESTMENT POOL		
FOR FISCAL YEAR ENDING JUNE 30, 2018		
(in thousands)		
Assets		
Investments:		
Cash and cash equivalents held at custodial bank	\$	2,250,669
Investments at fair value		<u>1,080,556</u>
Total investments		<u>3,331,225</u>
Dividend and interest receivable		<u>3,971</u>
Total assets		<u>3,335,196</u>
Liabilities		
Income due participants		<u>5,666</u>
Total liabilities		<u>5,666</u>
Net position held in trust	\$	<u><u>3,329,530</u></u>

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STATEMENT OF CHANGES IN FIDUCIARY NET POSITION	
SHORT TERM INVESTMENT POOL	
FOR FISCAL YEAR ENDING JUNE 30, 2018	
(in thousands)	
Additions	
Purchases by participants	\$ 8,043,349
Net investment earnings	
Investment earnings:	
Net increase (decrease) on fair value of investments	31,312
Dividend/interest income	21,543
Other investment income	11,768
Investment earnings	<u>64,623</u>
Administrative expenses	(704)
Short Term Investment Pool reserve expense	<u>(8,330)</u>
Net investment income	<u>55,589</u>
Total additions	<u>8,098,938</u>
Deductions	
Sales by participants	7,708,119
Income distributions to participants	<u>47,513</u>
Total deductions	<u>7,755,632</u>
Change in net position	<u>343,306</u>
Net position held in trust - beginning of year	2,961,989
Adjustment to beginning net position (Note 2)	<u>24,235</u>
Beginning of the year net position - as adjusted	<u>2,986,224</u>
Net position held in trust - end of year	<u>\$ 3,329,530</u>

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**NOTES TO FINANCIAL STATEMENTS**

The Short-Term Investment Pool (STIP) financial statements are included in the Board's Unified Investment Program (UIP) financial statements, which are audited by the Montana Legislative Auditor. These stand-alone STIP financial statements are for informational purposes only and are not separately audited. The Board's audited annual financial information is available from the Board at 2401 Colonial Drive 3<sup>rd</sup> Floor, PO Box 200126, Helena, MT 59620-0126 or by calling 406-444-0001. The Board's information can also be found on the Board's website at [www.investmentmt.com](http://www.investmentmt.com).

1. DESCRIPTION OF FUNDS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Funds

State agencies with accounts that retain their interest earnings are legally required to invest in STIP. Local governments entities can be statute voluntarily participate in STIP.

Basis of Accounting

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting and have been prepared in conformity with accounting principles generally accepted in the United States for governments (GAAP) as established by the Governmental Accounting Standards Board (GASB).

Cash and Cash Equivalents held within Pools

Cash and cash equivalents generally, are short-term, highly liquid investments with maturities of three months or less at time of purchase. STIP holds cash and cash equivalents that are measured at cost. STIP also holds cash and cash equivalents at fair value.

Type of Investments

STIP investments are primarily in short-term, high quality, fixed income securities with a maximum maturity of 397 or less. Variable rate securities shall have a maximum maturity of 2 years. STIP shall maintain a dollar-weighted average portfolio maturity of 60 days or less. This pool is managed to preserve principal while providing 24-hour liquidity for state agency and local government participants.

Valuation of Investments

Investments are reported at fair value on a trade date basis. Quoted market prices, when available, have been used to value investments. The fair values for securities that have no quoted market price represent estimated fair value. Fair value measurements are reviewed monthly, and third-party valuations are reviewed for reasonableness and compliance with approved price source authorization policy. Additional information on how the Board reports fair value measurements can be found in the Fair Value Measurement Note 6 – Fair Value Measurements.

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Revenue Recognition

Unrealized gains and losses are included as a component of investment income in the Statement of Changes in Fiduciary Net Position. Unrealized gains and losses are computed based on changes in the fair value of investments held from the beginning of the year, but unsold at the fiscal year end. The net change in fair value of investments also consists of the realized gains or losses. Interest income is recognized when earned. Dividend income is recorded on the ex-dividend date.

Investment Fees

The State Legislature sets management fees the Board charges. The maximum fee is set at the aggregate level at the beginning of each fiscal year for the UIP. Custodial bank fees are paid by a statutory appropriation from the State's general fund. The Board allocates the aggregate fees across the UIP, including STIP. During the fiscal year, STIP was allocated \$443 thousand in board fees and \$261 thousand in custodial bank fees for a total of \$704 thousand in fees. The STIP investment fee ratio was 0.02%.

Contributions and Withdrawals

Contributions and withdrawals are recorded when received or paid. STIP participants receive monthly income distributions. STIP distributable income includes net investment earnings, excluding the net increase (decrease) on the fair value of investments. STIP distributable income also includes amortization and accretion of securities purchased at a discount or premium.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from estimated amounts.

Regulatory Oversight

The Board was created by the State Legislature to manage the UIP established by the State Constitution. The Board is not registered with the U.S. Securities and Exchange Commission as an investment company.

Pool Participant Units

Pool units are purchased and sold in the same manner as individuals investing in mutual funds. The STIP participants purchase and sell units, at \$1 per unit, at the participant's discretion. Individual investments in the pools are not specifically identified to the respective participants.

2. OTHER ACCOUNTING CHANGES

Adjustment to Beginning Net Position

In November 2007, the STIP Reserve account was established. The STIP Reserve account may be used to offset losses within the STIP portfolio. STIP distributes income to its participants based on accrued interest and discount amortization, net of fees and STIP Reserve expense. Prior to the fiscal year ending June 30, 2018, the STIP Reserve was reported as a liability, instead of as a component of fiduciary net position in

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accordance with GAAP. As shown in the Statement of Changes in Fiduciary Net Position, the Board restated the liability as an increase to fiduciary net position of \$24.2 million as of July 1, 2017. For further detail on the STIP Reserve see Note 7 – STIP Reserve.

3. SECURITIES LENDING

As of October 2016, STIP was no longer participating in the security lending program. STIP did not have securities on loan as of June 30<sup>th</sup>.

4. INVESTMENT RISK DISCLOSURES

Custodial Credit Risk (Cash and Cash Equivalents and Investments Held at Custodial bank)

Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the Board will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Per policy, the Board's custodial bank must hold short-term and long-term credit rating by at least one Nationally Recognized Statistical Rating Organization (NRSRO) with a minimum requirement of A1/P1 (short-term) and A3/A-1 (long-term).

As of June 30<sup>th</sup>, all the public securities were registered in the nominee name of Board and held in the possession of the Board's custodial bank. Commingled fund investments are registered in the name of the Montana Board of Investments.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of any single investment per issuer name. Investments explicitly guaranteed by the U.S. Government are excluded from the concentration of credit risk requirement. Concentration risk is within the policies as set by the Board.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Except for U.S. Government securities, the pools' fixed income instruments have credit risk as measured by NRSRO ratings. Credit risk is contemplated for each individual portfolio in the investment policy statements (IPS). Credit risk is managed by constraining portfolio purchases around investment grade NRSRO ratings as appropriate. The U.S. Government guarantees its securities directly or indirectly.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Board uses effective duration as a measure of interest rate risk for all fixed income portfolios.

STIP investments are categorized to disclose credit risk and weighted average maturity (WAM). Credit risk reflects the weighted security quality rating by investment type as of the June 30<sup>th</sup> report date. Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated. An A-1+ rating is the highest short-term rating by the S&P rating service. STIP interest rate risk is determined using the WAM method. The WAM measure expresses investment time horizons

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– the time when investments are due or reset and payable in days, months or years – weighted to reflect the dollar size of the individual investments within an investment type. Inclusive of cash and cash equivalents, the WAM averages 46 days for the portfolio.

STIP Credit Quality Ratings and Weighted Average Maturity as of June 30, 2018 (in thousands)				
<u>Security Investment Type</u>	<u>Total Fixed Income Investments at Fair Value</u>	<u>Credit Quality Rating</u>	<u>WAM (Days)</u>	
Treasuries	\$ 19,900	A-1+	97	
Corporate:				
Commercial Paper	288,944	A-1	71	
Notes	225,121	A-1+	67	
Certificates of Deposit	546,591	A-1	42	
Total STIP Fixed Income Investments at Fair Value	\$ 1,080,556			

5. SUMMARY OF INVESTMENT POLICY – LEGAL AND CONTRACTUAL PROVISIONS

The Board manages the Investment Program pursuant to the “Prudent Expert Principle” mandated by state law, which requires an investment manager to:

- (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims;
- (b) diversify the holdings of each fund within the UIP to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and
- (c) discharge the duties solely in the interest of and for the benefit of the funds forming the UIP.

Allowed Investments

All investment policy statements (IPS) are approved by the Board. The IPSs also reflects Board approved asset allocation ranges.

The STIP IPS limits concentration of credit risk exposure by limiting portfolio investment types to 3% in any issuer except for U.S. Treasury and US Agency securities as well as any repurchase agreements with a financial institution.

STIP invests primarily in short-term, high quality, fixed income securities with a maximum maturity of 397 days or less. Variable securities shall have a maximum maturity of 2 years. STIP shall maintain a dollar-weighted average portfolio maturity of 60 days or less. STIP is managed to preserve principal while providing 24-hour liquidity for state agency and local government participants.

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Per the STIP IPS, "The STIP portfolio will minimize interest rate risk by:

- 1) structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations thereby normally avoiding the need to sell securities on the open market prior to maturity;
- 2) maintaining a WAM of 60 days or less (for this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities); and
- 3) STIP will maintain a reserve account."

STIP may hold fixed and variable rate securities. Interest payments on variable securities are based on an underlying reference rate, for example, the London Interbank Offered Rate (LIBOR).

## 6. FAIR VALUE MEASUREMENTS

The Board categorizes its fair value measurements within the fair value hierarchy established by GAAP as follows:

- Level 1—Quoted prices for identical assets or liabilities in active markets.
- Level 2—Prices determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly.
- Level 3—Prices determined using unobservable inputs.

Valuations not classified within these levels are further explained in the Investments at Net Asset Value section of the footnote.

### Fair Value Level

Fixed income and equity investments classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Fixed income investments classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Investments measured at cost are included to account for all investments.



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STIP has the following fair value measurements as of June 30<sup>th</sup>:

STIP Investments Measured at Fair Value (in thousands)		Fair Value Measurements Using		
	June 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by fair value level</u>				
Fixed income investments				
Treasuries	\$ 19,900	\$ 19,900	\$ -	\$ -
Corporate:				
Commercial Paper	288,944	-	288,944	-
Notes	225,121	-	225,121	-
Certificates of Deposit	546,591	-	546,591	-
Total fixed income investments by fair value level	<u>\$ 1,080,556</u>	<u>\$ 19,900</u>	<u>\$ 1,060,656</u>	<u>\$ -</u>
<u>Investments Not Required to be Categorized</u>				
Cash and cash equivalents held at custodial bank	2,250,669			
Total investments	<u>\$ 3,331,225</u>			

7. STIP RESERVE

In November 2007, a reserve account was established for STIP. The reserve account may be used to offset losses within the STIP portfolio. The STIP Reserve is detailed as follows for the year ending June 30<sup>th</sup>:

STIP Reserve Activity as of June 30, 2018 (in thousands)	
Beginning STIP Reserve	\$ 24,235
STIP Reserve activity	
Additions	
Interest income	350
Other investment income:	
Transfer of daily STIP income	4,192
Recoveries from write offs	3,626
Perm Coal enhancement fees	162
Total other investment income	<u>7,980</u>
Total additions	<u>8,330</u>
Total STIP Reserve activity	<u>8,330</u>
Ending STIP Reserve	<u>\$ 32,565</u>

8. SUBSEQUENT EVENTS

The Board's Executive Director retired September 28, 2018 and a new Executive Director started September 29, 2018.

The Board's Deputy Executive Director also announced their retirement effective November 23, 2018.