

## **RETIREMENT FUNDS BOND POOL (RFBP) INVESTMENT POLICY STATEMENT**

### **INTRODUCTION**

The purpose of this policy statement is to provide a broad strategic framework for fixed income investments, which are consolidated in the Retirement Fund Bond Pool (RFBP). This statement provides a basis on which to invest in fixed income securities through the employment of both internal and external managers and enables appropriate staff to monitor the progress of the fixed income managers on behalf of the retirement funds. The managers of the various portfolios and strategies are governed by their respective investment management guidelines. External manager are also governed by their investment management contract.

The types of fixed income managers are classified in the following broad strategy categories:

- Core fixed income
- Core Plus fixed income
- High Yield

### **OBJECTIVES**

**Strategic:** Attaining investment returns from fixed income markets while diversifying investment risk and manager risk.

- The primary objective of the fixed income investment program is to provide diversified exposure to the various fixed income markets for the benefit of the pension fund participants in a prudent and cost effective manner.
  - The majority of the core fixed income allocation will be managed internally to provide cost effective management as well as to act as a mechanism for liquidity within the program's overall allocation. The internal portfolio will also provide primary liquidity to retirement fund participants.
  - The balance of the fixed income assets will be invested with external fixed income managers selected with experience outside the core fixed income markets to provide broader exposure to the fixed income universe.

### **Performance:**

The return objective of the overall Retirement Fund Bond Pool (RFBP) is to achieve an annualized time weighted total rate of return exceeding that of the Lehman Government Aggregate Bond Index over any three year rolling period, after fees.

The return objective for the individual fixed income managers is the achievement of an annualized, time weighted total rate of return exceeding that of the relevant benchmark over any three year rolling period, after fees.

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**ALLOCATION BY STRATEGY**

Pool assets will be allocated within the following ranges by sector category:

| <b>Fixed Income Sector</b>                | <b>Range</b> |
|---|--------------|
| U.S. High Yield                           | 0 – 15%      |
| Non-U.S. (including emerging market debt) | 0 – 10%      |
| Total “Plus” Sectors                      | 0 – 20%      |
| Core (U.S. Investment Grade)              | 80 – 100%    |

These sector descriptions are more fully described below. The underlying security types listed here are not meant to be an exhaustive list but to capture the general market sector categories. Each portfolio will also include an allocation to a short term investment fund which is used to invest cash not utilized for the purchase of individual securities.

**Core:** This strategy primarily consists of U.S. investment grade rated securities, though may also contain an allocation to dollar denominated obligations of a foreign investment grade rated issuer (Yankee bonds). Sector exposures include government obligations, predominantly U.S. Treasury and Agency obligations; securitized obligations, including mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities; and credit obligations primarily in the form of corporate bonds.

**Non-U.S.:** This category includes both emerging market debt and developed market debt. Either of these could be denominated in dollars or non-dollar currencies. The underlying holdings utilized in the non-U.S. segment of the portfolio would be expected to consist predominantly of sovereign debt, though a limited exposure to corporate credit may be allowed. With respect to currency risk posed by non-U.S., non-dollar holdings, this will be hedged as fully as practicable with respect to the major currencies where liquid instruments exist to hedge assets back into dollars at low cost; primarily developed market debt instruments. This would not apply to emerging market holdings denominated in local currencies.

**High Yield:** This sector consists of predominantly U.S. corporate credits, whether in the form of bonds or loans that are rated below investment grade. Specific portfolio guidelines that prohibit or constrain certain types of securities will be addressed in the manager’s specific investment guidelines.

**LIQUIDITY**

Liquidity needs for the fixed income program are low, as participant capital allocated to the pool is not expected to change dramatically on short notice. Nevertheless, the underlying assets held are predominantly publicly traded securities which can normally be liquidated in a relatively short period to accommodate broad asset allocation changes between fixed income and other asset categories held by the retirement plan participants.

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### ROLES AND RESPONSIBILITIES

**Board of Investments** – The Board is responsible for approving the Investment Policy Statement for the Retirement Fund Bond Pool. The Board reviews this document periodically and, as needed, approves any changes to the policy and allocation ranges.

**Chief Investment Officer** - The Chief Investment Officer (CIO), with the support of other staff, is responsible for recommending policy changes, including any changes in allocation ranges, for Board approval.

**Staff** - Staff is responsible for investing the internal fixed income portfolio, monitoring allocations and external managers, recommending allocation changes to the CIO, and recommending retention or termination of external managers to the CIO.

**Investment Consultant** – The investment consultant assists the CIO and staff with policy recommendations and provides advice to the Board. The investment consultant also assists staff in monitoring all external managers and reports to the Board independently.

**External Managers** – Managers are responsible for all aspects of portfolio management as set forth in the contract specific to each manager. Managers must communicate with staff as needed, regarding investment strategies and results. 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.

### LEGAL

According to the unified investment program directed by Article VIII, section 13, of the 1972 Montana Constitution (MCA 17-6-201: Unified investment program-General Provisions):

- (1) Public funds must be administered by the Board of Investments in accordance with the prudent expert rule, which requires any investment manager to:
  - (a) discharge 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 within each fund of Retirement Fund Bond Pool 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 duties solely in the interest of and for the benefit of the funds forming the Retirement Fund Bond Pool.