

STATE FUND INSURANCE – NEW FUND (FUND (MU26) INVESTMENT POLICY STATEMENT

INTRODUCTION

This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge 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 manners exercises in the conduct of an enterprise of a like character with like aims; (b) diversify the holdings of each fund within the unified investment program 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 unified investment program.

The Montana Constitution, Article VIII, Section 13 (4) requires that "Investment of state compensation insurance fund assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of a private insurance organization. State compensation insurance fund assets may be invested in private corporate capital stock. However, the stock investments shall not exceed 25 percent of the book value of the state compensation insurance fund's total invested assets.

OBJECTIVES

To maximize investment income consistent with safety of principal through a broadly diversified portfolio of fixed income securities. In addition the portfolio will contain an allocation to public stocks in order to provide dividend income and long-term price appreciation potential.

Performance: The primary objective of the fixed income portfolio is to obtain a relatively high level of book (purchase) yield versus the benchmark. A secondary objective is to provide a total return in excess of the benchmark. Success in attaining the return objective will be measured against the return on the Barclays Capital Government /Credit Intermediate Term Index, the return on the S&P 500 index and the return on the MSCI ACWI Ex U.S. Index (international equity index), each weighted proportionately to the portfolio's holdings, over a five-year moving average.

PERMITTED FIXED INCOME INVESTMENTS

- Debt obligations of the U.S. Government, including its agencies and instrumentalities. These include Treasuries, Treasury Inflation Protected Securities (TIPS) and fixed and floating rate agency obligations.
- Dollar denominated debt obligations of developed country foreign governments.
- Dollar denominated debt obligations of index-eligible supranational agencies (e.g., EIB, IFC, IADB).
- Dollar denominated debt obligations of domestic and foreign corporations (Yankee bonds) up to 2% of portfolio assets per issuer. These may include trust preferred securities and be fixed or floating rate coupon structures.
- Securitized assets, including U.S. Agency mortgage pass through securities (MBS), non-agency MBS (limited to 3% of portfolio market value in total), collateralized mortgage obligations (CMOs), commercial mortgage backed securities (CMBS), hybrid ARMS and asset backed securities.
- When-issued securities.
- Rule 144a securities.
- Medium term notes.

PROHIBITED FIXED INCOME INVESTMENTS

- Over the counter derivatives, including interest rate swaps and credit default swaps.
- Short sales and securities margin loans.
- Bank loans.
- Interest only (IO) and principal only (PO) mortgage strips.
- Companion/residual/equity tranches of CMOs or other structured securitizations.
- Capital securities (convertible from fixed to floating)
- Inverse floaters.

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- Convertible bonds.

CONSTRAINTS

Liquidity: Liquidity is needed to pay claims on a daily basis. A STIP balance of 1 percent to 5 percent will be held for liquidity purposes.

Term: This fund is considered an intermediate-term insurance account. The maximum maturity will be approximately ten years for fixed income securities and the average duration of the fixed income segment of the portfolio will be maintained in a range of 2 to 5 years, except in extraordinary circumstances where a shorter duration may be advisable in order to preserve principal.

Equity Allocation: The allocation to public equities is targeted at 10 percent of total portfolio market value. The allocation range is set at +/-2% or 8% to 12%.

Fixed Income Quality:

- Fixed income securities purchased must be investment grade and be rated by either Moody's or S & P and the maximum fixed income credit risk will be limited to 2 percent of the total securities portfolio in any one name. There will be no limitation on US Government/Agency Securities.
- Fixed income holdings rated lower than "A3" or "A-" are limited to a maximum of 25 percent of the fixed income portfolio at the time of purchase. In the case of split rated securities, the lowest rating will apply.
- On a quarterly basis, the BOI will notify the State Fund of any issues out of compliance or issues that have fallen below investment grade.

Sector Allocation:	
Fixed Income – Government/Agency Bonds	20% - 70%
▪ U.S. Treasury/Agency	20% - 45%
▪ U.S. Mortgage Backed Securities	0% - 20%
▪ Non-U.S. Developed Country (U.S. Pay)	0% - 5%
Fixed Income - Corporate Bonds	30% - 55%
▪ Domestic	30% - 50%
▪ International (U.S. Pay)	0% - 5%
Cash - Short- Term Investment Pool (STIP)	1% - 5%
Equity – Common Stock	8% - 12%
▪ S & P 500 Index Fund	6% - 12%
▪ MSCI ACWI Ex U.S. Index Fund	0% - 4%
Total Portfolio	<u>100%</u>