

## SHORT-TERM INVESTMENT POOL (STIP) INVESTMENT POLICY

### PURPOSE

The purpose of this document is to establish policies that will govern the investment activities of the Montana Board of Investments (MBOI) with regard to the management of the Short-term Investment Pool (STIP). These policies are adopted by, and can be changed only by a majority of Board members at a publicly-noticed meeting.

These policies are designed to ensure the prudent management of public funds, conformance to Montana Constitution and law, the availability of operating and capital funds when needed, and an investment return competitive with comparable funds and financial market indices.

All participants in the investment process shall act responsibly as custodians of the public trust and shall recognize that the STIP portfolio is subject to public review and evaluation. The pool shall be designed and managed in accordance with the standards of a “prudent expert” and managed as a “2a-7-like” portfolio.

### SCOPE

This Investment Policy applies to the investment of short-term operating funds of the State of Montana, participating local government entity funds, and the liquidity requirements of the various pension and trust funds managed by the MBOI.

1. **Pooling of Funds.** Each participant choosing to invest in the STIP must provide a legal opinion that it is authorized by law to participate. The STIP will consolidate cash balances from all participating funds to maximize investment earnings. Investment income is accrued daily and allocated monthly to participants based on their pro rata participation and in accordance with generally accepted accounting principles.
2. **Amortized Cost.** STIP holdings are carried at amortized cost.

### DELEGATION OF AUTHORITY

1. **Board.** The Board, as a quasi-judicial body under state law is legally responsible for the prudent investment of the STIP. The Board is responsible for approving and amending this policy and delegates the responsibility for administering the STIP as outlined below:
2. **Staff.** Responsibility for the daily operation of the STIP is delegated to Board Staff, who shall act in accordance with this policy. Staff’s duties include, but are not limited to, the following:
  - a. **The Executive Director** (ED) is responsible for the creation of the STIP investment program and the establishment of investment and financial reporting procedures consistent with this policy. The ED is also responsible for the following:
    - i. collection and reporting of all income;
    - ii. reconciling all transactions with the records of brokers and custodians; and,
    - iii. monitoring compliance with statute and this policy.
  - b. **The Chief Investment Officer** (CIO) shall establish a system to review and regulate the activities of subordinate investment officers and shall exercise authority over the entire investment staff and investment process.
  - c. **The Portfolio Manager** (PM) assigned to the STIP portfolio is responsible for, but not limited to, the following:
    - i. developing and recommending amendments to the STIP policy to the CIO;
    - ii. implementing and adhering to the STIP policy;
    - iii. structuring the portfolio to meet investment objectives;
    - iv. all trades undertaken in the portfolio; and,
    - v. reporting to the Board at least quarterly on the results and investment strategy for the pool.

## SHORT-TERM INVESTMENT POOL (STIP) INVESTMENT POLICY

- d. **The Board Internal Auditor (BIA)**, if the Board chooses to employ one, will periodically review the STIP internal controls. The audit will be designed to measure Board Staff compliance with this policy.
3. **General Investment Consultant.** The General Investment Consultant shall provide assistance to the Board's Staff as requested in conjunction with the management of the STIP.

### OBJECTIVES

1. **Investment Objective.** The STIP shall be managed to accomplish the following hierarchy of objectives:
  - a. **Preservation of Principal.** The STIP portfolio investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate the inherent risks associated with short-term money market investments, primarily credit risk and interest rate risk
    - i. **Credit Risk.** The STIP portfolio will minimize credit risk, the risk of loss due to the failure of the security issuer or backer by means of the following:
      1. limiting investments to those securities with high credit ratings;
      2. pre-qualifying the financial institutions, broker/dealers, intermediaries and advisers with whom the STIP will conduct business; and
      3. diversifying the investment portfolio so that potential losses on individual securities will be minimized.
    - ii. **Interest Rate Risk.** The STIP portfolio will minimize the risk that the market value of the securities will deviate significantly from cost due to changes in the general level of interest rate by means of the following:
      1. structuring the investment portfolio so that 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. investing funds primarily in short-term maturities of money market securities; and
      3. maintaining a dollar-weighted average portfolio maturity 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).
  - b. **Maintenance of Liquidity.** The STIP portfolio will maintain sufficient liquidity to meet all state agency and local government operating requirements and STIP participant investment cash flow needs that can be reasonably anticipated; and
  - c. **Return.** The STIP investment portfolio shall be managed with the objective of attaining a money market rate of return throughout market and economic cycles, taking into account the investment risk constraints and liquidity needs of the participants.

### AUTHORIZED & SUITABLE INVESTMENTS

1. **Permissible Securities.** The following securities and investment vehicles are approved for purchase for the STIP:
  - a. U.S. Treasury and U.S. Governmental Agencies, or corporations wholly owned by the U.S. Government;
  - b. Publicly traded domestic corporate bonds, notes and medium term notes (MTNs);
  - c. Asset-backed securities (ABS) collateralized by: credit cards, automobile loans, leases and other receivables acceptable to staff in their analysis of this type of structure;
  - d. Publicly and privately traded U.S. dollar denominated money market securities, including, but not limited to:

## SHORT-TERM INVESTMENT POOL (STIP) INVESTMENT POLICY

- i. Bankers' Acceptances (BA),
    - ii. Commercial Paper (CP), and
    - iii. Certificates of Deposits (CD), including Eurodollar and Yankee obligations which include CDs issued in U.S. dollars by foreign banks and foreign branches of U.S. banks.
  - e. Floating rate securities tied to LIBOR, Fed Funds, Treasury Bills or commercial paper indices;
  - f. Repurchase Agreements and Reverse Repurchase Agreements;
  - g. U.S. Dollar bonds and money market securities issued in the United States by foreign borrowers (Yankees);
  - h. U.S. Dollar bonds and money market securities issued outside the United States by domestic or foreign borrowers; and
  - i. Institutional money market funds.
  - j. Investments required to implement the bond credit enhancement authorized by **Resolution 219**.
  - k. Short term investment fund of the custodial bank.
2. **Approved List.** Purchases of securities other than U.S. government or U.S. Agency obligations are restricted to those which are pre-approved. The approved list shall be maintained by Staff with issuers added or removed from time to time depending on an analysis of their risk characteristics and suitability for use in the portfolio. At least two investment staff must approve names on the list. Issuers on the list shall be reviewed at least semi-annually for continued inclusion on the approved list.

<b>DIVERSIFICATION AND LIMITATIONS</b>
--

These limitations shall apply at the time of purchase of a permissible security. Should the portfolio fall out of compliance due to downgrades or shrinkage of the total portfolio size, a reasonable cure period will be allowed so that compliance can be obtained through normal maturities or sales at fair market value. Sales will be considered as a means of curing any out-of-compliance condition only if deemed prudent by Staff in light of prevailing market conditions.

- 1. **U.S. Government Securities**
  - a. 100% of portfolio may be invested in U.S. Treasury Securities;
  - b. 65% maximum of portfolio may be invested in U.S. Government Agency Securities;
  - c. 25% maximum of portfolio per single U.S. Agency issuer.
- 2. **Commercial paper, corporate bonds, notes and medium-term notes (MTNs)**
  - a. 40% maximum of portfolio in corporate indebtedness;
    - i. Up to 100% of this corporate debt limit may consist of commercial paper; and
    - ii. Up to 50% of this corporate debt limit may consist of bonds, notes or MTNs.
    - iii. 2% maximum of portfolio per issuer in commercial paper and corporate bonds, notes, and MTN's except that up to 3% per issuer may be invested in CP maturing in seven days or less at times of restricted supply such as during calendar year-end. Repurchase agreement obligations of a financial institution shall not be considered in this limit;
  - b. CP, corporate notes, and MTNs must have a minimum of two separate credit ratings (either short or long term) by Standard & Poor's, Moody's or Fitch;
    - i. CP must be rated a minimum of A1 (S&P), P1 (Moody's) or F1 (Fitch) at the time of purchase; and
    - ii. Corporate notes & medium-term notes must be rated, by at least one rating agency, a minimum of AA- (S&P), Aa3 (Moody) or AA3 (Fitch) at the time of purchase.

**SHORT-TERM INVESTMENT POOL (STIP)  
INVESTMENT POLICY**

3. **Asset-backed Securities (ABS)**
  - a. 40% maximum of portfolio in Asset Backed Commercial Paper (ABCP);
  - b. 2% maximum of portfolio per issuer in ABCP;
  - c. ABCP must carry at least two separate credit ratings and be rated a minimum of A1 (S&P), P1 (Moody's) or F1 (Fitch) at the time of purchase;
  - d. ABCP purchases shall be limited to maturities of 30 days, except that up to 10% of the portfolio may be invested in maturities of up to 60 days;
  - e. 20% maximum of the portfolio may be invested in senior notes issued by Structured Investment Vehicles (SIV), however purchases as of the effective date of this policy may only be made if the issuer carries the explicit support of an approved financial institution that otherwise meets the criteria established for bank obligations listed below;
  - f. SIV's must be rated AAA or Aaa by at least two rating services (S&P, Moody's or Fitch) at the time of purchase; and
  - g. No more than 10% of the portfolio may be invested in any one financial sponsor of ABS of any type. In measuring exposure to a financial sponsor for this purpose, both holdings in the ABS sponsored by the firm as well as its direct obligations shall be considered. Repurchase agreement obligations of a financial institution shall not be considered in this limit.
  
4. **Bankers Acceptances and Certificates of Deposit**
  - a. 30% maximum of portfolio may be invested in the combination of BA's and CD's;
  - b. 2% maximum of portfolio invested in any one issuer, except that up to 3% per issuer may be invested in CD's maturing in seven days or less at times of restricted supply such as during calendar year-end. Repurchase agreement obligations of a financial institution shall not be considered in this limit;
  - c. BA's and CD's must carry at least two separate credit ratings and be rated a minimum of A1, P1 or F1 at the time of purchase; and
  - d. If rated by only one rating agency, the issuer's parent must also carry a minimum long-term unsecured senior debt rating of AA- or Aa3 or higher by a different rating agency.
  
5. **Repurchase and Reverse Repurchase Agreements**
  - a. Transactions will be conducted only with approved primary dealers or the master custodial bank, and under the terms of a written master repurchase agreement;
  - b. 30% maximum of the portfolio may be invested in repurchase agreements;
  - c. 5% maximum of the portfolio with any single primary dealer or financial institution;
  - d. The maximum term of any repurchase agreement will be 90 days;
  - e. Acceptable forms of collateral under repurchase agreements will consist of U.S. Treasury and/or U.S. Agency securities which will be required to be maintained at a market value of 102% of the value of the repurchase agreement;
  - f. The maximum term of any reverse repurchase agreement will be 90 days and must be matched to anticipated cash flows adequate to liquidate the transaction; and
  - g. A maximum of fifteen percent (15%) of the portfolio may be pledged to secure reverse repurchase agreements. Transactions will be used only to secure borrowings for temporary or emergency purposes.
  
6. **Institutional Money Market Funds (MMF's)**
  - a. Registered 2a-7 investment companies only;
  - b. 15% maximum of portfolio may be invested in institutional MMF's; and
  - c. 5% maximum of portfolio invested in any one MMF

## SHORT-TERM INVESTMENT POOL (STIP) INVESTMENT POLICY

### 7. Industry and Collateral Concentration Limitation

- a. No more than 15% of the portfolio will be invested in companies whose principal business activities are in the same industry except that holdings in financial service companies are not limited; and
- b. No more than 10% of the portfolio will be invested in any one type of receivable or collateral type via asset backed securities with the exception of financial institution obligations. These underlying types of collateral include such assets as trade receivables, student loans, residential mortgages, commercial mortgages, auto loans and leases, plant and equipment loans and leases, repurchase agreements, collateralized debt obligations of all types, credit card receivables, and other forms of collateral acceptable as part of the approval process for a specific issuer.

8. **Maximum Maturities.** To the extent possible, investment in the STIP portfolio shall attempt to match the anticipated cash flow requirements. For the purposes of the STIP portfolio, selection of investment maturities must be consistent with SEC Rule 2a-7 which requires a maximum final maturity of any security not to exceed 397 days, with the following exceptions:

- a. Securities used as collateral in repurchase agreements;
- b. A variable rate security which on any reset date can reasonably be expected to have a market value that approximates its amortized cost; and
- c. Securities received as settlement in exchange for an originally purchased security.

### 9. Liquidity

- a. Minimum one-day maturities equal to 5% or greater and minimum maturities within one week equal to 10% or greater of the total fund value including MMF holdings and balances in the U.S. Bank sweep account which is held by the Treasurer's Fund;
- b. The fund may not acquire any security if, or as a result, more than 10% of the fund's net assets would be invested in securities that are illiquid; and
- c. Illiquid securities shall include repurchase agreements maturing in more than seven days, and restricted, privately placed securities that are not registered under the Securities Act of 1933, with the exception that certain restricted securities eligible for resale to qualified institutional investors, including Rule 144a securities, are not subject to this limitation on illiquid securities.

## BENCHMARK

The STIP portfolio performance results will be compared to the return of a one month LIBOR index as a market benchmark, and the iMoneyNet First Tier Institutional only (gross) return as a peer group measure.

## DEFINITIONS

1. **2a-7-like** – A reference to a rule promulgated under the Investment Company Act of 1940 which defines the requirements of SEC-registered money market mutual funds.
2. **Asset-Backed Security** - Bonds or notes backed by loan paper or accounts receivable originated by banks, credit card companies, or other providers of credit; not mortgages.
3. **Banker's Acceptance** - A short-term credit investment which is created by a non-financial firm and whose payment is guaranteed by a bank. Often used in importing and exporting, and as a discount money market fund investment.

**SHORT-TERM INVESTMENT POOL (STIP)  
INVESTMENT POLICY**

4. **Certificate of Deposit** – A short-or medium-term, interest-bearing, deposit obligation offered by banks and savings and loans.
5. **Commercial Paper** - An unsecured obligation issued by a corporation or bank to finance its short-term credit needs, such as accounts receivable and inventory. Maturities typically range from 2 to 270 days. Commercial paper is available in a wide range of denominations, can be either discounted or interest-bearing, and usually have a limited or nonexistent secondary market. Commercial paper is usually issued by companies with high credit ratings, meaning that the investment is almost always relatively low risk.
6. **Corporate Note** - A type of unsecured debt issued by a corporation that may be longer-term than Commercial Paper, but shorter-term than a typical Corporate Bond.
7. **Repurchase Agreement** - A contract in which the seller of securities, such as Treasury Bills, agrees to buy them back at a specified time and price. May also be called “Repo” or “Buyback.” Typically used a short term form of collateralized borrowing by a bank or securities dealer.
8. **Reverse Repurchase Agreement** - A purchase of securities with an agreement to resell them at a higher price at a specific future date. The investor essentially borrows money and allows its securities to be held as collateral. Reverse Repurchase Agreements occur most often in government securities or other securities that are highly valued and thus considered a good form of collateral.
9. **Structured Investment Vehicle** - Bankruptcy-remote entities sponsored by large banks or investment managers for the purpose of generating leveraged returns. The sponsor earns the spread (differences in yields) between the longer-dated assets purchased and the short-term liabilities issued. The balance sheet of a structured investment vehicle typically contains assets such as residential mortgage-backed securities (RMBS), asset-backed securities (ABS) and other high-grade securities.