

**REGULAR MEETING OF THE
MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

**2401 Colonial Drive, 3rd Floor
Helena, Montana**

Thursday, March 13, 2003

AGENDA

I. CALL TO ORDER 1:00 p.m.

- A. Roll Call
- B. Approval of the January 30, 2003 Regular Meeting Minutes

II. EXECUTIVE DIRECTOR REPORTS - Carroll South 1:15 p.m.

- A. Budget Status Report
- B. Commercial Loan Policy Revisions
- C. Value - Added Loan Policy Revisions
- D. In-State Investment Procedure Recommendation
- E. Legislative Update (Verbal)
- F. Out-of-State Travel Requests

III. BOND PROGRAM - Louise Welsh 2:00 p.m.

- A. INTERCAP
 - 1. Activity Report
 - 2. Staff Approved Loans Report
 - 3. Loan Requests
 - 4. Resolution No. 200 - Issuance of INTERCAP Bonds

IV. CHIEF INVESTMENT OFFICER REPORTS - Jim Penner, CFA 2:30 p.m.

- A. Economic Overview - Newsletter
- B. Asset Allocation
- C. Investment Performance
- D. CRP Purchase Rates (FYI)
- E. Education Forum (FYI)

V. MONTANA LOAN PROGRAM - Delrene Rasmussen 3:00 p.m.

- A. Coal Tax Loan Program Activity Report - January
- B. Pension Mortgage Program Activity Report - January
- C. Pension Mortgage Program Delinquency Report
- D. Coal Tax Loan Program Delinquency Report

IV. INVESTMENT ACTIVITY - Internal Management 3:15 p.m.

A. Domestic Equities (Montcomp) - Rande Muffick, CFA

- 1. Transactions - January
- 2. Holdings Report
- 3. Strategy
- 4. Portfolio Additions
 - a. Chubb
 - b. First Data
 - c. Eli Lily

B. International Equities (MTIP) - Paul Runnalls

1. Internal Pool
 - a. Internal Transactions - January
 - b. Internal International Holdings Report
 - c. Strategy

C. Fixed Income - Bob Bugni, CFA

1. Transactions - January
2. Strategy

D. STIP and Treasurer's Funds - Rich Cooley, CFA

1. STIP Transactions - January
2. STIP Holdings Report
3. Treasurer's Fund Transactions - January
4. Treasurer's Fund Holdings Report
5. Strategy
6. Investment Policy Statements
 - a. Group Benefits Fund
 - b. Subsequent Injury Fund

IV. INVESTMENT ACTIVITY - External Management - Ed Kelly

- A. Security Lending Active
 1. Earnings Report - January
- B. Montana Private Equity Pool (MPEP)
 1. Transactions - January
 2. Holdings Report

VII. ADJOURNMENT 5:00 p.m.

The Board of Investments makes reasonable accommodations for any known disability that may interfere with a person's ability to participate in public meetings. Persons needing an accommodations must notify the Board (call 444-0001) or write to P.O. Box 200126, Helena, Montana 59620) no later than three days prior to the meeting to allow adequate time to make needed arrangements.

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

**2401 Colonial Drive, 3rd Floor
Helena, Montana
March 13, 2003**

MINUTES

BOARD MEMBERS PRESENT:

**Dick Anderson, Chairman
Dennis Beams
Karen Fagg
Maureen Fleming
Jay Klawon
Joel Long
Terry Moore
Tim Ryan
Calvin Wilson**

BOARD MEMBERS ABSENT:

None

STAFF PRESENT:

Robert T. Bugni, CFA, Senior Investment Officer
Geri Burton, Deputy Director
Richard Cooley, CFA, Assistant Investment Officer
Dana Chapman, Investment Staff Support
Kimberly Dallas, Program Assistant
Roberta Ecklund, Investment Analyst
David Ewer, Senior Portfolio Manager
Edward Kelly, Assistant Investment Officer
Herbert Kulow, Senior Portfolio Manager
Rande Muffick, CFA, Assistant Investment Officer
James R. Penner, CFA, Chief Investment Officer
Adam Nelson, Investment Analyst
Delrene Rasmussen, Assistant Investment Officer
John Romasko, Investment Analyst
Paul Runnalls, Investment Analyst, International Equities
Carroll V. South, Executive Director
Daniel Stevens, Investment Analyst
Louise Welsh, Bond Program Officer
Lon Whitaker, Investment Analyst

GUESTS: Gordon Hoven, US Bancorp/Piper Jaffray

CALL TO ORDER

Chairman Anderson called the regular meeting of the Board of Investments (Board) to order at 1:15 p.m. in the conference room at 2401 Colonial Drive, 3rd Floor, Helena, Montana. As noted above, the meeting convened with nine members of the Board present.

Member Ryan motioned for approval of the January 30, 2003 minutes; Member Moore seconded the motion and the motion was passed 9-0.

ADMINISTRATIVE BUSINESS

Chairman Anderson presented the following Administrative Business:

1. Staff Introductions - Ms. Gayle Moon introduced Ms. Tammy Lynn Hjelsted and Ms. Tami Pippin as the newest members of the Accounting staff for the Montana Board of Investments.

Member Klawon requested an opportunity to speak and stated that the Board has approximately \$15million invested in French companies. Member Klawon voiced his concerns about France's role in the United States attempt to disarm Iraq peacefully and quoted a statement made by President Bush following the "9/11" terrorists attacks that "you are either with us, or with the terrorists." Member Klawon sees no reason for the Board to help capitalize French companies by holding their stocks.

Member Klawon moved that the Board sell all French company stock and not purchase any more French stocks until

such time as a future Board determines that France has proven it is a friend of the United States again. Member Ryan seconded the motion.

Chairman Anderson requested that the motion be postponed until the presentation of the International Investments, so the Board could consider the impact of this motion on the portfolio. Member Fleming moved that the motion be tabled until presentation of the International Investments; Member Moore seconded this motion and the motion passed unanimously.

EXECUTIVE DIRECTOR REPORTS

Budget Status Report

Executive Director Carroll South presented this report for the period ending February 28, 2003.

Commercial Loan Policy Revisions

Executive Director Carroll South presented staff recommended revisions to the Commercial Loan Policy. The revisions address the circumstances under which interest rate reservations may be extended and the time lines for funding loans that have been committed. Proposed revisions to this policy are:

Section 4, Reservation Extensions -

Current policy states lenders may reserve an interest rate for 365 days and, with the payment of another fee, extend the reservation for two additional one year periods.

Proposed policy change would be -

- (a) If the project for which the loan proceeds will be utilized is not completed within the initial 365 day reservation period up to two additional 365 day increments may be granted upon written request and payment of an additional ¼% fee for each extension.
- (b) Additional 365 day extensions will not be granted if the project has been completed within the existing reservation/commitment period.

Section 5, Fundings -

This section would be new to the policy and would state the following:

- (a) Funding documents required in the commitment letter must be received within ninety (90) days after the first principal and interest payment date of the project term note or the commitment date expiration, whichever comes first.
- (b) Fundings will occur on or around the 10th day of the month.
- (c) At least thirty (30) days notice must be provided to be eligible for fundings.

Member Ryan moved for approval of staff recommendations; Member Wilson seconded the motion and the motion was passed 9-0.

Value Added Loan Policy Revisions

Executive Director Carroll South presented staff recommended revisions to the Value Added Loan Program Policy. The revisions specifically address the lenders responsibilities under the law.

Section 6, Lender Requirements -

This section would be new to the policy and would state the following:

- (a) A participating private financial institution may charge interest in an amount equal to the national prime interest rate, adjusted on January 1 of each year, but the interest rate may not be less than 6% or greater than 12%.
- (b) At the borrower's discretion, the borrower may request the lead lender to change this prime rate to an adjustable or fixed rate on terms acceptable to the borrower and lender.
- (c) Lenders may require Borrower to provide guarantees.
- (d) Any guarantees provided are shared 75.0% to the Board and 25.0% to the Lender
- (e) A participating private financial institution, or lead private financial institution if more than one is participating, may charge a 0.5% annual service fee.

- (f) The loan agreement must contain provisions providing for pro rata lien priority and pro rata liquidation provisions based upon the loan percentage of the board and each participating private lender.
- (g) If a portion of a loan made pursuant to this section is for construction, disbursement of that portion of the loan must be made based upon the percentage of completion to ensure that the construction portion of the loan is advanced prior to completion of the project.
- (h) A private financial institution shall participate in a loan made pursuant to this section to the extent of 85% of its lending limit or 25% of the loan, whichever is less. However, the board's participation in the loan must be 75% of the loan amount.

Member Fleming moved for approval of staff recommendation; Member Beams seconded the motion and the motion was passed 9-0.

In-State Investment Procedure Recommendation

In addition, Carroll South and Delrene Rasmussen presented staff recommendation to adjust loan pricing for federally guaranteed loans to approximate pricing for loan participation rates. The change in pricing structure would preserve funds for purchasing participation loans and increase the investment return on the overall portfolio commensurate with an increase in default risk.

Member Beams moved for approval of staff recommendation; Member Ryan seconded the motion and the motion was passed 9-0.

House Bill 94 - Public Participation and Notice Requirements

Carroll South, Executive Director presented House Bill 94 "An act revising and clarifying the public participation and notice requirements for open meetings; providing that an agenda for an open meeting must include an item allowing public comment on any public matter within the jurisdiction of the agency conducting the meeting; clarifying that an agency may not take action on any matter discussed unless specific notice of that matter is included on an agenda and public comment has been allowed; clarifying that the Governor's duty to ensure that agencies have policies and procedures to facilitate public participation applies to the Executive branch of state government; amending Section 2-3-103, MCA; and providing an immediate effective date."

Legislative Update

Executive Director Carroll South gave a Legislative update to the Board:

" SB 131 - Lending to Economic Development Offices/Regions has passed;

" A bill has been introduced that would change the performance bond process for extraction industries. Currently these industries can pledge surety other than the standard performance bond or escrowed funds. House Bill 433, as introduced, would not permit the Department of Environmental Quality to accept any other types of surety. The bill was amended on the House floor to permit other types of surety if it is prudent and approved by the Board of Investments. Mr. South is recommending to the sponsor of the bill that DEQ consult with us in these "other" surety situations, which is how it is currently being.

" \$93 million dollar Bill to transfer that money out of the Coal Tax Trust Fund was amended on the House floor to \$31.6 million. This vote did not receive the three-fourths votes required. A Bill has been introduced that is a combination of a cigarette tax increase of \$29 million and a transfer out of the Coal Tax Trust for \$29 million, totaling \$58 million. Mr. South is monitoring this Bill.

Out-of-State Travel

Executive Director Carroll South, presented travel recommendations for:

" Jim Penner to attend the Institutional Investors "Public Funds Symposium", July 9 11, 2003, in Avon, CO. Estimated cost of trip is \$84.00. Mr. Penner's expenses, with the exception of meals not included in the conference, will be reimbursed as he is attending as a presenter.

" Rich Cooley to attend the D.A. Davidson "Client Roundtable", Portland, May 15 - 18, 2003. Estimated cost of trip, including airfare, lodging, registration fee (if any), meals and misc. expense is: \$550.00.

Member Beams moved for approval of these recommendations; Member Long seconded the motion and the motion was passed 9-0.

In addition, Member Terry Moore will be attending the KKR Conference in Phoenix, April 28 & 29, 2003 and Member Maureen Fleming will be attending the Schrodgers Conference in London, May 26 - June 2, 2003.

Member Fleming announced that the Board of Investments has been invited to hold their September meeting at the University of Montana. This has been done in the past with staff making presentations to classes and students attending the regular meeting of the Board as well. The date for this meeting is September 18 & 19, 2003.

BOND PROGRAM

Activity Report

The Board reviewed this report for the period ending March 3, 2003.

Staff Approved Loans Report

Ms. Louise Welsh reported that:

Borrower: Jefferson County

Purpose: Finance costs associated with construction of a 2,000 sq. ft building

Staff Approval Date January 23, 2003

Board Loan Amount: \$100,000

Term: 3 years

Borrower: Sheaver's Creek, Lake County Water & Sewer District

Purpose: Finance costs associated with water system improvements

Staff Approval Date January 28, 2003

Board Loan Amount: \$178,400

Term: 10 years

Borrower: Billings Elementary District 2

Purpose: Finance purchase of 18 new copiers

Staff Approval Date January 31, 2003

Board Loan Amount: \$62,750

Term: 3 years

Borrower: Stevensville Rural Fire District

Purpose: Finance the purchase of a new water tender

Staff Approval Date January 31, 2003

Board Loan Amount: \$82,405

Term: 4 years

Borrower: City of Polson

Purpose: Finance the purchase of 2003 Ford Expedition police vehicle

Staff Approval Date February 3, 2003

Board Loan Amount: \$18,500

Term: 3 years

Borrower: Cascade County

Purpose: Finance reimbursement to City of Great Falls for improvements on Cascade County Fairgrounds Four Seasons Arena

Staff Approval Date February 11, 2003

Board Loan Amount: \$131,092

Term: 10 years

Borrower: City of Laurel

Purpose: Finance purchase of "Old Laurel Maintenance Site" excess land and building from MT Dept. of Transportation

Staff Approval Date February 26, 2003

Board Loan Amount: \$72,400

Term: 3 years

Borrower: Powder River County

Purpose: Finance costs associated to rebuild County livestock yards.

Staff Approval Date February 27, 2003

Board Loan Amount: \$30,000

Term: 5 years

Borrower: Town of Rexford

Purpose: To finance water system improvements.

Staff Approval Date February 28, 2003

Board Loan Amount: \$99,700

Term: Anticipation of USDA Rural Development long term financing

has been approved by staff.

INTERCAP

Ms. Louise Welsh presented staff's recommendation that the Board authorize staff to proceed with processing and closing the following loans using the Board's standard Bond Program Office procedures:

Borrower: Lewis & Clark County

Board Loan Amount: \$450,000

Term: 10 years

Purpose: Finance costs associated with remodel and mechanical/electrical system upgrade of the Lewis & Clark County Courthouse

Member Klawon moved for approval of this recommendation as presented; Member Wilson seconded the motion and the motion was passed 9-0.

Preliminary Resolution No. 200

Ms. Geri Burton, Deputy Director, presented Preliminary Resolution No. 200. The purpose of this Preliminary Resolution is to give preliminary approval to the issuance of bonds under the Municipal Finance Consolidation Act in an amount not to exceed \$15 million. This resolution also allows staff to work with the finance team to prepare the necessary documents for this bond issuance, and authorizes the issuance of bond anticipation notes should it be necessary to borrow from the Board of Investments as may be required to meet the needs of the Program prior to the issuance of bonds.

Staff recommendation is:

1. Authorize staff to take steps as deemed necessary to issue \$15 million in INTERCAP bonds for a term of 25 years;
2. Authorize the issuance of bond anticipation notes;
3. Adopt the INTERCAP Preliminary Resolution; and
4. Authorize the current INTERCAP Program finance team to provide the expertise to issue/underwrite the bonds.

Member Beams moved for approval of staff recommendation as presented; Member Long seconded the motion and the motion was passed 9-0.

CHIEF INVESTMENT OFFICER REPORTS

Asset Allocation Report

Mr. Jim Penner, Chief Investment Officer, presented the Asset Allocation report for March 14 and March 31, 2003 and April 15, 2003 transactions.

Quarterly Investment Performance Report

Mr. Penner presented the MTCP, International-Asia, International-Europe, Total International Equities, RFBP, TFBP, STIP, PERS, State Fund Performance and Returns by Asset Type quarterly report through the December 31, 2003.

LOAN PROGRAMS

Coal Tax Loan Program Activity Report

Ms. Delrene Rasmussen presented and the Board reviewed this report for January.

Pension Mortgage Program Activity Report

The Board reviewed this report for January.

Pension Mortgage Program Delinquency Report

The Board reviewed this report for the period ending December 20, 2002.

Coal Tax Loan Program Delinquency Report

The Board reviewed this report for the period ending December 31, 2002.

INVESTMENT ACTIVITY

Montcomp

Mr. Rande Muffick presented January transactions, the holdings report as of January 31, 2003 and the current investment strategy. Member Fleming moved for approval of the Montcomp strategy as presented; Member Klawon seconded the motion and the motion was passed 9-0.

In addition, Mr. Muffick presented Chubb, First Data, Eli Lilly as Portfolio Additions.

International Investment

Mr. Paul Runnalls presented January internal transactions, the internal international holdings report as of January 31, 2003.

The Board then asked that Mr. Runnalls continue the earlier discussion of French stocks owned by the Montana Board of Investments.

Mr. Runnalls reported that as of March 13, 2003, 13.7% of the Internal International Equities Portfolio is in French companies or \$14.4 million dollars; French companies make up 12.8% of the Index, which makes the portfolio slightly overweight. .

Member Klawon asked Mr. Runnalls how difficult it would be to reposition the money held in French stocks to another country. Mr. Runnalls reported that Air Liquide holdings were purchased in January; Alstom holdings have been sold; a small holding of Pechiney is still owned; continue to own holdings in Sanofi Synthelabo, Soc Generale, Peugeot SA, BNP Paribas, and Total Fina SA. Over the past 2 ½ months, with the exception of Pechiney and Alstom, the holdings

have been fairly good performers for the portfolio. Mr. Runnalls responded that it could be fairly hard to reposition. Staff would have to find that many more names to add to the portfolio, which does take time. Research and feeling comfortable with the company takes time. Transaction costs are steep. If the market were to rally, there would be transaction costs as well as the cost of missing out on the market while the French companies are being sold. Estimated cost to sell these stocks outright would be at a minimum of \$100,000. Determining the loss if a rally in the short term market were missed is hard to estimate.

Mr. Runnalls reported that the markets (MSCI Europe) were up 5 to 6% today and that he would be hesitant to sell right now. Mr. Runnalls thinks that there will be a short term rally once we get a resolution in Iraq and he has a very high comfort level with the French holdings, as well as the UK holdings, and is pretty comfortable with the Netherlands holdings. Member Klawon said that he would like to see the French stocks sold by the end of next week.

Member Anderson asked what the effect would be on the French companies if Americans did not purchase their products or services. Mr. Runnalls responded that Peugeot and Total Fina do not import many products to this country.

Member Fleming asked what the new benchmark would be. Mr. Runnalls responded that the benchmark could be customized, MSCI Europe ex - France.

Member Fagg asked if there are others that might be having this same discussion. Are others pulling their funds from France companies?

Member Beams stated that he would not be comfortable with any motion based on politics, although he shares the concerns and sentiment. The Board's responsibility is to make intelligent financial investments for the benefit of the beneficiaries. If we believe this portfolio may deteriorate because of the world situation then we should prudently reduce the exposure.

Member Ryan stated that the Board should be concerned that any backlash against France may be significant enough to impact French company stock.

Member Anderson believed that the backlash could be significant. The media has reported French goods not being purchased; French wines not being purchased, Evian water not being purchased. People are protesting against the French. There is a risk in holding French company stock.

Member Fleming does not want the Board to micromanage the investments. The Board does not have the ability to do this. Staff has heard our concerns and the responsibility has been given to them and they will exercise it. It is clear that the Board has expressed their intentions to staff not to make additional investments in France companies.

Member Long stated that the Board could clearly direct staff not to make investments in a specific country. By telling staff not to invest in France is not micromanaging. Micromanaging would be if staff was told not to invest in specific French companies. The reason not to invest in France is because French company stocks may not do well because of a possible backlash.

Member Fagg believes that customers are sophisticated and will do more research. If they discover that companies whose products they purchase are connected to French companies, there could be a further backlash. Philosophically, Member Fagg agreed with Member Klawon, but if there is going to be a motion, her concern is more about her fiduciary responsibilities and whether action in Iraq is taken, and growing sentiment in this country to not support the French and French companies. The impact may be short term and there may only be short term memories, but for the short term we should begin under-weighting and not purchasing any more French company stock.

Member Anderson stated that he realizes that the Board has fiduciary responsibilities but the \$15 million dollars invested in France could be invested elsewhere and that we must act on our convictions.

Member Klawon then asked whether Pyrford (the external European money manager) should be contacted and directed to eliminate the French stocks. If so, the contract would have to be reviewed.

Member Klawon restated his original motion that the Board sell all internally-managed French company stock in the next 30 days and put a moratorium on future purchases of French company stocks until such time that a future Board determines that France has proven itself to be a friend of the United States again. In addition, a new benchmark will be set. The motion does not include French company stock managed by Pyrford.

Chairman Anderson then called for any further discussion. Member Long asked Mr. Jim Penner, Chief Investment Officer to state his position. Mr. Penner stated that during his 19 years with the Board, staff has consistently opposed any kind of social screens, whether it be South Africa, tobacco, weapons, etc...and that position has not changed. Mr. Penner stated that staff monitors the International stocks on a daily basis. If in the judgment of the staff these stocks are at risk because of either an American backlash or some other kind of backlash, staff would lighten up on those holdings.

Mr. Penner stated that it is staff's position that a social screen not be applied. He believes that any time you limit the alternatives, you take on more risk. If the Board directs staff to liquidate French owned stocks in 30-days we will do so.

The Board then discussed the Public Participation and Notice Requirement as it relates to this motion. The Board concluded that this subject of the motion is included in the "strategy" for the International Investments and the "strategy" was include on the agenda and in the Board packet.

The Question was called and a Roll Call vote was taken. Those Members voting "Yea" are voting in favor of the motion; those Members voting "Nay" are against the motion.

Dennis Beams - "Nay" Karen Fagg - "Yea"
Maureen Fleming - "Nay" Jay Klawon - "Yea"
Joel Long - "Nay" Terry Moore - "Nay"
Tim Ryan - "Yea" Calvin Wilson - "Yea"
Dick Anderson - "Yea"

Motion passes, 5 "Yea" to 4 "Nay".

Member Fleming, speaking on behalf of those that voted "Nay", said that it was not because we approve of what France is doing, but it is our fiduciary responsibility to let the staff make these decisions.

Member Ryan shares Mr. Penner's concern that the Board should carefully consider establishing precedence in what staff may or may not invest in.

Member Anderson asked for a motion to direct staff to proceed with the new international investment strategy. Member Klawon made this motion; Member Ryan seconded the motion and the motion was passed 9-0.

Fixed Income

Mr. Robert Bugni presented January transactions, and the current investment strategy. Member Fleming moved for approval of the Fixed Income strategy as presented; Member Long seconded the motion and the motion was passed 9-0.

Treasurer's and STIP Funds

Mr. Cooley also presented January STIP transactions, the STIP holdings report as of January 31, 2003, the January Treasure's Fund transactions, the Treasurer's Fund holdings report as of January 31, 2003 and the current investment strategy for both of these funds. Member Fleming moved for approval of the STIP Fund and Treasurer's Fund strategy as presented; Member Wilson seconded the motion and the motion was passed 9-0.

In addition, Mr. Cooley presented the Investment Policy Statement for Group Benefits Fund. Member Fagg moved for approval of the Investment Policy Statement as presented; Member Moore seconded the motion and the motion was

passed 9-0.

Mr. Cooley presented the Investment Policy Statement for Subsequent Injury Funds. Member Long moved for approval of the Investment Policy Statement as presented; Member Wilson seconded the motion and the motion was passed 9-0.

Security Lending

Mr. Jim Penner presented this report for January.

Private Equities

Mr. Jim Penner presented January transactions.

Montana Private Equity Pool (MPEP)

Mr. Jim Penner presented January transactions and the holdings report as of January 31, 2003.

NEXT MEETING

The next regularly scheduled meeting of the Board will be April 17, 2003.

ADJOURNMENT

There being no further business, the meeting was adjourned at 5:10 p.m.

BOARD OF INVESTMENTS

APPROVE:

Dick Anderson, Chairman

ATTEST:

Carroll South, Executive Director

DATE: