

# MONTANA BOARD OF INVESTMENTS

Department of Commerce

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October 11, 2013

Senator Dee Brown, Chair and Honorable Members  
State Administration and Veterans' Affairs Interim Committee

RE: Montana Board of Investments 'Pension Investment Principles'

Dear Senator Brown,

As requested by SAVA for its August meeting, my office submitted information related to the Board of Investments (BOI) investment principles, investment goals, and asset allocations strategies. As a follow up, our Chief Investment Officer, Cliff Sheets, and myself will be attending your October meeting to answer questions. In addition, since SAVA's last meeting, we have received two requests from committee members for additional information.

Senator Lewis inquired about administrative and investment manager costs for the various pension funds and a question as to what entity sets the actuarial rate of return. The two accompanying exhibits show a breakdown of such costs apportioned by individual pension fund and by individual investment pool. Costs are driven primarily by asset allocation. As can be seen in the breakdown by asset pool, the highest fees are associated with private assets, both private equity and private real estate, which both play important roles in the total pension portfolio structure. Montana's Constitution provides that the governing boards of the retirement systems shall administer the system, including the actuarial determinations (Art. VIII, Sec. 15); the Board considers 'actuarial determinations' to include investment rate of return assumptions.

Senator Malek inquired about 1) how the Board chooses its investments, 2) making investments within Montana as opposed to 'Wall Street', and 3) the North Dakota State Bank as a possible model for Montana.

The Board chooses its investments by following the Constitution, state statutes, and Board investment policies. These various constraints and requirements are then administered under the leadership of the state's Chief Investment Officer and as further delegated to the Board's investment staff.

In general the Board adopts an investment policy that is specific to each investment mission such as pension funds, or the State Fund, or the various trust accounts. Each policy statement sets out the mission's investment needs and its tolerance for risk. Permissible investment types and ranges are also specified. Policies are reviewed annually and posted on the Board's website. Investment returns are driven mostly by what *types* of assets are held, not so much as the actual individual investments, so **asset allocation decisions**, given their importance, are reserved exclusively to the full Board, with recommendations from investment staff and the Board's investment consultant.

Page 2  
Senator Dee Brown  
October 11, 2013

In-state investments versus 'Wall Street': The Montana legislature has established several in-state loan programs administered by the Board with various interest subsidies funded primarily through coal severance money. At this time, demand for these programs is low due to the current low-interest and bank high-liquidity environment.

Investment types using coal severance monies are limited under the Constitution; no equity financings are allowed. Equity investments are allowed under the Constitution for both State Fund and the state's public pensions. The supply of investment quality Montana-based equities, public or private, has been negligible despite numerous efforts by the State and the Board over many years to enhance the prospects of such investments.

The Bank of North Dakota (BND) as a possible model for Montana: Nearly every service offered by BND is also offered by some Montana state agency. For example student loans, housing financings, and participation in commercial loans are also available in Montana through state agencies or non-profit agencies established specifically by state law.

BND requires all state money to be deposited into BND but not North Dakota's public pension assets (in contrast to Montana, where all state money *including pension funds* must be deposited to the Board, with a few exceptions). BND does accept deposits from its citizens; Montana state law does not authorize this. BND deposits are *not* FDIC insured. BND can purchase and has a long history of buying bank and bank holding company stock to support North Dakota banks. Montana does not specifically serve this niche through legislative policy but does support its banking community by participating in commercial loans originated by Montana Banks.

BND's own website acknowledges that for most of its commercial lending activities, it does not make direct loans. With few exceptions, the Montana Board of Investments cannot make direct loans either.

Again, the Bank of North Dakota **does not invest** North Dakota's public pension funds. These investments are overseen and carried out by the North Dakota Retirement and Investment Office which invests in similar asset categories as does the BOI including bonds, global equities, private equity and real estate.

We welcome the opportunity to appear before your committee.

Sincerely,



David Ewer  
Executive Director

cc: Board Members

**Fiscal 2013 Management Fees**

<u>Pool</u>	<u>Board</u>	<u>Custodial Bank</u>	<u>External Managers</u>	<u>Total</u>
Retirement Funds Bond Pool (RFBP)	\$ 558,450	\$ 226,812	\$ 1,533,111	\$ 2,318,373
Trust Funds Investment Pool (TFIP)	367,360	158,076	1,617,475	2,142,911
Montana Domestic Equity Pool (MDEP)	489,400	534,924	6,622,194	7,646,518
Montana International Equity Pool (MITIP)	438,790	125,523	2,975,855	3,540,168
Montana Private Equity Pool (MPEP)	665,110	128,514	16,152,981	16,946,605
Montana Real Estate Pool (MTRP)	407,900	79,468	9,265,854	9,753,222
Short Term Investment Pool (STIP)	461,430	211,104	-	672,534
All Other Funds (AOF) Investments Managed	<u>678,060</u>	<u>151,934</u>	<u>68,648</u>	<u>898,642</u>
<b>Total</b>	<b><u>\$ 4,066,500</u></b>	<b><u>\$ 1,616,355</u></b>	<b><u>\$ 38,236,118</u></b>	<b><u>\$ 43,918,973</u></b>

**Fiscal 2012 Management Fees**

<u>Pool</u>	<u>Board</u>	<u>Custodial Bank</u>	<u>External Managers</u>	<u>Total</u>
Retirement Funds Bond Pool (RFBP)	\$ 628,331	\$ 210,492	\$ 1,506,845	\$ 2,345,668
Trust Funds Investment Pool (TFIP)	428,978	126,445	1,564,946	2,120,369
Montana Domestic Equity Pool (MDEP)	506,725	556,285	9,483,507	10,546,517
Montana International Equity Pool (MITIP)	525,356	155,820	3,626,673	4,307,849
Montana Private Equity Pool (MPEP)	715,836	110,148	15,779,225	16,605,209
Montana Real Estate Pool (MTRP)	503,241	65,633	7,985,684	8,554,558
Short Term Investment Pool (STIP)	535,595	211,284	-	746,879
All Other Funds (AOF) Investments Managed	<u>775,721</u>	<u>158,963</u>	<u>26,805</u>	<u>961,489</u>
<b>Total</b>	<b><u>\$ 4,619,783</u></b>	<b><u>\$ 1,595,070</u></b>	<b><u>\$ 39,973,685</u></b>	<b><u>\$ 46,188,538</u></b>

**Fiscal 2013 Administrative Expense Reconciliation to SABHRS**

	<u>STIP</u>	<u>MDEP</u>	<u>MPEP</u>	<u>MITIP</u>	<u>MTRP</u>	<u>RFBP</u>	<u>Total</u>	<u>SABHRS</u>	<u>SABHRS +/-</u>
09500 PERS	16,614.81	3,841,244.43	8,514,749.02	1,780,693.39	4,906,565.20	1,165,856.04	20,225,722.89	20,225,722.89	-
09501 POLICE	1,155.07	229,612.05	513,249.33	106,069.58	295,621.23	69,571.58	1,215,278.84	1,215,278.84	-
09502 GAME WARDENS	512.95	100,333.96	222,957.49	46,656.90	128,768.34	30,350.16	529,579.80	529,579.80	-
09503 SHERIFFS	1,078.95	214,707.52	476,717.65	99,742.23	274,323.18	65,078.96	1,131,648.49	1,131,648.49	-
09504 JUDGES	319.45	64,132.63	142,473.34	29,788.17	81,948.70	19,443.53	338,105.82	338,105.82	-
09505 HWY PATROL	426.45	97,648.06	216,718.64	45,257.30	124,741.54	29,611.78	514,403.77	514,403.77	-
09506 TRS	11,776.13	2,840,167.98	6,289,222.99	1,314,111.52	3,613,658.66	861,145.05	14,930,082.33	14,930,082.33	-
09508 VOL FIREMANS	118.48	25,613.59	56,642.91	11,719.31	32,013.19	7,776.34	133,883.82	133,883.82	-
09509 FIREFIGHTERS	1,187.04	229,618.92	513,873.73	106,130.00	295,582.14	69,539.97	1,215,931.80	1,215,931.80	-
<b>Totals</b>	<b><u>33,189.33</u></b>	<b><u>7,643,079.14</u></b>	<b><u>16,946,605.10</u></b>	<b><u>3,540,168.40</u></b>	<b><u>9,753,222.18</u></b>	<b><u>2,318,373.41</u></b>	<b><u>40,234,637.56</u></b>	<b><u>40,234,637.56</u></b>	<b><u>-</u></b>