MONTANA PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION

TITLE: State of Montana Investment Policy Statement
457 Deferred Compensation Plan

POLICY NO: BOARD Admin 12 EFFECTIVE DATE: 06/11/2015

I. INTRODUCTION AND PURPOSE

The plan was formally adopted by the 1973 legislature and began operation in 1976. The plan is for the exclusive benefit of participants and their beneficiaries. The Montana Public Employees' Retirement Board (MPERB), the plan sponsor, is fiduciary of the plan. Participants make individual investment decisions, subject to the investments offered under the plan and, ultimately, bear the risks and rewards of investment returns.

The purposes of this Investment Policy Statement are to (1) provide investment guidelines for a supplemental retirement-savings vehicle which permits participants to invest on a tax-deferred basis; and (2) allow the plan sponsor, MPERB, to meet its fiduciary responsibilities, evaluate the progress of the plan and positively influence its direction.

MPERB will review this Investment Policy Statement annually.

II. OBJECTIVES

The objective of the plan's investment policy is to make available a broad range of diversified investment options that have varying degrees of risk and return. The selection is intended to make it possible for the individual participant to achieve a balanced portfolio consistent with modern portfolio theory.

A. Return Requirement: The plan will offer a wide spectrum of investment alternatives to maximize the total rate of return to individual participants. Participants may design an investment plan from those alternatives that best meets their individual needs.

B. Risk Tolerance: Individual participants vary in their level of risk tolerance. Because participants direct their own investments, the plan will offer a wide spectrum of investment alternatives with varying levels of risk and return. MPERB will provide participant education to inform participants of investment alternatives.

C. Glide Path: The plan will offer target date funds whose asset allocation over time is designed to become more conservative the closer the fund gets to the target date.

III. INVESTMENT ALTERNATIVES

The plan will maintain at least eight wide-ranging investment alternatives to ensure sufficient choices are available to best meet each participant's personal needs. The investment alternatives must include a fixed income alternative and a stable value alternative. The investment alternatives may include publicly traded mutual funds (both retail and institutional), separate account funds, and commingled fund alternatives.

Investment guidelines for the stable value alternative are available by contacting the Montana Public Employee Retirement Administration. The remainder of this Investment Policy Statement does not apply to the stable value alternative.

A. Investment Spectrum Guidelines

The mutual fund, separate account, and commingled fund alternatives come from the following categories:

1. Bond – government or corporate bond fund, active or passive management.
2. Large-cap equity – active or passive management
3. Mid-cap equity – active or passive management
4. Small-cap equity – active or passive management
5. International equity
6. Global equity
7. Balanced – combined equity and bond investments in one option
8. Socially responsible fund
9. Target retirement date asset allocation funds

The plan may provide additional investment alternatives such as, but not limited to, risk profile/asset allocation funds. The plan may also change the categories of investment alternatives to meet participants' changing needs or changes in the investment industry.

B. Investment Selection Guidelines

The minimum criteria for selecting and evaluating the investment alternatives are:

1. Requirements:

   a. A fund must have a minimum of 3 years of measurable operating history. A fund that has not been operating for at least 3 years may be measured by its investment manager's history of at least 5 years operating funds that have similar management and investment objectives as the fund being measured. The investment manager's relevant operating history may consist of the management of commingled funds, mutual funds, or a composite of funds. A composite is a group of "separate account" funds managed under the performance standards of the CFA Institute.

   b. A fund that requires participants to pay either front or back end load fees will not be considered.

   c. A fund must have an expense ratio (internal expense charge plus any 12(b)-1 fee) no greater than the mean for the fund's peer group unless the following conditions are satisfied~~.~~:

      i. A mutual fund share class is determined to be more beneficial to participants because the expense ratio less revenue sharing offset is less expensive on a net basis than other available share classes of the same fund.

      ii. The revenue sharing offsets of that fund are returned to participants invested in the same fund.

2. Quantitative Measures:

   Funds are expected to:

   a. Meet or exceed the performance of an appropriate benchmark over a three-year and five-year period.

   b. Meet or exceed the 50th percentile return of an appropriate industry accepted database, approved by the MPERB, containing a sufficient number of funds in the same asset class and investment category over the most recent 3- and 5-year periods.

c. Funds with very strong performance records over very long time periods, such as ten years, may be retained within the plan even if the funds have underperformed peers or benchmarks over shorter time periods.

Target Date funds shall:

a. Be measured against the relevant Dow Jones Target Date Indexes. Within each index, the weightings among stocks, bonds and cash are rebalanced monthly in a similar manner to the Target Date funds.

b. Have the underlying investment funds measured against the appropriate index and the asset allocation regularly compared to stated target weight objectives as established by the Target Date fund prospectus.

3. Qualitative Measures:

In addition, each fund will be reviewed for other indicators including but not limited to:

a. style drift,

b. duplication,

c. manager or other organizational changes,

d. alterations in investment style, philosophy or strategy, and

e. non-compliance with stated guidelines.

C. <u>Evaluation of Investment Alternatives</u>

The performance of all plan investment alternatives will be evaluated on at least an annual basis . The evaluation must be conducted by an appropriate third party provider, by the Employee Investment Advisory Council (EIAC), or by the Montana Board of Investments. Each investment alternative will be compared to its peers and the appropriate benchmark. Investment alternatives that are determined to have a sub-standard performance rating or other negative indicators may be recommended for one of the following statuses by EIAC.

1. Review status

a. “Review” generally means that factors, including but not limited to performance, bear ongoing assessment and analysis for future action,

b. Investment alternatives in a review status typically will be elevated to a “probation” status prior to termination.

2. Probation status

a. “Probation” generally means that factors, including but not limited to performance, bear a higher level of assessment and analysis using the quantitative and qualitative measures established in III B 2 and 3.

b. Investment alternatives typically will be in a probation status prior to termination.

c. Investment alternatives in a probation status will only be terminated when ongoing assessment and analysis over a reasonable period of time warrant termination. The reasonable period of time may vary depending upon the investment alternative’s class and category, factors being assessed, and extent of the lapse from the established measures or potential harm to participants.

3. Continue an existing “review” or “probation” status

4. Termination.

The EIAC will report the evaluation results and EIAC’s recommendations to the MPERB, which will make the final determination as to action regarding the fund’s status. Additionally, EIAC will state the rationale for their recommendations, expectations for future actions and intended timelines. Plan investment alternatives which have been placed on a review or probation status by MPERB will be evaluated on a quarterly basis.

D. <u>Closure of an Investment Alternative</u>

The MPERB will notify participants in a terminated investment alternative to transfer their fund balance to another investment alternative within a reasonable period time (usually 3 months). If a participant fails to transfer a fund balance in the time provided, MPERB will transfer the fund balance from the terminated investment alternative to an investment alternative similar in investment category and style selected by MPERB to replace the

terminated investment alternative. If a terminated investment alternative is not replaced, MPERB may transfer the fund balance from the terminated investment alternative into an existing investment alternative with similar objectives and strategies, or to the default balanced fund.

IV. CONSTRAINTS

A. Liquidity Needs: Participation in the plan is optional. Participants may withdraw or transfer their funds from the plan under certain circumstances, subject to possible adverse tax consequences. Participants may, on a daily basis, move their assets from one investment alternative to another, subject only to the limitations set by the specific investment alternative. MPERB seeks to offer a range of investment alternatives within the plan that offers sufficiently liquidity to accommodate participant-driven transfers and withdrawals.

B. Time Horizon: Time horizons vary for individual participants. Because participants direct their own investments, there is no time horizon expressed for the total fund. Investment choices will be offered that provide participants with a wide variety of time horizons, depending on a participant's unique needs. However, because retirement funding is the most important goal, the plan will seek to offer quality investment alternatives that provide participants with favorable long-term returns.

C. Tax Considerations: The plan is exempt from federal and state income taxes. Participants' contributions to the plan are not taxed. The appreciation of participants' assets in the plan are not taxed. Therefore, tax-advantaged investments are not offered by the plan.

D. Legal Considerations: The plan is governed by applicable federal and state statutes and regulations, including Section 457 of the Internal Revenue Code of 1986, as amended, and Title 19, chapter 50 of the Montana Codes Annotated. MPERB's Deferred Compensation Plan Document provides additional legal information.

V. Cross Reference Guide

Section 19-50-102, MCA
ARM 2.43.1802
Transferred to ARM 2.43.5102

VI. History

Approved July 12, 2002
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