



TREASURER OF THE STATE OF LOUISIANA

Millennium Trust Fund

Statement of Investment and Cash Management
Policy and Procedures

November 30, 2007

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**Statement of Investment and Cash Management
Policy and Procedures for the
MILLENNIUM TRUST FUND**

I. PREAMBLE

The Millennium Trust was established under the Louisiana State Constitution as a special permanent trust fund. It was established to receive certain monies as a result of the Master Settlement Agreement, executed November 23, 1998 between the State of Louisiana vs. Philip Morris, Inc., et al. under the following formula:

- A. Fiscal Year 2000-2001, forty –five percent of the total monies received that year.
- B. Fiscal Year 2001-2002, sixty percent of the total monies received that year.
- C. Fiscal Year 2002-2003 and each fiscal year thereafter, seventy-five percent of the total monies received that year.
- D. Fiscal Years 2000-2001, 2001-2002, and 2002-2003, ten percent of the total monies receive in each of those years for credit to the Education Excellence Fund.

Within the Millennium Trust three special funds shall be established:

- A. The Health Excellence Fund
- B. The Education Excellence Fund
- C. The TOPS Fund

Each of the above funds shall be credited one-third of the Settlement Agreement proceeds deposited annually into the Millennium Trust, and one- third of all investment earnings on the investment of the Millennium Trust.

Appropriations from the Health Excellence Fund, Education Excellence Fund, and TOPS Fund shall be limited to an annual amount not to exceed the estimated aggregate annual earnings from interest, dividends, and realized capital gains on investment of the trust as recognized by the Revenue Estimating Conference. Amounts determined to be available for appropriation shall be those aggregate investment earnings which are in excess of an inflation factor as determined by the Revenue Estimating Conference. The amount of realized capital gains on investment which may be included in the aggregate earnings available for appropriation in any year shall not exceed the aggregate of earnings from interest and dividends for that year.

The Millennium Trust shall be invested by the State Treasurer with the same authority and subject to the same restrictions as the Louisiana Education Quality Trust Fund. Currently, the Millennium Trust is limited to investing 35% of its market value in equities. However, the portion of the monies in the Millennium Trust which may be invested in equities may be increased to no more than 50% of market value by legislative approval of two-thirds of the elected members of each house of the legislature.

The Millennium Trust will consist of both a “taxable” and “tax-exempt” pool. The tax-exempt pool will be invested exclusively in tax-exempt bonds. The Millennium Fund tax-exempt bond portfolio shall be invested in maturities matching the payout of Louisiana’s tobacco revenue bonds. The taxable pool will be invested primarily in taxable bonds and equity securities. Over time, the tax-exempt pool will de-allocate assets to the taxable pool.

The State Treasurer has the authority to contract, subject to the approval of the State Bond Commission, for the management of the Millennium Trust assets.

This document sets forth the following:

- A. The investment policies and objectives which the State Treasurer deems to be appropriate for the prudent investment and strategic planning of the Millennium Fund.
- B. The investment policies and objectives, and the selection of investment managers and performance criteria for investment managers.
- C. A guide used by the Treasurer and advisory committee or group formed by the Treasurer for the ongoing supervision of the investment program for the Millennium Fund to ensure that the assets remain invested in accordance with this document.
- D. Accounting and reporting guidelines for the purposes of measuring the performance of the Millennium Fund assets.

II. RESPONSIBILITY & MANAGEMENT

The Constitution and laws of the State of Louisiana vests the investment responsibility for the Millennium Fund with the State Treasurer. The State Treasurer may promulgate rules for the overall investment of the Millennium Fund. The State Treasurer shall employ an investment staff to manage the assets of the Millennium Fund and ensure that the fund is invested in accordance with the guidelines outlined in this document. Specific investment decisions are to be made by the investment staff.

The State Treasurer shall establish rules and procedures for the investment of the Millennium

Fund by outside investment managers (“managers”), which may be employed from time to time. The State Treasurer shall select outside investment managers through a competitive Request for Proposal (“RFP”) process.

III. INVESTMENT GOALS

The Millennium Fund shall be prudently managed within the parameters established by the constitution and the laws of the State of Louisiana. The State Treasurer will seek three equally desirable goals:

- A. To provide income in a stable and predictable fashion to the beneficiaries.
- B. Enhancement of market value of Millennium Fund through active management and diversification
- C. Preservation of Millennium Fund’s capital

The State Treasurer shall have the authority and ability to review these goals from time to time for their continued feasibility and appropriateness, and to make revisions when necessary.

The State Treasurer shall strive to achieve a predictable level of income for the Millennium Fund beneficiaries. The interest income requirement of the Millennium Fund is substantial and continuous. The Millennium Fund needs to grow to ensure a perpetual benefit for the Fund beneficiaries. In addition, it is important to enhance the market value of the Fund and provide growth in real terms after the effects of inflation.

The State Treasurer shall attempt to meet these goals by maximizing the return on the Millennium Fund investments consistent with an appropriate level of risk and subject to a generation of adequate interest income. Additionally, the Millennium Fund shall be adequately diversified to provide reasonable assurance that an investment in any single asset class, security type, or industry group will not have an adverse impact on the fund.

IV. ASSET ALLOCATION

Asset allocation can be a primary determinant of Millennium Fund investment performance, and is the responsibility of the State Treasurer. Asset allocation determines the appropriate weighing of stocks and bonds that yields the best-expected return after adjusting for risk. The asset allocation may be changed from time to time based on the condition of the financial markets and the economy. In establishing the appropriate asset allocation, recognition of the role and relationship of various asset classes will be considered. These include:

Bonds

The principal purpose of fixed income investments is to provide relative safety of principal and a predictable source of interest income.

Stocks

The principal purpose of stock investments is to provide capital appreciation and to a lesser degree, dividend income.

Cash & Cash Equivalents

The principal purpose of maintaining cash equivalents in the portfolio is to provide liquidity to meet the cash flow needs of the Millennium Fund beneficiaries. Cash and cash equivalents may also be used as a defensive strategy to protect the Millennium Fund from erosion of principal during unfavorable market conditions.

Target Asset Mix

<u>Asset Category</u>	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>
Bonds	55%	70%	100%
Stocks	5%	25%	35%
Cash/Cash Equivalents	1%	5%	10%

Note

The target asset mix is the long-term (three to five years) asset allocation of assets in the Millennium Fund portfolio. The target may change from time to time as investment goals and objectives change.

V. INVESTMENT GUIDELINES

The State Treasurer is authorized to invest in stocks of any corporation listed on the New York Stock Exchange, the American Stock Exchange, or authorized for quotations display on the National Association of Securities Dealers Automated Quotations System, provided that the total investment in such stocks at any one time shall not exceed thirty-five percent (35%) of the market value of all funds held by the Treasurer in the Millennium Fund.

Entry Into The Market

The allocation of Millennium Fund assets from bonds to stocks will cause a temporary or short-term decrease in interest income to the fund's beneficiaries. Therefore, the allocation to stocks will be gradually phased in over a period of five years. The State Treasurer will annually allocate not more than seven percent (7%) and not less than (5%) of the market value of the Millennium Trust Fund to stocks, and under no circumstances, unless requisite legislative approval is obtained, may the State Treasurer invest more than thirty-five percent (35%.) of the market value of the Fund in stocks. The first annual allocation to stocks shall be placed in a Standard & Poor's 500 Index Fund. In years thereafter, the State Treasurer may select active investment managers' styles. Allocations to investment managers will be made on a monthly

basis up to the target of 25% to 35%. This methodology should enforce the concept of dollar cost averaging and minimize the impact on interest income.

Investment Restrictions

Investment managers for the Millennium Fund stock portfolio are restricted from the following activities:

- A. The purchase of any direct interest in oil, gas or other mineral exploration program.
- B. Unregistered, private or direct placement securities of any kind.
- C. Direct ownership of real estate.
- D. Collectibles (coins, stamps, or art).
- E. Securities of the custodian bank(s), investment advisor(s), or their parent company that have any contractual relationship with the State Treasurer or Millennium Fund.

Stock Investments

- A. The investment in stocks shall be prudent in nature. Stocks should be selected for their expected return over a three to five year period.
- B. The Millennium Fund shall not own more than five percent (5%) of the outstanding stock of any company.
- C. No individual investment advisory firm managing a stock portfolio for the Millennium Fund may concentrate more than twenty-five percent (25%) of the market value of that portfolio in any single industry.
- D. The investment manager(s) stock portfolio should be well diversified and exhibit a diversification factor between .90 to 1.00.
- E. All stock portfolios shall have a beta coefficient from .90 to 1.15.

Stock Investment Restrictions

Investment managers for the Millennium Fund stock portfolio are restricted from the following activities:

- A. The purchase of stock options, warrants or futures.
- B. The purchase of any stock on margin.

- C. The short sale of any security.

Fixed Income Investments

The taxable and tax-exempt portion fixed income (bond) portion of the Millennium Fund portfolio shall be invested in marketable fixed income securities. The following policies shall be strictly adhered to:

- A. Bonds purchased in any Millennium Fund portfolio should be selected for their expected annual income.
- B. Bonds purchased in any Millennium Fund portfolio should be selected for their expected return over a market cycle, as defined herein.
- C. Bonds purchased in any Millennium Fund portfolio should be selected to provide income in a stable and predictable fashion to beneficiaries.
- D. Bonds purchased in the Millennium Fund taxable bond portfolio should be selected with consideration for total return. Total return takes into consideration interest income and capital appreciation/loss.
- E. All fixed income (bond) investments shall be appropriately diversified by maturity, security, sector, and credit quality.
- F. Active management of the fixed income portfolio may be engaged. Active management permits shifting along the yield curve and sectors of the fixed income market.
- G. The Millennium Fund bond portfolio may not hold more than ten percent (10%) at cost of any issuer's securities other than direct obligations of the U.S. Treasury and/or U.S. Agencies.
- H. In order to benchmark and limit interest rate risk, the Millennium Fund taxable bond portfolio shall have duration characteristics similar to the Lehman Brothers Aggregate Bond Index (or similar fixed income index approved by the Treasurer of the State of Louisiana) and under no circumstances shall the Millennium Fund taxable bond portfolio duration exceed 10 years.
- I. The Millennium Fund tax-exempt bond portfolio shall be invested in maturities matching the payout of Louisiana's tobacco revenue bonds. The total return of the tax-exempt bonds is a secondary consideration and will be benchmarked against a customized tax-exempt index.

Acceptable Fixed Income Securities

- A. The Millennium Fund may invest in direct general obligations or obligations, which are guaranteed by the United States Government.
- B. The Millennium Fund may invest in bonds, debentures, notes or other evidences of indebtedness issued by any of the following agencies of the United States Government: Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal Home Loan Bank (FHLB), Student Loan Marketing Association (SLMA), Federal Farm Credit Bank (FFCB) and Small Business Administration (SBA).
- C. The Millennium Fund may invest in time certificates of deposits of state banks, national banks, savings and loan associations domiciled in the state of Louisiana. Investments in time certificates of deposits shall be conducted under the policy and guidelines of the General Fund of the State of Louisiana.
- D. The Millennium Fund may invest in bonds, debentures, notes or other evidence of indebtedness issued by corporations or the United States. All corporate fixed income securities held in the Millennium Fund portfolio shall be rated investment grade credit quality classes of Moody's, Inc. (Baa or above) or Standard & Poor's Corporation (BBB or above).
- E. The Millennium Fund may invest in tax-exempt bonds issued by states, municipalities, public entities, etc. All tax-exempt fixed income securities held in Millennium Fund portfolio shall be rated investment grade credit quality classes of Moody's, Inc. (Baa or above) or Standard & Poor's Corporation (BBB or above).
- F. The Millennium Fund may invest in bonds, debentures, notes or other evidence of indebtedness issued by, and backed by the full faith and credit of, sovereign nations that are denominated in United States dollars. All foreign fixed income securities held in the Millennium Fund portfolio shall be "A" or above by Moody's, Inc., "A" or above by Standard & Poor's Corporation, or the equivalent rating by a rating agency recognized by the National Association of Insurance Commissioners (currently Moody's, Standard & Poor's, Fitch's and Dominion Bond Rating Service).
- G. Should any security in a Millennium Fund portfolio be downgraded below investment grade by a rating agency, the investment manager must notify the State Treasurer of any such rating change along with the investment manager's plan for liquidating any such security.

Fixed Income Investment Restrictions

The State Treasurer and any investment managers for the Millennium Fund bond portfolio are

restricted from the following activities:

- A. The purchase of bonds on a margin.
- B. The short sale of any security.
- C. Private or direct placement of any kind.
- D. Debt securities of the custodian bank(s), investment advisor(s), broker dealer(s) or their parent subsidiaries entered into a contractual relationship with the State Treasurer or the Millennium Fund
- E. Direct loans or extension of lines of credit.
- F. Purchases of bonds denominated in foreign currencies, purchased on foreign exchanges, or cleared through foreign clearing entities.
- G. Direct purchases of single family or commercial mortgages.
- H. Any mortgage pass-through security such as, but not limited to, pass-through mortgage-backed securities (MBS), collateralized mortgage obligations (CMOs), real estate mortgage investment conduits (REMICs), collateralized debt obligations (CDOs) shall be subject to the constraints listed below.
 - 1. U.S. Government and Government Sponsored Entity (GSE or Agency) guaranteed fixed and floating rate MBS, CMOs and REMICs can be held without limitation.
 - 2. Private label CMOs, REMICs and CDOs are restricted to the following:

- i. All collateral must be AAA rated
 - ii. Collateral commonly referred to as subprime or Alt-A are prohibited
 - iii. All collateral must be backed by first mortgage liens
 - iv. Sequential Pay (SEQ) tranches whose average life is less than 12 years
 - v. Planned Amortization Class (PACs) tranches that that are Type I and whose average life is less than 12 years
 - vi. Scheduled Class (SCH) tranches whose average life is less than 12 years
 - vii. Accretion Directed (AD) tranches whose average life is less than 12 years
 - viii. Private label CMOs, REMICs and CDOs shall not exceed 35% of the portfolio
3. Inverse Floating Rate (Inverses), Interest Only (IOs), Principal Only (POs), Companion and Residual tranches of MBS, CMOs, REMICs and CDOs are prohibited regardless of issuer.
 4. Targeted Amortization Class (TACs) and Accrual tranches of CMOs, REMICS and CDOs in aggregate will be limited to 5% of the mortgage securities portfolio regardless of issuer.
 5. At the time of purchase any CMO, REMIC or CDO investment's price risk shall not exceed 25% change in market value at +/- 300bps stress test, and Weighted Average Life shall not to increase by more than 7 years at +300bps stress test.
 6. In the event that other types of mortgage-related securities are developed that have risk characteristics similar to the permissible investments in this category the portfolio manager will first seek the approval of the Chief Investment Officer before entering into any securities transactions involving any such security.

Cash & Cash Equivalents

The principal purpose of maintaining cash equivalents in the portfolio is to provide liquidity for the cash flow needs of the Medicaid Trust Fund beneficiaries. Cash and cash equivalents may also be used as a defensive strategy to protect the Medicaid Trust Fund from erosion of principal during unfavorable market conditions.

Idle cash shall be invested daily. Idle cash shall be invested under the policy and guidelines of the General Fund of the State of Louisiana. 100% of the idle cash of the Medicaid trust may be invested in any one of the following:

- A. Idle cash may be invested daily through an automatic sweep into the custodian bank short-term investment fund (STIF) or Money Market Mutual Fund (Money Market). To be eligible a STIF is restricted to those securities eligible for investment by the State Treasurer. To be eligible a Money Market must be organized as a Massachusetts Business Trust and invest solely in securities otherwise eligible for investment by the State Treasurer.
- B. Idle cash may be invested in commercial paper rated in the two highest credit quality classes of Moody's, Inc. (P1) or Standard & Poor's Corporation (A1).
- C. Idle cash may be invested in Repurchase Agreements.

VI. PERFORMANCE MEASUREMENT

Millennium Fund investment performance will be measured by an unaffiliated organization with recognized expertise. To the extent possible, all performance measurement will be in compliance with the Association for Investment Management and Research (AIMR) performance presentation standards. Measurement will occur on a quarterly basis and will be used to evaluate the results of the total fund, asset classes, investment managers, and adherence to the guidelines.

Performance Goals

Performance evaluations of the Millennium Fund will be conducted on an annual basis. Investment performance will be measured relative to the appropriate benchmark. Annual evaluations will examine the continued feasibility of achieving the Millennium Fund investment goals and objectives.

To accomplish the Millennium Fund investment objectives, it is critical to recognize the role of asset mix and specific performance goals that exist for separate asset classes. The achievement of these goals is most appropriately determined over a full market cycle. A full market cycle is generally a period of three to five years.

Specific investment performance benchmarks for the Millennium Fund are:

Common Stocks

An annualized total return equal to or greater than the Standard & Poor's 500 Index net of investment management fees, custodial fees, and transaction costs.

Taxable Bonds

An annualized total return equal to or greater than the Lehman Brothers Aggregate Bond Index (or similar fixed income index approved by the Treasurer of the State of Louisiana) net of investment management fees, custodial fees, and transaction costs.

Tax-exempt Bonds

An annualized total return equal to or greater than a customized tax-exempt index net of investment management fees, custodial fees, and transaction costs.

VII. INVESTMENT MANAGEMENT FIRMS

Selection of Investment Mangers

The State Treasurer shall follow a Request for Proposal process using a strict selection criteria based on sound investment industry principles for the selection of investment managers.

Investment Managers Must Meet the Following Criteria:

- A. The investment manager must be a Registered Investment Advisor and in good standing with the Securities and Exchange Commission under the Investment Advisors Act of 1940, or in the case of a bank trust department, under the supervision and in good standing with the Office of the Comptroller of Currency and the Louisiana Office of Financial Institutions.
- B. The investment manager must provide five years of verifiable performance rates of return calculated on a time-weighted basis. These performance numbers must be based on a composite of fully discretionary accounts with a similar investment style and be reported net and gross of investment management fees.
- C. The investment manager must clearly articulate the investment philosophy and strategy that will be adhered to over time.
- D. Funds contracted with the investment manager for management purposes shall not exceed ten percent (10%) of the firm's assets under management in the style contracted.
- E. Investment managers shall be compensated on a basis point fee as a percentage of the market value of assets contracted to manage. Investment managers shall be paid in arrears on a quarterly basis.

Duties and Responsibilities:

- A. The investment manager shall manage the Millennium Fund assets under its care, custody or control in accordance with the objectives and guidelines set forth in this document, State Constitution, state laws, and rules promulgated by the State Treasurer.
- B. The investment manager shall have the discretion to invest a portion of Millennium Fund assets in cash reserves when deemed appropriate. The investment manager will be evaluated against peers for performance of funds under management.
- C. The investment manager shall promptly inform the State Treasurer in writing regarding any significant or material matters or changes pertaining to the investment of the Millennium Fund or in personnel within its organization. This would include, but is not limited to, the portfolio manager for the Fund, any principals of the firm and the director of research, if any. Communication should be directed to the Treasurer, State of Louisiana, Post Office Box 44154, and Baton Rouge, Louisiana, 70804.
- D. The investment manager shall acknowledge and agree in writing to their fiduciary responsibility and to comply with the investment policy set forth in the contract and the investment objectives and guidelines for the Millennium Fund and as modified in the future.
- E. Investment managers shall appear before the State Treasurer at least once a year. Investment managers may be required to appear more frequently if deemed appropriate by the State Treasurer. During this appearance, the Investment Advisor must discuss the following:
 - 1. Review of portfolio goals and objectives.
 - 2. Review of the financial markets and economic outlook.
 - 3. Discussion of portfolio performance.
 - 4. Discussion of transactions, including brokerage.
 - 5. Material changes of staff and ownership of the firm.
- F. Investment managers shall submit quarterly a written performance report to the State Treasurer detailing investment performance. Quarterly reports shall be submitted in a timely fashion.

Investment Manager Review

Investment managers are expected to perform in the top fifty percentile of their peer group. Should an investment manager fail to meet their performance benchmark within any rolling twelve (12) months, they will be placed under review.

Reviews will consist of the following:

- A. Scrutiny of the investment philosophy and process.
- B. Explanation of substandard performance to the satisfaction of the State Treasurer.
- C. Two additional quarters to bring investment performance up to standard without modifying the stated investment philosophy or strategy.

Failure to comply with the conditions resulting from being placed on review may result in termination of the investment manager's contract.

VIII. INVESTMENT CONSULTANT

From time to time the State Treasurer may retain the services of an investment consultant for the purposes of assistance in the following:

- A. Establishing the appropriate asset allocation.
- B. Determination of appropriate equity manager styles (growth versus value, large capitalization versus small capitalization)
- C. Conducting investment manager searches.
- D. Determination of investment manager risk profile.
- E. Performance evaluation of investment managers.

Selection of Consultant

The State Treasurer shall follow a Request for Proposal process using strict selection criteria based on sound industry principles for the selection of a consultant.

Investment Consultants Must Meet the Following Criteria:

- A. The investment consultant firm must have at least five years of experience consulting accounts with assets greater than \$250 million.
- B. The investment-consulting firm must have experience conducting investment manager searches and performance measurement for public funds with total assets greater than \$250 million.

- C. The investment consultant shall be paid in arrears quarterly basis.
- D. Any consultant that is a broker/dealer or investment manager, or that is affiliated with a broker/dealer or investment manager, must disclose the nature of the relationship. The investment consultant may not receive commissions or fees as a form of payment from any broker/dealer or investment manager that conducts business with the Louisiana State Treasurer.

IX. FUND ADMINISTRATION

Administration is vital to the integrity of the Millennium Fund and necessary for the fulfillment of goals and objectives. The State Treasurer shall provide the appropriate internal controls and record keeping insuring the integrity of the Millennium Fund.

Transaction and accounting records shall be complete and prepared on a timely basis with consideration given to the adequacy of an audit trail. Custody of Millennium Fund assets shall be in compliance with applicable state laws and be arranged to provide as much security, trading speed, and fund accounting as possible. Adequate insurance levels will be maintained by the Millennium Fund custodian or agent contracted by the State Treasurer.

All securities transactions to purchase or sell shall be entered into on a “best execution” basis, yielding the best-realized net price. All securities transactions shall be conducted on a delivery versus payment basis.

On or before December first of each year, the treasurer shall prepare and submit a report on the performance of the Millennium Trust to the Joint Legislative Committee on the Budget and the commissioner of administration for their review. With respect to the Education Excellence Fund, the report shall also be provided to the state superintendent of education.

X. INVESTOR RESPONSIBILITY

As a shareholder, the Millennium Fund has the right to voice opinions in the corporate affairs of companies owned by the fund. This includes the right and obligation to vote proxies in a manner consistent with the unique role and mission of the fund’s beneficiaries, as well as, for the economic benefit of the fund. The Millennium Fund shall be the primary beneficiary of all investment decisions. The Millennium Fund shall not be invested to achieve temporary benefit for any purpose, including the use of its economic power, to advance any political or social cause.