

**PUBLIC SAFETY PERSONNEL RETIRMENT SYSTEM
STATEMENT OF INVESTMENT POLICIES
AND GUIDELINES**

Statement of Purpose

Pursuant to the Arizona Public Safety Personal Retirement System Governance Manual, Section: *Fund Manager Charter* paragraph 8, and pursuant to Title 38, Chapter 5, Article 3, (§38-848(B)) Arizona Revised Statutes; the Fund Manager of the Arizona Public Safety Retirement System hereby establishes and adopts these investment Policies and Guidelines.

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I. Responsibility Statement.

The specific responsibilities and Charters for the Fund Manager, the Fund Administrator and the Investment Consultant are outlined in the PSPRS Governance Manual and are incorporated herein by reference. The Administrator is authorized to invest the funds of the Plan subject to the Governance Manual and the following policies, which, from time to time, may be changed by the Fund Manager.

II. Fund Objective and Benchmark for each fund.

- The objective of the Fund is to ensure the integrity of the Public Safety Personnel Retirement System in order to adequately fund benefit levels for members as stated in Title 38, Chapter 5, articles 3, 4 and 6 of the Arizona Revised Statutes and as amended from time to time by the Legislature. To achieve the objective, the Fund will do the following:
 1. Maintain a goal for the Fund's assets to be equal to the Fund's liabilities within any twenty-year period;
 2. Annually adjust the employer contribution rates based on the recommendations made by the annual actuarial valuations;
 3. Determine a reasonable contribution rate necessary to fund benefits approved by the legislature and then reduce the variation in the employer contribution rate over time to the Fund;
 4. Preserve and enhance the capital of the Fund through effective management of the portfolio in order to take advantage of attractive opportunities various markets and market sectors have to offer;
 5. Provide the opportunity for increased benefits for retirees as the legislature may from time to time enact through systematic growth of the investments of the fund.
- Consistent with the Fund objectives, the primary investment objective of the Fund is to maximize long-term real (after inflation) investment returns recognizing established risk (volatility) parameters and the need to preserve capital by:

1. Deriving a reasonable asset allocation model that attempts to fully achieve the primary investment objective, over the long term,
 2. Consistent with these policies and the direction of the Fund Manager, strategically allocating within asset classes and investment styles in order to enhance investment returns. This strategic allocation must at all times be within ranges set forth in these Policies.
 3. Regularly reviewing the status of investments,
 4. Regularly assessing the need to adjust the mix, type and composition of the investment classes within the allocation ranges.
- The possibility of short-term declines in the market value of the Fund or the Fund's assets is a recognized consequence of achieving potentially higher long-term investment returns.
 - The time horizon for evaluating total fund investment performance shall be long-term.

III. Eligible asset classes.

The capital of the Fund may be invested in the following eligible asset classes in accordance with the applicable state laws and regulations:

- Large, Mid and Small Cap Equities¹ both domestic and international,
- Fixed income investment vehicles e.g. Gov't and Corporate Bonds and direct real estate lending etc.
- Cash or cash equivalents,
- Real Property (Real Estate) both equity investment and secured and unsecured lending,
- Private Equities.

IV. Target asset mix and rebalancing policy.

- The Target Asset Allocation is defined as the range (a minimum and a maximum) within which assets may be allocated for particular classes.

¹ As defined by Standard and Poors

- The target asset allocation ranges are listed below. (Asset allocation reports shall include both cost and market so as to comply with existing provisions of State law:

| <u>ASSET CLASS</u> | <u>TARGET</u> | <u>RANGE</u> |
|--|----------------------|---------------------|
| (Values to be precisely determined after completion of the Asset Allocation Study due February 2005) | | |
| [Equities] | | |
| Large Cap | 50% | 40%-60% |
| Mid Cap | 10% | 5%-15% |
| Small Cap | 5% | 0%-10% |
| International | 0% | 0%-10% |
| Total Equities | 65% | 45% -80% |
| [Fixed Income] | 20% | 10% - 25% |
| [Real Estate]² | 10% | 5% - 15% |
| [Cash] | 5% | 3% - 8% |
| Total Fund | 100% | |

- Rebalancing shall consider overall portfolio performance, diversification and expected long-term return. The Administrator and staff (and as needed or desired, with such outside consultant retained by the Fund at the time for the asset classes being rebalanced), at the direction of the Fund Manager, shall, from time to time, assess the need for, and the process of implementation of, a rebalancing of the assets of the Fund. Rebalancing shall be accomplished with a view towards the Fund's cash flows, the prevailing and anticipated economic environment, and general factors affecting the risk and expected return within the respective asset classes.

V. Benchmarks for each asset class.

² Including both equity and lending type investments.

Performance benchmarks are necessary to properly measure and evaluate the success of the Fund. Performance should be evaluated on an annual, rolling 3 year, rolling 5 year and a rolling 10 year basis (net of fees and expenses and in compliance with CFAI Performance Presentation Standards (CFAI PPS). Evaluation and performance reports shall be derived and compiled (on annual, 3, 5 and 10 year rolling periods) by comparison to the following:

TOTAL FUND:

| <u>Asset Class</u> | <u>Relevant Index</u> | <u>%</u> |
|--|----------------------------|----------|
| (Values to be precisely determined after completion of the Asset Allocation Study due February 2005) | | |
| Large Cap | S&P 500 Index | 50% |
| Mid Cap | S&P 400 Index | 10% |
| Small Cap | S&P 600 Index | 5% |
| International | MASCI World x US Index | 0% |
| Fixed income | Lehman Gov't Credit Index | 20% |
| Cash | 90 day T-Bills | 5% |
| Real Estate | 8% expected rate of return | 10% |
| | | 100% |

The Fund's performance shall also be compared to the following Total Fund Composite Universe Benchmarks (on an annual, 3 and 5 year rolling periods):

| <u>Asset Class</u> | <u>Relevant Index*</u> | <u>Percent</u> |
|--|---------------------------------------|----------------|
| (Values to be precisely determined after completion of the Asset Allocation Study due February 2005) | | |
| Large and Mid Cap | Stratford large Cap Equity Peer Group | 50% |
| Mid Cap | Stratford mid Cap Equity Peer Group | 10% |
| Small Cap | Stratford Small Cap Equity Peer Group | 5% |
| International | (to be determined) | 0% |
| Fixed income | Stratford market Duration | 20% |

| | | |
|-------------|---|------|
| | Fixed Income Peer Group | |
| Cash | Stratford Short Duration Fixed Income Peer Group | 5% |
| Real Estate | 8% expected rate of return | 10% |
| | | 100% |

*Or comparable Peer Group Index approved by the Fund Manager

VI. **Investment Restrictions.**

This section applies only to the publicly traded equity and publicly traded fixed income portions of the Fund.

The following are guidelines and restrictions on the investment activities of the Fund: (in the case of pooled investment vehicles including commingled funds, partnerships etc. the investment guidelines and restrictions defined and detailed by the vehicle will apply. The Fund Manager shall approve all such restrictions and definitions):

General Restrictions

- The Administrator shall vote proxies solely in the best economic interest of the Fund.
- The Fund will not serve as lead plaintiff in class action securities litigation.
- The Fund's assets may not be used for the following purposes:
 1. Short Sales with the exception of securities out on loan as part of a Securities Lending Program as approved by the Fund Manager
 2. Purchase of Letter Stock, Private Placements (except Rule 144 with sufficient float)
 3. Leveraged Buy –Out Transactions (LBOs)
 4. Purchase of Securities not readily marketable
 5. Commodities transactions
 6. Puts, calls, straddles, or other option strategies

Specific Equity Restrictions

- The equity segment should be diversified across a spectrum of market segments by allowing investments in small-, medium-, and large-capitalization stocks.
- Unless specified otherwise in writing, equity holdings should be readily marketable and diversified by issuer, industry, and sector.
- An individual security position may not exceed 5% of the total portfolio's market value. No more than 5% of the Fund shall be invested in securities issued by any one institution and the Fund shall not own more than 5% of the voting stock of any one corporation.

- Investments in venture capital and real estate (excluding publicly-traded REITS) are prohibited to be classified within the equity segment of the portfolio.
- Sector weightings are limited to no more than 4 percentage points above or below the S&P 500 sector weights at market.
- Any direct purchase of foreign corporate stocks not listed on an exchange registered under the laws of the United States or any state of the United States must be approved by the Fund Manager prior to purchase.

Publicly Traded Fixed-Income Restrictions

- Fixed income holdings should be readily marketable and diversified by issuer, sector, coupon and quality.
- Other than bonds issued as direct obligations of and fully guaranteed by the U.S. Government, not more than 5% of the Fund or its fixed income portfolio at market value shall be invested in bonds issued by any one institution, agency or corporation.
- Fixed income portfolios must have a minimum weighted average quality rating of A3/A-.
- Fixed income securities must have a minimum quality rating of Baa3/BBB- at purchase.
- The portion of the bond portfolio in securities rated Baa3/BBB- through Baa1/BBB+ must be 20% or less of the market value of the fixed income portfolio.
- Commercial paper must have a minimum quality rating of A-1/P-1 at purchase.
- Investments in non-dollar securities and securities rated below Baa3/BBB- may only be made upon the prior written approval of the Fund Manager.
- Investments in derivatives are limited to collateralized mortgage obligations (CMOs), collateralized bond obligations (CBOs), collateralized debt obligations (CDOs), and asset-backed securities (ABS). Investments in other derivatives may only be made upon the prior written approval of the Fund Manager.

Other Investments Restrictions

- Direct investments in real estate, whether a sole investment or with a partner of the Fund, are limited to the type, term and amounts approved by the Fund

Manager. Real estate investments shall be limited to property in the United States. Real estate transactions entered into between regular Fund Manager meetings shall be reported to the Fund Manager at their regular meeting.

VII. Evaluation and Review Process

On a quarterly basis, the Fund Manager will evaluate investment performance using at a minimum:

- The Fund's actual asset allocation relative to the Target Asset Allocation, and
- The Total Fund's and each asset class's return relative to the stated investment objectives and the appropriate benchmarks and the composite universe and peer groups, and
- Any other reports or available information deemed necessary and pertaining to the Fund's investment and administrative performance.

On an annual basis, the Fund Manager will review the PSPRS Governance Manual and these Policies and Guidelines to ensure that they are consistent with best practices, the efficient and effective administration of the Fund and that they contribute to the investment objectives of the Fund.

VIII. Other appropriate risk management provisions.

General guidelines that the Administrator shall follow in the selection of publicly traded equities for purchase and sale shall include:

- The Fund should have an overall bias for stocks rated by Standard and Poors as 4 and 5 Stars.
- The Administrator shall not purchase any equities without the recommendation or concurrence of Standard and Poors (S&P is the Fund's current investment advisor) and/or such other investment advisor retained by the Fund.
- The Administrator shall make recommendations, subject to the investment policies and restrictions contained herein, regarding the purchase or sale of stocks to the Fund Manager.
- The Administrator shall have discretion in market timing regarding the purchase or sale of stocks.

- The Administrator shall have discretion subject to the policies and restrictions contained herein, to purchase stocks recommended by Standard and Poors and rated 4 and / or 5 stars by Standard and Poors, without the prior approval of the Fund Manager so long as no such individual purchase exceeds 1% of the market value of the stock portfolio, but shall advise the Fund Manager of such purchases at the next regularly scheduled Fund Manager meeting.
- The Fund Manager must approve any stock purchase that exceeds 1% of the market value of the stock portfolio of each system or plan.
- A stock must be rebalanced if its performance compared to its 52 week high is 35% or more below the performance of the S&P 500 compared to its 52 week high. To rebalance the stock position will normally be reduced by approximately 25% within 30 days, when feasible. Any such stock that meets this requirement shall be reported to the Fund Manager at the next regularly scheduled meeting along with recommendations for further actions.
- All purchases and sales of stocks must be reported to the Fund Manager at its next regularly scheduled meeting.
- All brokers who trade for the Fund must meet the approval of the Fund Manager and the Administrator. Any broker who trades for the Fund may be terminated at any time without reason.
- The Fund Manager must approve any change in brokers used by the Fund to execute stock or bond transactions on behalf of the Fund, and also any increases in fee rates paid to brokers. The Administrator is to report to the Fund Manager, quarterly, the amounts paid to each broker and also verify the fee rates fro each broker at that time.