

**AMENDED AND RESTATED PUBLIC SAFETY PERSONNEL  
RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICIES  
AND GUIDELINES**

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**Statement of Purpose**

Pursuant to the Governance Manual of the Public Safety Personal Retirement System, *Fund Manager Charter* paragraph 8, and Title 38, Chapter 5, Articles 3, 4 & 6, Arizona Revised Statutes, the Fund Manager of the Public Safety Retirement System hereby establishes and adopts these Amended and Restated Statement of 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 (and his staff, as determined by the Administrator) is authorized to invest the funds (collectively, the “Fund”) of (i) the Public Safety Personnel Retirement System (“PSPRS”), (ii) the Elected Officials’ Retirement Plan (“EORP”), (iii) the Corrections Officer Retirement Plan (“CORP”), (iv) a group trust called the Arizona PSPRS Trust (the “Trust”) formed by PSPRS, EORP and CORP (collectively, the “Plans”) to commingle their assets for investment, and (v) the Fire Fighter and Peace Officer Cancer Insurance Policy Program (the “Cancer Program”) subject to the Governance Manual, the Trust Declaration and implementing resolutions, and all applicable laws, including without limitation, the Plans’ “Enabling Legislation” (Title 38, Ch. 5, Articles 3, 4 and 6, Arizona Revised Statutes), the “Swap Act” (Title 35, Ch. 8, Article 1, Arizona Revised Statutes), the laws establishing the Cancer Program (Title 38, Ch. 4, Article 3, Arizona Revised Statutes) and the following policies, which, from time to time, may be changed by the Fund Manager.

## **II. Fund Objective.**

- The objective of the Fund is to ensure the integrity of the Fund in order to adequately fund benefit levels for members of the Plans 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; and
  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.**<sup>1</sup>

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

- U.S. Equities,
- Non-U.S. Equities,
- Fixed Income
- Short Term Investments<sup>2</sup>,
- Real Estate, both equity investment and secured and unsecured lending,
- Private Equities, and
- Opportunistic/ Dislocated

### **IV. Target Asset Mix And Rebalancing Policy.**<sup>3</sup>

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

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<sup>1</sup> Motion 02-51-07 – Discuss whether the eligible asset classes will change with the implementation of the Relative Protection portfolio (“RPP”) investment structure.

<sup>2</sup> As defined by GASB.

<sup>3</sup> Will the target asset allocation mix change with the adoption of the RPP investment structure? Will these allocations remain in affect for the portion of the Fund's assets being invested under any Absolute Return Portfolio (“ARP”) which might be adopted?

- 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 are subject to later modification)	
U.S. Equities	38%	35%-50%
Non-U.S. Equities	21%	15%-30%
Fixed Income global	20%	15%-25%
Short Term Investments <sup>4</sup>	1%	Four (4) Weeks
Cash		Operating Capital - 4%
Real Estate <sup>5</sup> global	6%	0%-10%
Private Equity global	6%	0%-10%
Opportunistic/Dislocated	8%	0%-9%
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.<sup>6</sup>**

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. Evaluation and performance reports shall be derived and compiled (on annual, 3, 5 and 10 year rolling periods) by comparison to the following:

<sup>4</sup> Motion 09/20/07 Meeting – Substituted term “cash equivalents, with the term “short term investments”.

<sup>5</sup> Including both equity and lending type investments.

<sup>6</sup> Motion 02-51-07 – Floors and ceilings for ranges were modified per Motion 7-3-08 – [Kutak Rock Comment: With the adoption of the RPP investment structure, the benchmark for that portion of the Fund's assets under the RPP would be the return for the median public pension plan plus 50 basis points, presumably. With regard to the remaining portion of the Fund's assets, which presumably, will be held and dealt with under any ARP that might be approved, it is uncertain whether these benchmarks would continue to apply].

**TOTAL FUND:**

<u>Asset Class</u>	<u>Relevant Index</u>	<u>%</u>
U.S. Equities	Wilshire 5000 Stock Index	38%
Non-U.S. Equities	MSCI All Country Ex-US World Stock Index	21%
Fixed Income	Lehman Gov't Credit Index	20%
Short Term Investments <sup>7</sup>	90 day T- Bills	1%
Real Estate	NPI/NCREIF <sup>8</sup>	6%
Private Equity	Wilshire 5000 Stock Index, plus 3% <sup>9</sup>	6%
Opportunistic / dislocated	(to be determined)	8%
		<hr/> 100%

Note: In valuing the success of real estate investments of the Fund, the Fund marked real estate investments to market value on December 1, 2007. From and after December 1, 2007, real estate investments will be valued by a methodology adopted by the Chair of the Investment Subcommittee.<sup>10</sup>

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)<sup>11</sup>:

<u>Asset Class</u>	<u>Relevant Index*</u>	<u>Percent</u>
U.S. Equities	Stratford large Cap Equity Peer Group	38%
	Stratford mid Cap Equity Peer Group	
	Stratford mid Cap Equity Peer Group	
Non-U.S. Equities	(to be determined)	21%

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<sup>7</sup> Motion 09/20/07 Meeting – Substituted term “cash equivalents”, with the term “short term investments.”

<sup>8</sup> Motion 10-28-07.

<sup>9</sup> Motion 10-29-07.

<sup>10</sup> Motion 10-27-07.

<sup>11</sup> [Kutak Rock Comment: This is an additional benchmark used by the Fund Manager to determine the success of the Fund. On February 28, 2007, the Fund approved new benchmarks as recommended by EnnisKnupp & Associates, which were set forth in the table immediately above. We are uncertain whether this additional benchmark was eliminated when the Fund Manager adopted the benchmarks recommended by EnnisKnupp.]

Fixed Income	Stratford market Duration Fixed Income Peer Group	20%
Short Term Investments	Stratford Short Duration Fixed Income Peer Group	1%
Real Estate	NPI/NCREIF	6%
Private Equity	Wilshire 5000 Stock Index, plus 3%	6%
Opportunistic /dislocated	(to be determined)	8%
		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 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 unless in accordance with Fund Manager Motion 8-17-08, adopted August 21, 2008, a copy of which is attached and incorporated herein by this reference;<sup>12</sup>
- 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

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<sup>12</sup> Motion 8-17-08.

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.

Not more than 80% of the Fund shall be invested in corporate stocks based on cost value regardless of appreciation.<sup>13</sup>

- 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, and shall be classified as Private Equity or real estate respectively.
- Direct equity holdings Sector weightings are limited to no more than 4 percentage points above or below the S&P 500 10 GICS sector weights at market

Corporate stocks and exchange traded funds purchased on foreign (as opposed to domestic exchanges) must be purchased from exchanges in which the U.S.

maintains diplomatic relations at the time of purchase.<sup>14</sup>

Corporate stock and exchange traded fund purchases on foreign exchanges (except for bank stocks, insurance stocks, and membership interests in LLCs) are limited to 20% of the Fund based on cost regardless of appreciation.<sup>15</sup>

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<sup>13</sup> Per SB 1151, enacted April 29, 2008.

<sup>14</sup> SB 1151, enacted April 29, 2008.

<sup>15</sup> SB 1151, enacted April 29, 2008.



### **Publicly Traded Fixed-Income Restrictions**

- Fixed income holdings should be readily marketable and diversified by issuer, sector, coupon and quality.
- Fixed income holdings may be in exchange traded funds which are diversified and designed to track fixed income indices.
- Other than bonds issued as direct obligations of and fully guaranteed by the U.S. Government and AAA rated US Federal agency debt, not more than 5% of the Fund (or its fixed income portfolio delete this section in parentheses) 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- provided, however, at least 75% of the portfolio must be rated A- or above, evaluated and rated at market value at the time of purchase.<sup>16</sup>
- Fixed income securities must have a minimum quality rating of Baa3/BBB- at purchase. However investments in securities below this minimum quality rating may be made and retained with the approval of the Fund Manager so long as the total of such fixed income investments does not exceed 5% of the total fixed income portfolio at market value.
- The portion of the bond portfolio in securities rated Baa3BBB- through Baal/BBB+ must be 25% or less of the market value of the fixed income portfolio; provided , however, not more than 5% of the portfolio may be rated below BBB-, evaluated and rated at market value at the time of purchase.<sup>17</sup>
- Other than short term investment funds or money market funds at the Fund's custodian Bank, 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 fixed income derivatives are limited to collateralized mortgage obligations (CMOs), collateralized bond obligations (CBOs), collateralized debt obligations (CDOs), and asset-backed securities (ABS) and collateralized loan

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<sup>16</sup> Motion 05-81-07.

<sup>17</sup> Motion 05-81-07 – [Kutak Rock Comment: Does this restriction permitting not more than 5% of the portfolio to be rated below BBB- contradict the prior restriction providing that fixed income securities must have a minimum quality rating of Baa3/BBB-?]

obligations (CLOs). Investments in other derivatives may only be made upon the prior written approval of the Fund Manager.

### **Other Investments Restrictions**

- Investments in real estate, whether direct investments or indirect through special purpose vehicles limiting liability with a partner, are limited to the type, term and amounts approved by the Fund Manager. Direct real estate investments shall be limited to property in the United States. Real estate transactions previously authorized by the Fund Manager and actually closed between Fund Manager meetings shall be reported to the Fund Manager at its next regularly scheduled meeting.

### **VII. Short Term Investments.**<sup>18</sup>

- Subject to the investment policies and restrictions contained herein, the Administrator may buy, sell and trade futures, currency forwards and other similar instruments for purposes of hedging risk exposures, equitizing cash and to facilitate transitions, optimizing asset exposure and asset allocations and other like purposes. This authority does not authorize the use of these products for purposes of economic leveraging up of returns on any asset classes, or for other speculative purposes.
- Subject to the investment policies and restrictions contained herein, the Administrator may invest in extendable commercial paper as an adjunct to the Fund's commercial paper investment program and money market instruments utilizing the Mellon Liquidity Management System.

### **VIII. 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

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<sup>18</sup> Motion 08-05-07.

efficient and effective administration of the Fund and that they contribute to the investment objectives of the Fund.

**IX. 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:

Effective October 1, 2008

- The Administrator may purchase equities not currently held in the portfolio only with the express prior consent of the Fund Manager except that the Administrator may purchase domestic equities not currently held in the Fund's portfolio without Fund Manager approval if the equities:
  1. are members of the Standard and Poors 500 index and,
  2. have analyst coverage by at least 4 analysts and,
  3. at purchase do not exceed 50 basis points of the market value of the total Fund and,
  4. the purchase does not result in a violation of the S&P sector weightings provisions above.

All such purchases shall be reported to the Fund Manager at the next monthly Fund Manager meeting following the purchase.

- The Administrator may purchase and sell exchange traded funds (ETFs) and mutual funds so long as such ETFs and mutual funds are diversified across and designed to track broad market indices and such purchases do not violate the 5% total Fund assets provisions herein.
- The Administrator may sell equities currently held by the Fund so long as such sales do not violate the S&P sector weightings herein, and all such sales are reported to the Fund Manager at the next monthly Fund Manager meeting following the sales.
- The Administrator may add to positions in equities held in the Fund's portfolio so long as such additions:
  1. do not overweight those securities by more than the greater of 1.5 X the S&P index weight of that security at market or 50 basis points.
  2. do not violate result in a violation of the S&P GICS sector weightings
  3. and such additions do not violate the 5% total plan assets provisions herein and do not violate the S&P sector weightings herein.

- REPORTING REQUIREMENTS: The Fund's Custodian Bank or other independent provider shall report to the Fund Manager on a monthly basis:
  1. The Holdings of the Fund
  2. All transactions in the plan in the preceding month
  3. Fund Performance
  4. The Fund's Asset Allocation
  5. S&P GISC sector weightings compliance for the direct equity portfolio
  6. Any direct holdings in excess of 5% of the total fund assets
- The Administrator shall make recommendations, subject to the investment policies and restrictions contained herein, regarding the purchase or sale of stocks.
- The Administrator shall have discretion in market timing regarding the purchase or sale of stocks.
- PLACE HOLDER – DELETED MANDATORY SELL LIST<sup>19</sup>
- 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 for each broker at that time.
- Global risk report will be issued for review by the Fund at monthly meetings.<sup>20</sup>
- Effective for the fiscal year 2006-2007, suspend the program of the Fund's assumed earnings rate reducing said rate by ¼ of 1% per year until such rate equals 8%. Thus, from this point forward, the Fund's assumed earnings rate shall remain at 8.5% until the Fund Manager otherwise directs.<sup>21</sup>

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<sup>19</sup> Motion 08-04-07.

<sup>20</sup> Motion 06-92-07.

<sup>21</sup> Motion 01-50-06.

## **X. Relative Protection Portfolio and Absolute Return Portfolio**<sup>22</sup>

- The Fund approved the Relative Protection Portfolio investment structure on April 17, 2008, subject to additional due diligence, clarification and agreement upon all necessary specifics, and, upon approval, implementation. The specific investment objective of the RPP is, for all one-year time periods ending on a specified date, the total gross return for that portion of the Fund's assets allocated under the RPP shall not be less than that of the median defined public pension plan. Under the RPP as proposed by investment staff at this time, the Fund's assets (or a portion thereof) will be distributed between four (4) Master Managers for investment, subject to the limitations of the Fund. Upon implementation of the RPP investment structure, certain of the limitations, restrictions and provisions of this policy may be subject to change.
- The goal of the Fund is to slowly transition the assets of the Fund to an Absolute Return Portfolio investments structure; however, the ARP has not and will not be presented for consideration or study by the Fund Manager until the RPP is in place.
- The current investment policy will remain in effect, and has not been repealed, but staff is directed to propose necessary amendments, including a section on Master Managers. Contracts for Master Managers shall not be placed on the Fund Manager's agenda until:
  1. The Administrator, CIO, Legal Counsel and Compliance Officer certify that the due diligence on same is complete and recommend approval;
  2. Ennis Knupp & Associates certifies that it has received all requested documents and information from staff, including full and unfettered access to the proposed Master Managers, together with a reasonable opportunity to review same;
  3. The Administrator and Compliance Officer certify that the account reconciliation for Mellon Bank is complete and operationally integrated on an ongoing basis. Master Manager encourages contracts with Master Managers to include provisions allowing a gradual phase in of the full amount authorized to be committed to such contracts by the Fund Manager.

## **XI. The Trust**

The Trust is approved, and the resolutions ("Resolutions") implementing the Trust are adopted.

All restrictions and controls that impact the operation of the Plans prior to adoption of the Trust apply equally to the Trust.

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<sup>22</sup> Motion 04-77-08.

Each of the Plans shall contribute assets to the Trust in such amounts and kind as the Administrator, in consultation with any Assistant Administrators and the Chief Investment Officer, shall determine.<sup>23</sup>

The Fund Manager delegates day-to-day administration of the Trust's affairs to the Administrator and those persons chosen by the Administrator and employed by the Plans, including any Assistant Administrator and Chief Investment Officer, whose powers are circumscribed by all laws and rules governing the Trust and Plans;<sup>24</sup>

Pursuant to the Declaration and Resolution, and subject to the Enabling Legislation and the Fund Manager's Governance Policies (and these policies), the Administrator (and those employed and designated by him) shall be empowered to take all action they deem necessary and appropriate to effect the purposes of the Trust and facilitate its operation, including without limitation, entry into custody agreements with custodial banks and related agreements, entry into investment management agreements with prospective investment managers, and the making of contracts of every kind.<sup>25</sup>

The annual cost of the Trust's administration shall be borne by the Plans in proportion to each Plan's beneficial interest in the Trust<sup>26</sup>;

The Trust and/or Plans shall credit all receipts and earnings, and charge payments to, the appropriate Plans or employers.<sup>27</sup>

The Trust shall account for its assets and operations as deemed appropriate by the Administrator in accordance with GASB and GAAP and in consultation with the Plans' auditors and other relevant professionals.<sup>28</sup>

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<sup>23</sup> Resolution of the Fund Manager No. 2008-02, at ¶ 2.

<sup>24</sup> Resolution of the Fund Manager No. 2008-02, at ¶ 4.

<sup>25</sup> Resolution of the Fund Manager No. 2008-02, at ¶ 5.

<sup>26</sup> Resolution of the Fund Manager No. 2008-02, at ¶ 6.

<sup>27</sup> Resolution of the Fund Manager No. 2008-02, at ¶ 7.

<sup>28</sup> Resolution of the Fund Manager No. 2008-02, at ¶ 8.