BOARD ACTION ITEMS
September 11, 2009

AGENDA ITEM: G.3.

Consider Delegation of Board Investment Authorities to the Arizona State Parks Executive Director

Background

The Board's statutory oversight of funds administered by Arizona State Parks (ASP) includes the Land Conservation Fund, Heritage Fund, State Lake Improvement Fund, OHV Recreation Fund, and the Publications and Donations funds. In particular, statutes for the Land Conservation Fund (A.R.S. §41-511.23) and the Heritage Fund (A.R.S. §41-502) both say "on notice from the Arizona state parks board, the state Treasurer shall invest and divest monies in the fund as provided by A.R.S. §35-313, and monies earned from investment shall be credited to the fund." The ASP Board has not made additional investment policy or directives with regard to these or the other ASP Board funds to date.

Current Status

A.R.S. §35-313 stipulates the types of fixed income investments that the Treasurer can make on behalf of the state and local governments (attached). Investments are limited to state bonds, U.S. government securities, and investment grade corporate commercial paper and bonds. Investment grade securities are described as those "which carry as a minimum one of the Baa ratings of Moody's investors service or one of the BBB ratings of Standard and Poor's rating service or their successors."

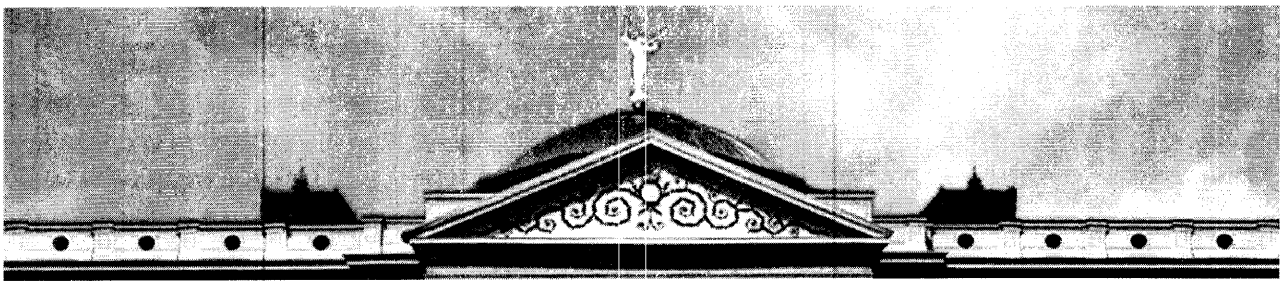
The Treasurer's Office states that its investment goals are, in order of importance: 1) Safety, 2) Liquidity and 3) Investment return given the first two requirements. Without direction from its state agency clients, however, the Treasurer typically invests in very short term, U.S. government and investment grade corporate bonds that currently yield less than 1 percent annually.

Staff Recommendation

By following both the statutorily allowed investment grade fixed income investments permitted by A.R.S. §35-313 and the Treasurer's written investment policies that emphasize safety, liquidity and, given those requirements, investment income, staff recommends that the Board delegate to the Executive Director, or designee, the authority to determine, in conjunction with the Treasurer's Office, the statutorily available investments that suit the goals of safety of principal while achieving the highest prudent yield for all ASP statutorily administered funds.

Recommended Board Action

I move that the Board delegate to the Director the authority to determine, in conjunction with the Treasurer's Office, the statutorily eligible and available investments from the Treasurer's Office that suit the goals of safety of principal while achieving the highest prudent yield for all ASP statutorily administered funds.



35-313. Investment of trust and treasury monies; loan of securities

A. The state treasurer shall invest and reinvest trust and treasury monies in any of the following items:

1. Obligations issued or guaranteed by the United States or any of its agencies, sponsored agencies, corporations, sponsored corporations or instrumentalities.

2. Collateralized repurchase agreements purchased from securities dealers that make markets in those securities listed in paragraph 1 of this subsection.

3. Bonds or other evidences of indebtedness of this state or any of the counties or incorporated cities, towns or duly organized school districts.

4. Commercial paper whose issuer is rated in one of the two highest rating categories for short-term obligations by any two nationally recognized statistical rating organizations.

5. Bills of exchange or time drafts known as bankers acceptances which are drawn on and accepted by a commercial bank.

6. Negotiable certificates of deposit issued by a nationally or state chartered bank or savings and loan association.

7. Bonds, debentures, notes or other evidences of indebtedness which are issued by entities organized and doing business in the United States and which carry as a minimum one of the Baa ratings of Moody's investors service or one of the BBB ratings of Standard and Poor's rating service or their successors.

8. Securities of or any other interests in any open-end or closed-end management type investment company or investment trust registered under the investment company act of 1940 (54 Stat. 789; 15 United States Code sections 80a-1 through 80a-64), as amended, if both of the following apply:

(a) The investment company or investment trust takes delivery of the collateral for any repurchase agreement either directly or through an authorized custodian.

(b) The investment policy of the investment company or investment trust includes seeking to maintain a constant share price.

9. Certificates of deferred property taxes as provided by section 42-17309.

10. Treasurer's warrant notes issued pursuant to section 35-185.01 or registered warrants of a county issued pursuant to section 11-605, if the yield is equal to or greater than yields on eligible investment instruments of comparable maturities.

11. Shares in the treasurer's local government investment pools provided that investment policies of the pool seek to maintain a constant share price.

12. Subject to subsection D of this section, state transportation board funding obligations delivered pursuant to section 28-7678.

13. Certificates of deposit purchased in accordance with the procedures prescribed in section 35-323.01.

B. In case of default or failure to honor a county treasurer's warrant, the state treasurer may withhold the first state shared revenues that would otherwise be distributed to the defaulting county in the amount necessary to honor the note including accrued interest to and beyond the date of default.

C. The state treasurer may contract to loan securities owned by the trust funds and operating monies deposited in the investment pools pursuant to section 35-316, subsection B to the financial or dealer community through one or more of the entities listed in section 35-317, subsection A, or authorized by the board of investment pursuant to section 35-311, subsection E, if the borrower transfers collateral to the state treasurer or acting agent of the state in the form of cash or securities specified in subsection A of this section. Collateral posted in the form of cash shall be in an amount equal to at least one hundred per cent of the market value of the loaned securities as agreed. Collateral posted in the form of securities shall be in an amount of no more than one hundred ten per cent of the market value of the loaned securities as established from time to time by the board of investment. The loaned securities shall be valued as to market value daily, and, if necessary, the borrower shall post additional collateral, as agreed, to ensure that the required margin is maintained. The state treasurer may collect from the borrower all dividends, interest, premiums, rights and other distributions to which the lender of securities would otherwise be entitled. The state treasurer may terminate the contract on not less than five

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business days' notice, as agreed, and the borrower may terminate the contract on not less than two business days' notice, as agreed.

D. The state treasurer shall invest operating monies in state transportation board funding obligations delivered pursuant to section 28-7678 pursuant to the following:

1. The state treasurer shall liquidate investments of operating monies if necessary in order to invest in state transportation board funding obligations, except that if operating monies in the state general fund fall below an eight hundred million dollar average over the previous twelve consecutive months, the state treasurer is not required to purchase state transportation board funding obligations pursuant to this subsection.

2. Each series of state transportation board funding obligations shall bear interest at a fixed interest rate equal to the mean bid-ask price of the United States treasury obligation with a maturity date closest to the maturity date of the state transportation board funding obligation as published most recently in the Wall Street Journal before the date the state treasurer receives a certificate from the state transportation board that states the board's determination to deliver an obligation to the state treasurer and the anticipated delivery date of the obligation. The delivery date shall be between fifteen and sixty days after the day the state treasurer receives the certificate.

3. The state treasurer shall provide written notice to the state transportation board and the director of the department of transportation when the operating monies fall below four hundred million dollars. If operating monies fall below two hundred million dollars, the state treasurer may call the investment in the state transportation board funding obligations in twenty-five million dollar increments up to the amount that the operating monies are below two hundred million dollars. The state treasurer shall give the state transportation board and the director of the department of transportation at least fifteen days' notice of the call.

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ARIZONA STATE TREASURY
INVESTMENT POLICY
FOR INVESTED MONIES

DEAN MARTIN, STATE TREASURER

I. POLICY

It is the investment policy of the Arizona State Treasurer and his office (hereinafter referred to as "the Treasurer") to maintain the safety of principal, maintain liquidity to meet cash flow needs, and provide competitive investment returns. The Treasurer will strive to invest with the judgment and care that prudent individuals would exercise, in the exercise of their own affairs.

The Treasurer with the State Board of Investment (BOI), acting in their capacity as trustees, pursuant to Article X, Section 7, Constitution of Arizona and A.R.S. § 35-314.01, has determined that a portion of the assets of the permanent endowment funds be invested in equities. The equity allocation in equities shall be capped at 60% of the total cost of the permanent endowment funds. Any investment of the State Budget Stabilization Fund in equity securities pursuant to A.R.S. § 35-314.02, shall also be governed by this policy including a phase-in over five years of up to 25% of total cost.

This policy shall:

- Establish the S&P Large-Cap 500, S&P Mid-Cap 400, and the S&P Small-Cap 600 indices as the benchmarks for determining the mix of equity weightings in the portfolio
- Establish the role of the Treasurer in managing an equity portfolio consistent with the requirements of Article X, Section 7 C., of the Arizona Constitution.

II. SCOPE

The Treasurer follows A.R.S. Title 35, Chapter 2, Article 2.0, and other investment guidelines mandated by statute. The Treasurer, however, does not determine the legal capacity or statutory investment restrictions that will apply to specific depositors (such as investment restrictions set by statute, regulation or local charter). Any political subdivision of the state depositing monies with the Treasurer must assure itself that investments contained in the applicable pool comport with the subdivision's specific investment authority. In addition, the Treasurer does not limit or restrict yield on pools unless specifically mentioned herein. Depositors wishing to restrict yield for purposes of the Internal Revenue Service's Arbitrage Bond Regulations (Treasury Regulation Section 1.148-1 et seq.) must make their own determinations as to whether any designated pool deposit meets any restricted yield obligation pertaining to the funds deposited.

III. Objectives

A. FIXED INCOME

The primary objectives, in order of priority, of the Treasurer's investment activities as they relate to non-equity investments are:

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1. **Safety.** Safety of principal is the foremost objective of the investment programs. The Treasurer will seek to ensure preservation of principal in the overall portfolio.

2. **Liquidity.** The investment pools and funds will remain sufficiently liquid to enable pools and funds to meet all operating requirements that might be reasonably anticipated. At present, withdrawals of the Local Government Investment Pool (Pool 5) or Local Government Investment Pool GOV (Pool 7) may be made on the same day if a draw down request is received by 10:00 a.m. on such day. Withdrawals over $3 million dollars require 24-hour advance notice; withdrawals over $5 Million require 72-hour notice; withdrawals over $10 Million require 5-day notice; and withdrawals over $20 Million require 7-day notice.

Transfers to and from the LGIP Long-Term Pool (Pool 500) or LGIP-GOV Long Term Pool (Pool 700) shall be made once per month upon receipt of notification at least five business days prior to the end of the month. The effective date of the transfer will be the first business day of the next month. A minimum of $250,000 is required to open and maintain an account in the long-term pools.

The Treasurer cannot anticipate all instances which might adversely affect this policy therefore; the goal of liquidity is subject to change as economic or other conditions warrant.

3. **Return on Investment.** The investment pools and funds shall be managed with the objective of attaining a competitive rate of return given the constraints of the aforementioned safety and liquidity objectives.

B. EQUITY

The Treasurer may manage up to three separate equity funds.

The benchmark for the funds will be the S&P 500 Large-Cap Index, the S&P 400 Mid-Cap Index, and the S&P 600 Small-Cap Index. The total cost basis of the S&P 500 Equity Index Pool shall not exceed 75% of the total cost basis of all equities.

The total cost basis of the S&P 400 Equity Index Pool shall not exceed 40% of the total cost basis of all equities.

The total cost basis of the S&P 600 Equity Index Pool shall not exceed 20% of the total cost basis of all equities.

IV. PERFORMANCE EVALUATION AND REPORTING

Evaluation and monitoring of investment performance is the responsibility of the Investment Risk Management Committee. The Investment Accounting Manager shall generate investment performance statistics and activity reports.

The Investment Accounting Manager shall provide summary reports on a monthly basis to the Treasurer and the Investment Risk Management Committee. The monthly reports shall also be provided to the Board of Investment for review and approval.

Comparative performance reviews will be conducted monthly. The State Board of Investment reviews the performance and status of the portfolio monthly.

A. Monthly Performance Analysis

1. The following reports are provided in the monthly report to the Treasurer and the Board of Investment and are matters of public record.

a. Month-end Investment Summary: The month-end investments are summarized by type of investment. The report summarizes original cost and market values of investments in the pools and funds. The month-end equity investments are summarized by S&P 500 Equity Index Pool, S&P 400 Equity Index Pool, and S&P 600 Equity Index Pool sectors (including cash and SPDR holdings) specified in each index, with columns depicting market value and fund and index sector weightings.

b. Investment Returns (period, year-to-date, and prior year).

c. Interest distributed for period.

d. Investment trading activity detail (endowment and equity funds only).

e. Actual interest distributed for general fund.

f. Comparison of fund/pool performance to selected benchmarks or indices. (S&P 500 Large-Cap, S&P 400 Mid-Cap, & S&P 600 Small-Cap Indices for equities.)

g. Realized gains and losses (endowment and equity funds only).

h. Summary of accounts by cities, counties, and other public entities.

i. Broker activity report.

j. Fixed-income investments maturity distribution.

k. Credit rating analysis.

l. Duration / WAM analysis.

m. Investment returns vs. index analysis.

n. Investment policy compliance report (quarterly).

o. Summary of accounts by cities, counties, and other public entities (quarterly).

p. Broker activity report (quarterly).

B. Daily Reporting

The Investment Accounting Manager prepares a daily report of all purchases and sales, investment pool and fund balances.

C. Annual Reporting

The annual audited financial report shall be submitted to the Governor pursuant to A.R.S. § 41-172A.8, on or before November 1 of each year.

D. Custodian Reconciliation

The report of investment holdings shall be reconciled within 30 days of the close of each month to the Treasurer's custodian bank. Discrepancies shall be reported to the Treasurer.

V. Permitted Investment Instruments

Under A.R.S. 35-312 and 35-313, the Treasurer is permitted to invest and reinvest treasury monies in certain permitted investments. The following items set forth those investments permitted by law. The individual pool or fund may be designed in a manner, which does not permit all such investments to be made.

A. Obligations issued or guaranteed by the United States or any of its agencies, sponsored agencies, corporations, sponsored corporations or instrumentalities.

1. Repurchase agreements and tri-party repurchase agreements, collateralized at no less than 102 percent by securities or 100 percent by cash, purchased from securities dealers that make markets in those securities listed in Section A. Repurchase agreements and tri-party repurchase agreements collateralized by mortgage-backed securities shall be collateralized at no less than 105 percent. In all cases, collateral must be delivered to the Treasurer's custody institution, or held in an account for the benefit of the Treasurer in an institution meeting the requirements of ARS § 35-310.1 as an eligible depository. In the case of tri-party repurchase agreements, the eligible depository may price and verify collateral but is required to provide a report of pricing and adequacy of collateral to the Treasurer or a designated portfolio manager within 24 hours of settlement. The portfolio manager will measure the volatility and make a professional judgment on appropriateness of the collateral.

B. Bonds or other evidences of indebtedness of this state or any of the counties or incorporated cities, towns or duly organized school districts which carry as a minimum a Baa (Investment Grade) or better rating of Moody's Investors Service or a BBB (Investment Grade) or better rating of Standard and Poor's Rating Service or their successors.

C. Treasurer's warrant notes issued pursuant to A.R.S. § 35-185.01 or registered warrants of a county issued pursuant to A.R.S. § 11-605, if the yield is equal or greater than yields on eligible investment instruments of comparable maturities.

D. State Transportation Board Funding Obligations, subject to A.R.S. § 35-313(D), delivered pursuant to A.R.S. § 28-7678.

E. Commercial paper must be rated by at least two nationally recognized statistical rating organizations (NRSO's). The three current NRSO's include Standard & Poor's, Moody's, and Fitch. The ratings assigned by at least two NRSO's must be of the two highest rating categories for short-term obligations. All commercial paper must be issued by entities organized and doing business in the United States.

F. Bills of exchange or time drafts known as bankers acceptances which are issued by commercial banks chartered and doing business in the United States with ratings as outlined in Section V (E), and/or long term debt rating of Baa (Investment Grade) or better by Moody's Investors Service or BBB (Investment Grade) or better rating of Standard and Poor's Reporting Service or their successors.

G. Negotiable certificates of deposit issued by a nationally or state chartered bank or savings and loan association which carry as a minimum a Baa (Investment Grade) or better rating of Moody's Investors Service or a BBB

(Investment Grade) or better rating of Standard and Poor's Rating Service or their successors.

H. Bonds, debentures and notes issued by corporations organized and doing business in the United States which carry as a minimum a Baa (Investment Grade) or better rating of Moody's Investors Service or a BBB (Investment Grade) or better rating of Standard and Poor's Rating Service or their successors.

I. Securities of or any other interests in any open-end management type investment company or investment trust registered under the Investment Company Act of 1940 (54 Stat. 789; 15 United States Code §§ 80a-1 through 80a-64), as amended, if all of the following are stated to be the investment company's policy:

1. The investment company or investment trust takes delivery of the collateral for any repurchase agreement either directly or through an authorized custodian.

2. The investment policy of the investment company or investment trust includes seeking to maintain a net asset value of one dollar.

J. Any of the investments authorized in A.R.S. § 35-312 and A.R.S. § 35-313 not heretofore mentioned, which are limited to shares in the Treasurer's local government investment pools which seek to maintain a constant share price, certificates of deposit, collateralized repurchase agreements, deposit accounts and collateralized interest bearing saving accounts with eligible depositories, and certificates of deferred property taxes as provided by A.R.S. § 42-17309.

K. Any of the investments authorized in A.R.S. § 35-312 and 35-313 not heretofore mentioned, which are limited to certificates of deposit, collateralized repurchase agreements, deposit accounts and collateralized interest bearing saving accounts with Arizona depositories.

L. Securities with a Hard Put may be purchased even though the stated final maturity exceeds the fund/pool's guidelines for maximum final maturity as long as the put-date does not exceed those same guidelines. The portfolio manager may decide not to put the security back to the issuer only if the final maturity (or next hard put date) falls within the fund/pool's guidelines for maximum allowable maturity.

M. For the purposes of managing and reporting, the equity portfolio is a separately managed pool that may include any investment participant authorized by statute to invest in equities.

The equity portfolio manager shall divide the stocks in the S&P 500 Equity Index Pool, S&P 400 Equity Index Pool, and S&P 600 Equity Index Pool into the appropriate industry sectors for the purpose of reporting and performance tracking.

Bloomberg Inc. and other available analytical systems will be utilized as necessary in order to establish the capitalization weight of each stock in each sector as a percentage of the total S&P 500 Large-Cap Index, S&P 400 Mid-Cap Index, and S&P 600 Small-Cap Index market capitalization.

For the S&P 500 Equity Index Pool, the sector and individual equity weightings of the pool will coincide with the weights of the S&P 500 Large-Cap Index. The S&P 500 Equity Index Pool weightings shall be managed with the goal of allowing a variance relative to the S&P 500 Large-Cap Index. The variance shall be no more than 5 percent of the market value of the portfolio per sector and 1 percent of the market value of the portfolio per individual equity.

For the S&P 500 Equity Index Pool, the equity portfolio manager shall replicate the stocks currently in the S&P 500 Large-Cap Index and shall rebalance the fund at least quarterly and invest all cash received in Standard and Poor's Depository Receipts (SPDRs). SPDRs may be liquidated as needed to rebalance the portfolio.

For the S&P 400 Equity Index Pool, the equity portfolio manager shall manage the pool with the goal of producing results similar to the S&P 400 Mid-Cap Index. Equities in the pool shall be limited to those existing in the S&P 400 Mid-Cap Index.

For the S&P 600 Equity Index Pool, the equity portfolio manager shall manage the pool with the goal of producing results similar to the S&P 600 Small-Cap Index. Equities in the pool shall be limited to those existing in the S&P 600 Small-Cap Index.

VI. FUND DESCRIPTIONS AND MATURITY LIMITATIONS

POOL 2 - STATE AGENCIES I (U.S. Govt Full Faith and Credit); This pool invests in the full faith and credit of the United States of America, or funds qualified in V. (I) above that invest in the full faith and credit of the United States of America. The final maturity or, if applicable, average life based on Bloomberg average pre-payment estimates at time of purchase, shall not exceed five years from the settlement date of the purchase. This pool is used by any State Agency who has a statutory requirement that investments carry the full faith and credit of the United States of America. Only participants that are considered to be part of the State's reporting entity will be allowed to participate in this pool.

POOL 3 - STATE AGENCIES II (Diversified Asset Mix); the final maturity, or if applicable average life based on Bloomberg average pre-payment estimates at time of purchase, shall not exceed five years from the settlement date of the purchase. This pool is used by any state agency where the authority to invest references A.R.S. §35-312 or §35-313. Only participants that are considered to be part of the State's reporting entity will be allowed to participate in this pool.

POOL 4 - STATE AGENCIES IV. (U.S. Govt and Agencies); This pool is used by state agencies that may only invest in U.S. Treasury & Agency securities (but, not necessarily required to be guaranteed by the full faith and credit of the U.S. Government), or funds qualified in V. (I) above that invest in U.S. Treasury and Agency securities. The final maturity or, if applicable, average life based on Bloomberg average pre-payment estimates at time of purchase, shall not exceed five years from the settlement date of the purchase. Only participants that are considered to be part of the State's reporting entity will be allowed to participate in this pool.

POOL 5 - LGIP; the final maturity of any fixed-rate security shall not exceed 18 months from the settlement date of the purchase. The final maturity of any variable-rate security shall not exceed five years. The dollar weighted average portfolio maturity (WAM) shall not exceed 120 days. The pool is used for liquid cash equivalent needs for public entities.

The portfolio manager shall strive to maintain a Net Asset Value (NAV) of $1.00 ($.995 - 1.005) for the pool. Unrealized market value gains/losses exceeding this threshold will be realized against income in that same month to the extent that they exceed the allowable range.

POOL 7 - LGIP - GOV; the final maturity of any fixed-rate security shall not exceed 18 months from the settlement date of the purchase. The final maturity of any variable-rate security shall not exceed five years. The dollar weighted average maturity (WAM) shall not exceed 120 days. Only securities backed by the full faith and credit of the U.S. Government may be purchased for this pool or funds qualified in V. (I) above the invest in the full faith and credit of the United States of America. This pool is used for public entities requiring or desiring a liquid investment in a "full faith and credit" pool.

The portfolio manager shall strive to maintain a Net Asset Value (NAV) of $1.00 ($.995 - 1.005) for the pool. Unrealized market value gains/losses exceeding this threshold will be realized against income in that same month to the extent that they exceed the allowable range.

POOL 9 - BOARD FUNDING OBLIGATIONS. The only securities issued for this pool are State Infrastructure Bank Board Funding Obligations issued pursuant to A.R.S. §28-7678. The only participant in the pool is the state operating fund.

POOL 12 - CAWCD MEDIUM-TERM POOL. This pool is established to provide the Central Arizona Water Conservation District with investments in medium and long-term securities. The target duration of the pool is 4.5 years. Securities, at time of purchase, will carry, as a minimum, an A or better rating by either Moody's Investors Service or Standard and Poor's Rating Service or their successors. Eligible securities include U.S. Treasury, agency, corporate notes, MBS/ABS, and money market instruments with a minimum rating of A1/P1. No state agency or general fund participation is allowed in this pool. CAWCD owns the SECURITIES in this pool (as opposed to SHARES).

Pool 15 – GADA Pool. This pool is established to provide the Greater Arizona Development Authority with investments in long-term securities. The target duration of the pool is five years. Any fixed income investment authorized under A.R.S. § 35-313 is allowed in this pool. GADA owns the SECURITIES in this pool (as opposed to SHARES).

POOL 201 - S&P 500 EQUITY INDEX POOL. This pool of domestic equities is intended to mirror the composition of the Standard & Poor's 500 Index.

POOL 203 - S&P 400 EQUITY INDEX POOL. This pool of domestic equities is intended to produce results similar to the S&P 400 Mid-Cap Index.

POOL 204 – S&P 600 EQUITY INDEX POOL. This pool of domestic equities is intended to produce results similar to the S&P Small-Cap 600 Index.

POOL 205 - LONG-TERM ENDOWMENT FIXED-INCOME POOL. All of the fixed-income securities that had separately belonged to the endowment funds (101-114) were pooled on July 1, 2001 and SHARES of the pool were distributed to the endowment funds. This is a pool of fixed-income corporate and U.S. Government securities. Established to provide the endowment funds with fixed-income exposure and to diversify holdings for the smaller funds. The maximum allowable weighted-average duration is 15 years.

FUNDS 101-114 - Monies shall be invested pursuant to Article X, Section 7 of the constitution to provide income to recipients of the thirteen endowment funds. Allowable investments include shares in Pool 201 (S&P 500 Equity Index Pool), Pool 203 (S&P 400 Equity Index Pool), Pool 204 (S&P 600 Equity Index Pool), and Pool 205 (Long-Term Endowment Fixed-Income Pool).

Pool 500 – LGIP Long-Term Pool. This pool is designed to meet the longer term investment needs of local government/public entities. The final maturity, or applicable average life based on Bloomberg average pre-payment estimates at time of purchase, of any fixed-rate security shall not exceed five years from the settlement date of the purchase. The final maturity of any variable-rate security shall not exceed five years. The duration for the pool shall not exceed .75 years greater than the Merrill 1-5 U.S. Domestic Master Index.

The portfolio manager will not strive to maintain a Net Asset Value (NAV) of $1.00 for the pool. Income is distributed monthly. Gains and losses (realized and unrealized) are reflected in the NAV calculated each month.

Pool 700 – LGIP-GOV Long-Term Pool. This pool is for local government/public entities requiring or desiring an investment in a "full faith and credit" pool. The final maturity, or applicable average life based on Bloomberg average pre-payment estimates at time of purchase, of any fixed rate security shall not exceed five years from the settlement date of the purchase. The final maturity of any variable rate security shall not exceed five years. The duration for the pool shall not exceed .75 years greater than the Merrill 1-5 U.S. Treasuries Index. Only securities backed by the full faith and credit of the U.S. Government may be purchased for this pool.

The portfolio manager will not strive to maintain a Net Asset Value (NAV) of $1.00 for the pool. Income is distributed monthly. Gains and losses (realized and unrealized) are reflected in the NAV calculated each month.

VII. DIVERSIFICATION

It is the policy of the Treasurer to diversify the investment portfolio to minimize losses due to various circumstances. The circumstances include, but are not limited to; issuer defaults, market price changes, non-earning assets, technical complications leading to temporary lack of liquidity, risks resulting from an over-concentration of assets in a specific maturity, a specific issuer, a specific geographical distribution, or a specific class of securities. No more than five percent of the total of each pool or fund (defined as five percent of the prior month's ending amortized book value on the date purchased), or five percent of the issues outstanding, whichever is less, shall be invested in securities issued by a single corporation and its subsidiaries/affiliates. The diversification policy, as it relates to the maximum (5%) investment with a single issuer, applies only to Pools 3, 5, 205, and 500. Securities issued by the federal government or its agencies, sponsored agencies, corporations, sponsored corporations or instrumentalities are exempted from this provision. Purchases of Treasurer Warrant Notes for Pool 3 are also exempt from this policy, provided the maximum amount of notes shall not exceed 50% of the market value of pool 3.

VIII. PORTFOLIO MANAGEMENT

Following the primary objective of preservation of capital, investments shall be actively managed to take advantage of market opportunities. In so doing, negotiable securities may be sold prior to their maturity to provide liquid funds as needed for cash flow purposes, to enhance portfolio returns, or to restructure maturities to increase yield and/or reduce risk.

IX. PROHIBITED INVESTMENT PURCHASES

A. Reverse Repurchase Agreements (unless otherwise authorized under a securities lending agreement with a second party).

B. Futures, Contractual Swaps, Options

C. Inverse Floaters

D. Interest Only Securities

E. Forward Contracts

F. Interest bearing securities that have a possibility of not accruing current income

G. Closed end management type companies

H. Securities whose yield/market value is based on currency, commodity or non-interest indices

I. Bearer-form securities

J. The Treasurer, prior to purchase, shall approve any security product not described in this document in writing.

X. BROKERS/DEALERS

Investment transactions shall only be conducted with financial institutions that are licensed as may be required by law to do business in Arizona. Primary government securities dealers, or broker-dealers engaged in the business of selling government securities shall be registered in compliance with section 15 or 15C of the Securities Exchange Act of 1934 and registered pursuant to A.R.S. § 44-3101, as amended. In addition, investment transactions shall be conducted only with those direct issuers who meet both credit and capital requirements established by the Treasurer. It shall be the responsibility of the broker-dealer to provide the following:

A. Audited most recent annual financial statements within six months of the close of the fiscal year

B. Unaudited most recent quarterly financial statements

C. Proof of Financial Industry Regulatory Authority (FINRA) or successor agency certification.

D. Proof of Arizona registration (as needed)

E. A signed letter acknowledging that they have read the Treasurer's investment policies.

The Treasurer shall maintain a listing of approved broker dealers that is reviewed at least semi-annually.

The Treasurer will periodically ask brokers to quote prices (as of the last day of the prior month) for securities. This is required because the pricing service did not provide a price/prices for certain securities. The Treasurer requires these quotes no later than six business days after the broker has received the request. Non-compliance with this policy will result in the suspension of trading with that broker until such quotes are received.

XI. DELEGATION OF AUTHORITY

Authority to manage the State's investment program is vested in the Treasurer under the trusteeship of the Board of Investments pursuant to the Arizona Constitution and Arizona Revised Statutes. Day-to-day management responsibility for the investment program is delegated to the portfolio managers under the direction of the Investment Risk Management Committee. The Committee and Portfolio Managers are responsible for investment decisions and activities under the direction of the Treasurer. The Investment Risk Management Committee consists of the Treasurer, a Deputy Treasurer, Portfolio Managers, and any outside financial advisors employed by the Treasurer's office. The Committee shall establish written procedures for the operation of the investment program consistent with this investment policy. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Investment Risk Management Committee.

The Investment Risk Management Committee shall establish a system of internal controls to regulate the activities of investment personnel and the Treasurer shall approve this system. In the development of the system of internal controls, consideration shall be given to documentation of strategies and transactions, techniques for avoiding collusion, separation of functions, delegation of authority, limitations of action and custodial safekeeping.

XII. PURCHASES AND SALES OF SECURITIES

All trades shall be executed with the objective of realizing the best bid or offer price available. It is the responsibility of the investment personnel to know the "market price" or relative values of all securities before trades are executed. The method used by the investment personnel shall be the one that will obtain the best execution price or value given the objective of the transaction.

XIII. ETHICS AND CONFLICTS OF INTEREST

Officers and employees of the Treasurer involved in the investment process shall adhere to the conflict of interest laws as set forth in A.R.S. § 38-501 through 38-511. They shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. All such investment officials shall disclose to the Treasurer, at least annually, any holdings material to their investment portfolio in financial institutions that conduct business within this jurisdiction, and they shall further disclose any related parties who are employed by financial institutions doing business with the State's portfolios. All investment officials shall subordinate their personal investment transactions to those of the State, particularly with regard to the timing of purchase and sales.

QUALIFICATIONS OF INVESTMENT OFFICIALS

PORTFOLIO MANAGERS

Portfolio managers are appointed by the Treasurer, and are responsible for planning directing and managing the investment programs of the State as

outlined in this policy document. These positions are under the direction of the Treasurer and such appointee shall meet the following guidelines:

A bachelor's degree from an accredited institution in a finance-related field;

And

Eight years of work experience as an investment or trust officer for a financial institution, association, or corporation, or governmental entity;

Or

Five years experience in fixed income and/or equity portfolio analysis which includes the use off fixed income and/or equity analytics systems.

Or

Five years experience in money market and fixed income investing or equivalent experience as approved by the Treasurer.

Or

Any combination of the above equaling five or more years experience.

XIV. SAFEKEEPING AND CUSTODY

All security transactions, including collateral for repurchase agreements, entered into by the Treasurer shall be conducted on a delivery versus payment basis. Securities shall be held by the Treasurer or a custodian designated by the Treasurer and evidenced by custodial reports.

XV. INVESTMENTS NOT GUARANTEED

Participants of investment pools own shares in the pool, except where noted in section VI. The value of a share in a pool is determined by dividing the total market value of the pool by the number of shares outstanding. The owners of share(s) are entitled to their proportional share of principal of bonds in the pool (at any point in time) and interest (as determined by their weighted average daily balance of the pool). Neither the Treasurer nor the State of Arizona makes any guarantees that the value of a participant's shares will remain constant.

XVI. OTHER

Any deviation from the preceding policy shall require the prior specific written authority of the Treasurer.

This policy will be reviewed semi-annually to keep abreast of changes in the financial market place.

Questions regarding, or requests for copies of this investment policy can be addressed to the Investment Accounting Manager at (602) 604-7800.

Effective Date: July 22, 2009

Dean Martin, State Treasurer

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