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BUREAU OF
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January 16, 2014

Donna K. Davis
Administrative Rules Review Section
Arkansas Legislative Council
Bureau of Legislative Research
One Capitol Mall, Fifth Floor
Little Rock, AR 72201

Re: APERS Regulation 501

Dear Ms Davis:

I am writing to submit two copies of the questionnaire and financial impact statement for APERS Regulation 501, along with a copy of the regulation itself, which was adopted by APERS's Board of Trustees. It is intended to become effective on March 1, 2014. I have also enclosed two extra copies for Matthew to transmit to the Retirement Subcommittee, should that be necessary.

It will be published in the Arkansas Democrat-Gazette on January 17-19, 2014. It was transmitted electronically to John Davidson at the Secretary of State on today's date. The public comment period will expire February 20, 2014. As of today's date, we have received no comment from the public about it. The public hearing on it will be held at 10:00 a.m. on February 21, 2014 in the APERS Board of Directors conference room, which is located at the above address.

Please let me know if you have further questions about this (682-7856). I would appreciate your advising me when this is put on the calendar for hearing. Thank you.

Cordially,

A handwritten signature in dark ink, appearing to be "FW", is written above the typed name.

Frank J. Wills, III
General Counsel

FJW/wls
enclosure

QUESTIONNAIRE FOR FILING PROPOSED RULES AND REGULATIONS
WITH THE ARKANSAS LEGISLATIVE COUNCIL AND JOINT INTERIM COMMITTEE

DEPARTMENT/AGENCY ARIZ. PUBLIC EMPLOYEES RETIREMENT SYSTEM ("APERS")
DIVISION N/A
DIVISION DIRECTOR GAIL H. STONE
CONTACT PERSON FRANK J. WILLS ("Jay")
ADDRESS 124 W. CAPITOL AVE., LITTLE ROCK, AR 72201
PHONE NO. 501-682-7800 FAX NO. 501-682-7825 E-MAIL jay.wills@arkansas.gov
NAME OF PRESENTER AT COMMITTEE MEETING _____
PRESENTER E-MAIL _____

INSTRUCTIONS

- A. Please make copies of this form for future use.
- B. Please answer each question completely using layman terms. You may use additional sheets, if necessary.
- C. If you have a method of indexing your rules, please give the proposed citation after "Short Title of this Rule" below.
- D. Submit two (2) copies of this questionnaire and financial impact statement attached to the front of two (2) copies of the proposed rule and required documents. Mail or deliver to:

Donna K. Davis
Administrative Rules Review Section
Arkansas Legislative Council
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One Capitol Mall, 5th Floor
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- 1. What is the short title of this rule? APERS INVESTMENT Policy (Reg. 501)
 - 2. What is the subject of the proposed rule? Amend APERS Investment Policy to conform to modern (current) investment environment.
 - 3. Is this rule required to comply with a federal statute, rule, or regulation? Yes No
If yes, please provide the federal rule, regulation, and/or statute citation. _____
 - 4. Was this rule filed under the emergency provisions of the Administrative Procedure Act? Yes No
If yes, what is the effective date of the emergency rule? N/A
- When does the emergency rule expire? N/A
- Will this emergency rule be promulgated under the permanent provisions of the Administrative Procedure Act? Yes No
N/A

5. Is this a new rule? Yes No
If yes, please provide a brief summary explaining the regulation. _____

Does this repeal an existing rule? Yes No
If yes, a copy of the repealed rule is to be included with your completed questionnaire. If it is being replaced with a new rule, please provide a summary of the rule giving an explanation of what the rule does. _____

Is this an amendment to an existing rule? Yes No
If yes, please attach a mark-up showing the changes in the existing rule and a summary of the substantive changes. **Note: The summary should explain what the amendment does, and the mark-up copy should be clearly labeled "mark-up."**

6. Cite the state law that grants the authority for this proposed rule? If codified, please give the Arkansas Code citation. _____ 24-4-105(b)(1)

7. What is the purpose of this proposed rule? Why is it necessary? _____ To conform APERS's investment policy to the current investment environment.

8. Please provide the address where this rule is publicly accessible in electronic form via the Internet as required by Arkansas Code § 25-19-108(b). _____
www.apers.org/docs/pubs/APERS_BR_2013.pdf

9. Will a public hearing be held on this proposed rule? Yes No

If yes, please complete the following:

Date: 2/21/2014

Time: 10:00 a.m.

Place: APERS Conference Room

10. When does the public comment period expire for permanent promulgation? (Must provide a date.)

_____ 2/20/2014 _____

11. What is the proposed effective date of this proposed rule? (Must provide a date.)

_____ 3/1/2014 _____

12. Do you expect this rule to be controversial? Yes No

If yes, please explain. _____ N/A

13. Please give the names of persons, groups, or organizations that you expect to comment on these rules? Please provide their position (for or against) if known.

_____ None known or anticipated _____

FINANCIAL IMPACT STATEMENT

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PLEASE ANSWER ALL QUESTIONS COMPLETELY

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DEPARTMENT APERS
DIVISION N/A
PERSON COMPLETING THIS STATEMENT FRANK J. WILLS BUREAU OF LEGISLATIVE RESEARCH
TELEPHONE NO. 501-682-7856 FAX NO. 501-672-7825 EMAIL: jay.wills@arkansas.gov

To comply with Ark. Code Ann. § 25-15-204(e), please complete the following Financial Impact Statement and file two copies with the questionnaire and proposed rules.

SHORT TITLE OF THIS RULE APERS Investment Policy

- 1. Does this proposed, amended, or repealed rule have a financial impact? Yes No
- 2. Is the rule based on the best reasonably obtainable scientific, technical, economic, or other evidence and information available concerning the need for, consequences of, and alternatives to the rule? Yes No
- 3. In consideration of the alternatives to this rule, was this rule determined by the agency to be the least costly rule considered? Yes No

If an agency is proposing a more costly rule, please state the following:

- (a) How the additional benefits of the more costly rule justify its additional cost;
N/A
- (b) The reason for adoption of the more costly rule;
N/A
- (c) Whether the more costly rule is based on the interests of public health, safety, or welfare, and if so, please explain; and;
N/A
- (d) Whether the reason is within the scope of the agency's statutory authority; and if so, please explain.
N/A

4. If the purpose of this rule is to implement a federal rule or regulation, please state the following:

- (a) What is the cost to implement the federal rule or regulation? N/A

<u>Current Fiscal Year</u>	<u>Next Fiscal Year</u>
General Revenue _____	General Revenue _____
Federal Funds _____	Federal Funds _____
Cash Funds _____	Cash Funds _____
Special Revenue _____	Special Revenue _____
Other (Identify) _____	Other (Identify) _____

Total _____

Total _____

(b) What is the additional cost of the state rule? *N/A*

Current Fiscal Year

Next Fiscal Year

General Revenue _____
 Federal Funds _____
 Cash Funds _____
 Special Revenue _____
 Other (Identify) _____
 Total _____

General Revenue _____
 Federal Funds _____
 Cash Funds _____
 Special Revenue _____
 Other (Identify) _____
 Total _____

5. What is the total estimated cost by fiscal year to any private individual, entity and business subject to the proposed, amended, or repealed rule? Identify the entity(ies) subject to the proposed rule and explain how they are affected. *N/A*

Current Fiscal Year

Next Fiscal Year

\$ _____

\$ _____

6. What is the total estimated cost by fiscal year to state, county, and municipal government to implement this rule? Is this the cost of the program or grant? Please explain how the government is affected. *N/A*

Current Fiscal Year

Next Fiscal Year

\$ _____

\$ _____

7. With respect to the agency's answers to Questions #5 and #6 above, is there a new or increased cost or obligation of at least one hundred thousand dollars (\$100,000) per year to a private individual, private entity, private business, state government, county government, municipal government, or to two (2) or more of those entities combined?

N/A Yes No

If YES, the agency is required by Ark. Code Ann. § 25-15-204(e)(4) to file written findings at the time of filing the financial impact statement. The written findings shall be filed simultaneously with the financial impact statement and shall include, without limitation, the following:

- (1) a statement of the rule's basis and purpose; *N/A*
- (2) the problem the agency seeks to address with the proposed rule, including a statement of whether a rule is required by statute; *N/A*
- (3) a description of the factual evidence that:
 - (a) justifies the agency's need for the proposed rule; and *N/A*

- (b) describes how the benefits of the rule meet the relevant statutory objectives and justify the rule's costs; *N/A*
- (4) a list of less costly alternatives to the proposed rule and the reasons why the alternatives do not adequately address the problem to be solved by the proposed rule; *N/A*
- (5) a list of alternatives to the proposed rule that were suggested as a result of public comment and the reasons why the alternatives do not adequately address the problem to be solved by the proposed rule; *N/A*
- (6) a statement of whether existing rules have created or contributed to the problem the agency seeks to address with the proposed rule and, if existing rules have created or contributed to the problem, an explanation of why amendment or repeal of the rule creating or contributing to the problem is not a sufficient response; and *N/A*
- (7) an agency plan for review of the rule no less than every ten (10) years to determine whether, based upon the evidence, there remains a need for the rule including, without limitation, whether:
- (a) the rule is achieving the statutory objectives;
 - (b) the benefits of the rule continue to justify its costs; and
 - (c) the rule can be amended or repealed to reduce costs while continuing to achieve the statutory objectives. *N/A*

**REGULATION 501-ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
INVESTMENT POLICY**

SUMMARY OF AMENDMENT CHANGE TO REGULATION 501

The amendment to APERS Regulation 501, Investment Policy, conforms APERS existing investment policy to the current financial environment. Due to interest rates arguably being held artificially low due to the depressed Federal Reserve rate, pension funds such as APERS, which have traditionally used debt instruments to achieve their target rates of return, have been forced to explore alternative investments in order to achieve their target rates of return.

After substantial consideration, the APERS Board of Trustees decided to amend its existing investment policy to conform to modern investment realities. This amendment, which adds additional investment classes that APERS may pursue as well as reducing APERS reliance on what can be underperforming fixed income classes (e.g. debt instruments), achieves that goal in the judgment of the APERS Board of Trustees.

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**REGULATION 501-ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
INVESTMENT POLICY**

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I. STATEMENT OF PURPOSE

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The assets of the Arkansas Public Employees Retirement System (APERS) shall be invested as determined from time to time by the APERS Board. This statement sets forth the investment objectives of APERS and the investment policies to be followed in carrying out those objectives.

Investment of the APERS' funds shall be made for the exclusive benefit of the participants and beneficiaries of the System. The purposes of investing APERS' funds are to provide benefits to participants and their beneficiaries and to defray the necessary expenses associated with investing APERS' funds and administering the System.

II. BACKGROUND (HISTORY)

The Arkansas Public Employees Retirement System was established by the General Assembly in 1957 and is governed by a nine member Board of Trustees. From its inception until 1985, the investment of the trust fund was governed by Arkansas Statutes that provided for a permissible list of investments. However, Act 412 of 1985 repealed the permissible investment list and enacted the prudent investor rule. Act 412 of 1985 also allows the establishment of a custodial bank relationship. Act 412 of 1985 states that the System shall seek to invest at least five percent, but not more than ten percent of the System's portfolio in Arkansas related investments, but only when consistent with the fiduciary requirements of the trustees. Act 302 of 1989 allows the System to employ Multiple Discretionary Money Managers as appropriate. Act 1194 of 1997 revises and updates the investment policies and rules, including the prudent investor rule.

III. STATUTORY AUTHORITY

The primary statutory authority for the investment activities of APERS is found in Sections 24-2-601 through 24-2-619 of the Arkansas Code, as amended. Trustees shall invest and manage trust assets as a prudent investor would, by

considering the purposes, terms, distribution requirements, and other circumstances of the trust. Trustees who have special skills or expertise, have a duty to use those special skills or expertise (24-2-611). The prudent investor rule shall be applied by each party serving in a fiduciary capacity for APERS.

IV. INVESTMENT OBJECTIVES

The investment objectives shall be: (1) the protection of the APERS' Fund so that such assets are preserved for providing benefits to participants and their beneficiaries; and (2) to maximize total return - either in the form of income or capital appreciation or both - consistent with prudent risk taking on the amounts available to provide such benefits. For this purpose, short-term fluctuations in value shall be considered secondary to long-term investment results. The long-term return objective for the APERS' Fund shall be to achieve a real rate of return of ~~3.5%~~ 4.0%. This is the return over the rate of inflation (as measured by the Consumer Price Index). This objective is not to be a goal from year to year, but is intended as a long-term guideline to those involved in investing the Trust's assets. The investments of the APERS' Fund shall be so diversified as to minimize the risk of large losses, unless under particular circumstances it is clearly prudent not to do so. Investments will be further diversified by hiring an appropriate number of managers whose investment styles are varied enough to provide a balance to the overall risk of the Fund.

V. ASSET ALLOCATION (BY MAJOR CATEGORIES)

To avoid extreme exposure to investment risk, the following percentages represent the minimum and maximum portion at market of the portfolio that may be invested by types:

<u>Asset Class</u>	<u>Market Value Exposure</u>	
	<u>Target</u>	<u>Range</u>
<u>Domestic Equity</u>	64% <u>37 %</u>	59% <u>32 % - 69%</u> <u>42 %</u>
<u>International Equity</u>	<u>24%</u>	<u>19% - 29%</u>

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<u>Domestic Fixed Income</u>	21%	<u>18 %</u>	16%	<u>13 %</u>	-26%	<u>23 %</u>
<u>Alternatives Diversified Strategies</u>	15%	<u>5%</u>	10%	<u>0%</u>	-20%	<u>10%</u>
<u>Real Assets</u>		<u>16%</u>		<u>11%</u>	-	<u>21%</u>

The Board of Trustees shall review its asset allocation at least annually to determine if the asset allocation is consistent with the level of risk and volatility acceptable to the Fund. Should actual asset class percentages fall outside the target ranges, the Fund will rebalance to the target percentages.. The rebalancing will necessitate the movement of funds from style to style. This rebalancing will occur at least annually unless circumstances dictate that it be done more frequently. Within these broader asset classes, the Trustees shall establish commitment levels to various investment styles, as the dynamics of the Plan's financial needs dictate.

VI. PORTFOLIO GUIDELINES

Through selecting, timing and weighting investments, the Fund's objective is to maximize the total return of the account assets, through price appreciation and/or yield, consistent with the level of risk taken. In determining the appropriate risk posture for the Fund, consideration should be given to the overall risk characteristics of the Fund, and the extent to which components of the Fund are diversified. Additionally, the Board of Trustees establishes the following specific guidelines:

- A. Securities may not be purchased on margin.
- B. The System may establish a Securities Lending Program subject to restrictions established by the Board.
- C. Each investment manager will be required to invest within the specific guidelines and parameters set by the Board of Trustees.

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- D. APERS recognizes a legal responsibility to seek to invest in the Arkansas economy, while realizing its primary, legal, and fiduciary commitment is to beneficiaries of the retirement system, under the prudent investor rule.
- E. It is the intent of APERS to include qualified minority (African-American, Hispanic-American, American Indian, Asian-American, or Pacific Islander-American), female, and disabled owned business enterprises in the Fund's investment manager selection process. The inclusion of the above managers in the selection process will be recorded and periodically reviewed by APERS staff and presented to the Board as requested. This process is intended to ensure all investment managers are given equitable consideration in the manager selection process in keeping with the fiduciary obligations of the APERS Board for the beneficiaries and annuitants of the System.

VII. CUSTODIANSHIP OF SECURITIES

Securities may be held by the State Treasurer or, under the authority granted by Arkansas Code 24-2-606, APERS may establish an arrangement with a financial institution, as specified by this Code, for the custodianship of its securities subject to the approval of the Board of a Request for Proposal as well as a proposed contract.

VIII. ROLES AND RESPONSIBILITIES

A. Custodian Bank

The custodian bank shall, by nominee agreement, hold any and all securities for the beneficial interest of the APERS fund. Custodial activities will include, but are not limited to, the purchase, registration, and sale of stocks, bonds, notes, and other securities, as well as the collection of any income. In order to maximize the Fund's return, no money should be allowed to remain idle. Dividends, interest, proceeds from sales, new contributions and all other moneys are to be invested or reinvested promptly.

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B. Administrative Staff

The Administrative Staff, at the direction of the, Board of Trustees, executes all investment transactions for any assets managed in- house. In addition, they are responsible for communicating with the investment professionals the information necessary to fulfill contractual obligations. The Administrative Staff also communicates decisions of the Board of Trustees to investment managers, custodian bank, actuary, and consultant.

C. Board of Trustees

The Board of Trustees shall review the total investment program. The Board shall approve the investment policy and provide overall direction to the administrative staff in the execution of the investment policy. The Board of Trustees shall review and approve or disapprove investment recommendations not governed by Investment Policy prior to their execution. The Board shall also review and approve investment policy changes, deletions, or additions. The Board shall review and approve or disapprove any contracts of a financial nature, when performed by other than APERS' staff persons, such as, although not limited to, those for investment counselors, custodial arrangements, option programs, and security lending.

IX. TOTAL FUND PERFORMANCE MEASUREMENT STANDARDS

A. The Fund's overall annualized total return (price change plus income) should exceed the return available from a policy of "rolling over" 90-day Treasury Bills (as a proxy for the inflation rate) by at least ~~3.5%~~ 4.0% percentage points per year measured over a period of 10 years.

B. The Total Fund should rank in the upper 50th percentile compared to the results of other similarly managed public fund portfolios measured over a five-year period.

C. The Fund's annualized total return over rolling five year periods should, after manager's fees, exceed the return of the following Target Indices as established by the Board.

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X. PROXY VOTING

The Board has directed that the individual investment managers will be responsible for voting proxies in the best interest of APERS. Each investment counselor is responsible for maintaining records of how each proxy is voted. A written report of proxy voting will be provided to the Board within 30 days from the end of each quarter. In general, each investment counselor is expected to vote for improvements in corporate governance, for the alignment interests of corporate management with shareholder interests, and for equal access to the management proxy card. A detailed explanation will be given for each instance where the proxy is voted against these concepts or against management.

XI. REVIEW OF INVESTMENT PROCESS

A. On a timely basis, but not less than twice a year, the Board will review actual investment results achieved by each manager (with a perspective toward a three to five-year time horizon or a peak-to-peak or trough-to-trough market cycle) to determine whether;

1. The investment managers performed in adherence to the investment philosophy and policy guidelines set forth herein,
2. The investment managers performed satisfactorily when compared with:
 - a. The objectives set.
 - b. Other similarly managed funds.

B. In addition to reviewing each investment manager's results, the Board will reevaluate, from time to time, its progress in achieving the total fund, equity, fixed-income, and international equity segments objectives previously outlined.

C. The periodic re-evaluation also will involve an evaluation of the continued appropriateness of:

1. The manager structure;

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2. The allocation of assets among the managers; and
3. The investment objectives for the Fund's assets.

D. The Board may appoint investment consultants to assist in the ongoing evaluation process. The consultants selected by the Board are expected to be familiar with the investment practices of other similar retirement plans and will be responsible for suggesting appropriate changes in the Fund's investment program over time.