

**Minutes
Investment Committee
Board of Trustees
September 14, 2010**

IN ATTENDANCE:

Investment Committee Members:	Dr. Edward Britt Brockman, Chair Mr. Dermontti F. Dawson Mr. Carol Martin Gatton Mr. Erwin Roberts Mr. James W. Stuckert
Community Advisory Members:	Mr. Henry Clay Owen
Investment Staff & Consultants:	Ms. Angela S. Martin Ms. Susan I. Krauss Ms. Donna A. Counts Mr. Rob Palmeri (R.V. Kuhns & Associates)
Others:	Ms. Shelia Brothers Ms. Jo Hern Curris Mr. Everett McCorvey Ms. Sandy Bugie Patterson Dr. Joe Peek Dr. Lee T. Todd, Jr.

The Investment Committee meeting was called to order at 9:00 a.m. Dr. Brockman asked for a motion to approve the June 8, 2010 minutes. Mr. Stuckert made the motion to approve the minutes, Mr. Gatton seconded the motion and all approved.

Dr. Brockman then stated that the investment committee needs to go into closed session in order to hear a report on the evaluation of proposals for a new non-U.S. active growth equity manager. The committee must go into closed session because an open discussion on the recommended manager could jeopardize the contract negotiations with the firm. Dr. Brockman then outlined the guidelines for the closed session. Dr. Brockman then made a motion for the committee go into closed session pursuant to KRS 61.810 (1) (g). The motion was seconded by Mr. Dawson. The motion was approved unanimously. The committee went into closed session at 9:05 a.m.

The committee came out of closed session at 9:15 a.m. Dr. Brockman then stated the committee was now back in open session and will proceed with a vote on IC1. Ms. Krauss summarized IC1 which authorizes the Executive Vice President for Finance and Administration or his designee to enter into contract negotiations with a new manager. Once the new manager negotiations and contract are complete, staff will work to transfer assets to the new manager from Gartmore. Mr. Stuckert moved to approve IC1 and Mr. Gatton seconded the motion. The motion was approved unanimously.

Dr. Brockman then introduced the next agenda item, a review of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) by Ms. Krauss. Ms. Krauss stated that UPMIFA was approved by the state legislature in March 2010, and became effective in July. Ms. Krauss explained that in order to

understand UPMIFA, it was necessary to understand its predecessor, UMIFA. UMIFA, a model act passed in 1972, stated that institutions needed to consider the long term investment needs of the institutions and not just focus on maximizing actual income. It introduced the concept of intergenerational equity which is that there is a responsibility to ensure assets will generate adequate income in perpetuity for future beneficiaries. As a result of UMIFA, institutions began investing in equities and other asset classes to maximize growth. UMIFA also allowed institutions to spend a prudent amount of appreciation, including realized and unrealized gains. However, institutions could not spend below the historic dollar value, or contributed value. This model worked well until the first market downturn of this decade when institutions found themselves with underwater endowments and had to limit or suspend distributions. The National Conference of Commissioners of Uniform State Laws reviewed this subject again in 2006 and made changes that would modernize the law and provide clearer guidance in other areas.

Ms. Krauss stated that UPMIFA provides guidance on investment conduct, expenditure of funds (notwithstanding restrictions put in place in donor agreement), delegation of management and investment functions and release or modification of restrictions. She stated that most of the UK endowment agreements do not limit investments and they specify that spending distributions will be made in accordance with the spending policy adopted by the Investment Committee. Ms. Krauss clarified that an underwater endowment was any endowment where the market value has fallen below the contributed value. She stated that as a result of the market declines over the last two years, UK does have underwater endowments. However, since most of the agreements have the standard spending language, spending distributions were not limited on underwater accounts. However, UK had just over 100 endowments with spending limited to actual income due to donor request.

Ms. Krauss then reviewed some of the specific provisions of UPMIFA. In the investment conduct area, UPMIFA adopted the Prudent Person standard of care, which indicates that the funds will be managed in good faith and with the care an ordinarily prudent person would exercise in a like position. A second investment conduct guide is the special skills standard, which states that if a person is selected for investment functions because of special skills or expertise, the person has a duty to use those special skills in managing and investing institutional funds. Other investment conduct guidelines include a duty to manage services and costs appropriately, practice modern portfolio theory, balancing overall risk and return, and requirements to diversify and rebalance the portfolio.

Ms. Krauss stated UPMIFA eliminated the UMIFA's historic dollar threshold and provided seven factors to consider in the expenditure of endowment funds. UPMIFA also specifically provides direction for delegation of investment management to external agents and states the delegation must be made in good faith under the Prudent Person standard in selecting and monitoring the agents. One of the last major changes from UPMIFA is the ability to release endowment restrictions under specific conditions and processes without court approval.

As Ms. Krauss concluded her presentation she responded to a question from Dr. Peek on the assumed rate of inflation used as a basis for develop spending rates. Dr. Peek suggested the 3% assumed rate may be too high for the short term. Ms. Krauss responded that some institutions use the price index for higher education which is much higher than the overall rate of inflation and the 3% is a reasonable for the long term, defined as ten to fifteen years.

Dr. Brockman then introduced Rob Palmeri with R. V. Kuhns and Associates (RVK) and the next item on the agenda, the portfolio risk review and asset allocation study. Mr. Palmeri stated that the portfolio risk review is a model that reviews historical data on the investment portfolio and attempts to identify any unintended biases built into the portfolio due to asset allocation or manager performance. One finding of the portfolio review was that 53% of UK's endowment is targeted to equities, yet equities account for 72% of the portfolio risk. A second finding is that Reams, one of the fixed income managers, is

contributing to increased overall portfolio risk because the portfolio allocation is behaving more like an equity investment rather than fixed income. Mr. Palmeri indicated that if there is another challenging financial market, this part of the portfolio could be subject to equity type volatility, rather than fixed income volatility.

Mr. Palmeri then discussed the asset allocation study. The inputs to the asset allocation model are expected return, risk, correlations and constraints for each asset class. The output of the model is potential asset allocations that maximize expected return for one unit of expected risk, or “efficient” allocations. The asset allocation process/analysis was completed in 2008, 2009 and then again in 2010. Mr. Palmeri stated that for the 2010 study, RVK reduced the real estate constraint, based on concerns about real estate expressed by the Committee, and relaxed the absolute and real return constraints. As a result, the model supports higher allocations to absolute and real return. Specifically, RVK recommends reducing equities by 6% and increasing alternatives by 9%. Within the alternatives asset class, RVK recommends reducing real estate 4%, increasing absolute return 10% and real return 3%. This asset allocation is expected to reduce return slightly, by .08%, but reduce expected risk by .78%, which is a substantial improvement.

Dr. Brockman then introduced IC2, approval of an updated endowment investment policy and introduced Ms. Martin to discuss this agenda item. Ms. Martin stated that each year the Investment Committee must review the investment policy. Based on the changes in state law and the review performed by Staff and by RVK, several changes are being recommended this year. One change is to update the policy language to reflect the passage of the UPMIFA. Also, this proposed policy establishes the Endowment Advisory Group which would be appointed by the President to advise the Vice President for Financial Operations and Treasurer on various matters pertaining to prudent management of individual endowment funds. The Endowment Advisory Group would help review and establish policy on endowment spending, and specifically help establish policy for spending on underwater endowments. The group would also evaluate minimum endowment thresholds and review the small individual endowments and those over 20 years old for possible release restrictions.

Ms. Martin stated that another change in the investment policy is a new asset allocation designed to reduce the projected risk of the endowment. Changes to the asset allocation include a decrease in the target allocations of Broad US Equities from 26% to 20%; an increase in the Real Return allocation from 7% to 10%; an increase in the Absolute Return allocation from 10% to 20%; a decrease in the Real Estate allocation from 12% to 8%; and a decrease in the Fixed Income allocation from 18% to 15%. The revised investment policy also includes a new manager structure related to the new asset allocation. Another change in the policy is the inclusion of new appendices which include Kentucky’s Uniform Prudent Management of Institutional Funds Act, a summary of endowment investment manager structure and related benchmarks, and investment strategy definitions.

Dr. Brockman asked for any questions. There being none he asked if there was a motion. Mr. Gatton moved to approve IC2, approving the Endowment Investment Policy. Mr. Roberts seconded the motion. It was approved unanimously.

Dr. Brockman introduced Mr. Palmeri for the next item on the agenda, the investment performance review and market update. Mr. Palmeri stated that volatility returned to the market in the second quarter of 2010 in part due to the Euro-debt crisis and concerns over a slowing U.S. Economy. For the equity market, most sectors had negative returns for the quarter ending June 30, 2010, but healthy returns for the year. With the exception of High Yield, all fixed income returns sectors posted positive returns in the second quarter.

Mr. Palmeri stated there was a very positive story of endowment fund performance over the last twelve months. For the fiscal year ended June 30, 2010, the total fund returned 13.05%, net of fees, and outperforming the target allocation by 2.63%. The total fund out performance was attributed to

outperformance of the Fixed Income, Real Return and Absolute Return composites. In the Fixed Income asset class Reams had equity like returns and did extremely well. Real Return added significant value and was the best performing asset class over the past twelve months, with both PIMCO and Wellington performing extremely well. Absolute return outperformed its index by 235 basis points. The real estate composite detracted from total returns, declining by 3.56%. Some of this underperformance can be attributed to the RREEF America II fund which is in the redemption queue following one of the earlier recommendations to diversify the real estate. Even with the underperformance of this manager, overall the fund performed very well over the last twelve months.

Mr. Palmeri then referred to the Manager Compliance Summary matrix sheet in the notebook. Mr. Palmeri stated that this matrix summarizes the types of issues that are monitored by RVK on a daily basis. Mr. Palmeri stated RVK will continue to review all the managers in this way and then concluded his presentation.

The next item on the agenda was a review of the Cash, Overnight and Short-Term Investment Report. As of July 31, 2010 the total portfolio subject to the overnight and short term investment policy was \$374.8 million. Overnight investments totaled \$223.6 million and short-term investments totaled \$151.2 million. Ms. Counts then stated that overnight investments earned an annualized return of 0.16%. While this rate of return appears low, it is actually much better than the rates of return on the government money market funds that the University could invest in under our current policy. This overnight pool is managed by the Office of Financial Management (OFM) at the state and they are able to invest our funds a bit more aggressively, including investment in nongovernmental money market funds, corporate paper and other fixed income investments with a higher yield than government agencies. Short term investments include two different investment pools managed by OFM totaling \$125 million. The University also holds \$26.2 million in direct investment of federal agencies. Ms. Counts stated they intend to purchase more agencies in the future..

Dr. Brockman asked for questions. Dr. Peek asked a question about the rates of return on the overnight bank balances compared to the rates the bank is earning on those funds overnight, indicating that the bank was earning the federal funds rate of .25% while UK was earning only .16% on our funds. Ms. Counts responded that our banking contract ties our overnight earning rate to the OFM overnight rate. Ms. Counts also pointed out that our banking contract should be viewed in total package, and we get very good rates on our banking services and transactions, including account maintenance fees, wires and ACH.

Dr. Brockman asked if there was other business to be considered. Dr. Todd then introduced Mike Richey and asked him to relay some information regarding the UK endowment compared to the other SEC school endowments. Mr. Richey responded that last month at the SEC Development meeting a summary of the endowments for the SEC schools, except for Vanderbilt, was presented. The largest endowment was Florida at \$1.1 billion and UK was second at \$788 million. Dr. Todd then stated he thought this was something the committee would like to be aware of.

With no further business the meeting adjourned at 11:00 a.m.

Donna Counts
Office of the Treasurer

MARKUP VERSION WITH CHANGES

UNIVERSITY OF KENTUCKY
AND AFFILIATED CORPORATIONS

ENDOWMENT INVESTMENT POLICY

Amended [September 14, 2010](#)~~December 1, 2009~~

University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Athletic Association
The Fund for Advancement of Education and Research in the UK Medical Center
~~University of Kentucky Business Partnership Foundation, Inc.~~
University of Kentucky Mining Engineering Foundation, Inc.
University of Kentucky [Gluck](#) Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Center on Aging Foundation, Inc.

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I. General

The University of Kentucky Endowment ("Endowment") is an aggregation of funds comprised of gifts from provided by donors and grants from the Commonwealth of Kentucky with the requirement they be held in perpetuity to generate income earnings now and in the future, years to support the University's programs of instruction, research and public service. The income Earnings from endowment investments supports scholarships, chairs, professorships, basic research, as well as academic and public service programs, as defined by the individual endowment agreements. The Endowment is expected to provides fiscal stability since the principal is invested and income earnings is are generated year after year.

The University of Kentucky has a fiduciary responsibility to prudently manage the Endowment prudently and to preserve the purchasing power of the Endowment, as well as the individual endowment funds, in order to evenly support present and future beneficiaries. This fiduciary responsibility constitutes both a legal and moral obligation to donors and the Commonwealth of Kentucky who intend that their gifts and grants provide support for the University in perpetuity.

The Endowment also includes other funds set aside by the Board of Trustees with the expectation that they be invested on a long-term basis.

II. Purpose of the Investment Policy

In general, the purpose of this policy is to outline a philosophy and attitude which will guide the management of the investment assets toward the desired results. It is intended to be sufficiently specific to be meaningful, yet flexible enough to be practical.

This investment policy is set forth by the Investment Committee ("Committee") of the University of Kentucky Board of Trustees in order to:

- a. Define and assign the responsibilities.
- b. Establish a clear understanding of the investment goals and objectives of the Endowment assets.
- c. Offer guidance and limitations regarding the investment of Endowment assets.
- d. Establish a basis of evaluating investment results.
- e. Manage the Endowment's assets according to industry best practices and applicable laws.

The investment policy will be reviewed annually by the Committee and investment staff.

III. Roles and Responsibilities

Responsibilities of the Investment Committee

The Board of Trustees has established the [Investment](#) Committee with members appointed annually by the Chair of the Board of Trustees. The Committee is responsible for the review and oversight of [the Endowment](#) investments of the University of Kentucky and its affiliated corporations, ~~consisting of the Research Foundation, Athletic Association, The Fund, Equine Research Foundation, Business Partnership Foundation, Humanities Foundation, Mining Engineering Foundation, and Center on Aging Foundation.~~

Governing Regulation II, A (6) (f) of the University of Kentucky sets forth the specific responsibilities of the Investment Committee as follows:

Under delegation from the Board of Trustees, and consistent with KRS 164A.550 through 164A.630, the Investment Committee is responsible for review and oversight of the endowment investment programs of the University and its affiliated corporations. These responsibilities include: formulating and reviewing investment policies; appointing, monitoring and evaluating investment managers and consultants; and reviewing and approving plans for the general management of the endowment funds of the University.

The membership of the Committee shall include five members from the Board of Trustees. Each member shall be appointed by the Chair of the Board of Trustees. A quorum of the Committee members must be present in order to conduct business.

In addition to voting members, the Investment Committee may, from time to time, have the Chair of the Board of Trustees appoint, upon recommendation of the University President, Community Advisory Members to assist it in its functions by providing specialized advice and support. Said Community Advisory Members shall be selected on the basis of their expertise in such areas as investment management and finance. The appointments of Community Advisory Members to the Investment Committee shall be for three years and may be reappointed for an unlimited number of three year terms. The maximum number of Community Advisory Members authorized at any one time shall be three (3).

The Investment Committee Chair reports to the Board of Trustees after each meeting of the Committee on the performance results of endowment investments. Policies of the Committee are implemented by the Office of the Treasurer in carrying out the day-to-day operations of the University's endowment funds.

Responsibilities of Investment Staff and Endowment Advisory Group

Investment Staff

Investment staff ("Staff") will consist of the University's Vice President for Financial Operations and Treasurer and the Assistant Treasurer for Investments. Staff is responsible for executing the policies and decisions enacted by the Committee and the general daily activities and administration of the Endowment assets. The Staff will prepare analysis and recommendations for the Committee on development of policies and guidelines, selection of an appropriate long-term asset allocation, and selecting an appropriate manager structure. The Staff will issue requests for proposals and provide recommendations to the Committee as to the managers most appropriate for managing the Endowment's assets. The Staff will maintain summaries of the investment guidelines for the various investment managers and periodically provide to the Committee.

Endowment Advisory Group

An Endowment Advisory Group of senior University administrators and faculty will be established by the President to advise the Vice President for Financial Operations and Treasurer on various matters pertaining to the prudent management of individual endowment funds.

Responsibilities of Investment Consultant

The Committee may engage an independent Investment Consultant ("Consultant") to assist the Committee and Staff in developing policies and guidelines, selecting an appropriate long-term asset allocation, selecting an appropriate manager structure, identifying investment managers, evaluating investment performance, and offering other services as requested. The Consultant will prepare quarterly and annual assessments of investment performance that include results for the total endowment and each individual investment manager compared to appropriate market indices and manager universes. The Consultant will also periodically provide in-depth and detailed analysis of each manager's portfolio.

IV. Delegation of Authority

The Committee may delegate the following investment related activities to qualified industry experts, but will be responsible for the selection and oversight of the vendors.

Investment Custodian

The Committee will hire a Custodian for the University's endowment investments to establish and maintain direct account relationships with each investment manager and perform standard custodial functions, including security safekeeping, collection of income, settlement of trades, collection of proceeds of maturing securities, distribution of income, and daily investment of cash. The Custodian will provide monthly account statements and other reports as requested by the Staff.

Investment Managers

The Committee will delegate the selection, buying and selling of individual securities to qualified

industry experts. Each individual investment manager will exercise discretion over assets in accordance with specified investment guidelines.

Investment managers that utilize separate accounts to manage Endowment assets will adhere to specific investment manager guidelines established by Staff with the assistance of the Consultant. Each investment manager using a separate account is required to summarize its holdings and transactions on a monthly basis.

Investment managers that utilize a mutual fund investment structure, a commingled trust fund structure or a limited partnership structure will have discretion to manage the assets in accordance with the policies and guidelines outlined in the respective mutual fund's prospectus, the commingled trust fund's offering memorandum or limited partnership's private placement memorandum.

~~[A summary of the investment manager structure and benchmarks is provided in Appendix 2. All investment managers' guidelines and policies are located in the addendum of the Policy.](#)~~

V. Financial and Investment Objectives

The Investment Committee has established the following financial and investment objectives for the Endowment:

1. To preserve the purchasing power of the endowment assets and the related revenue stream over time to evenly allocate support between current and future beneficiaries (intergenerational equity).
- ~~2. To manage the endowment assets in a single investment pool, employing multiple investment managers to gain specialization and diversification benefits of different investment asset classes and strategies.~~
- ~~3. To establish an annual spending rate policy of 4.25% of the average market value over the preceding 60 months.~~
- ~~4. To establish an annual management fee of .25% of the current market value.~~
- ~~5.2~~ To earn an average annual real return, after inflation and expenses, of at least 4.5% per year over full economic market cycles.

~~[Kentucky Uniform Prudent Management of Institutional Funds Act \(KRS 273.600-520 to 273.645-590\)](#)~~

~~[Endowment assets will be managed by the Investment Committee in accordance with the provisions of the Kentucky Uniform Prudent Management of Institutional Funds Act \(KRS 273.600 to 273.645\), included in Appendix 1. Endowment assets will be managed effectively and prudently in accordance with the provisions of the Uniform Management of Institutional Funds Act \(KRS 273.520 to 273.590\), which specifically requires trustees to consider both the long-term and short-term needs of the University. The Committee has established policies intended to accomplish the primary goal to preserve or increase the purchasing power of the Endowment by maximizing real total return, subject](#)~~

~~to risk constraints.~~

Spending Rate and Management Fee

The Investment Committee has established an target annual spending rate ~~policy~~ of 4.25% of the average market value of the Endowment over the preceding 60 months to establish financial equilibrium for the Endowment by creating a balance between annual spending and the expected real (after inflation) return on assets. As described below, Additionally, the Endowment ~~will be is~~ assessed an annual management fee of .25% of the current market value (assessed monthly) to support administrative costs. The target spending rate ~~of 4.25%~~ and ~~the~~ management fee ~~of .25%~~, in concert with the target asset allocation policy are is intended to support current and future program needs and allow the Endowment value to grow at a rate at least equal to annual inflation.

The above target spending rate and management fee policies will be phased in as follows:

- ~~• In FY 2009-10, the spending rate and management fee will be 4.5% and .5%, respectively. The spending rate will be applied to the average market value over the preceding 36 months.~~
- In FY 2010-11, the spending rate and management fee will be reduced from 4.5% and .5% to 4.375% and .375%, respectively. Effective FY 2010-11 and for all future years, the spending rate will be applied to the average market value over the preceding 60 months.
- In FY 2011-12, the spending rate and management fee will be reduced to 4.25% and .25%, respectively.

The target spending rate and management fee established by the Investment Committee represent maximum amounts that can be withdrawn annually from individual endowment funds. The Vice President for Financial Operations and Treasurer may reduce or suspend withdrawals from individual endowment funds that are underwater¹.

VI. Investment Policies

Diversification

The Committee will invest in different asset classes and engage multiple investment managers to ensure proper diversification of the Endowment. Investment diversification is essential to limit risks that include return volatility, the magnitude of potential losses, and manager underperformance. Equity investments will be diversified by market capitalization (company size), style (growth or value), industry, and country of domicile (as it will include non-U.S. based companies). Fixed income investments will be diversified by market sector, maturity, credit quality and issuer. Real estate investments will be diversified by property type, geographic location and investment style. Private equity investments will be diversified by strategy, including multiple venture capital, leveraged buyout, and special situation funds, by geographical allocation including U.S. and non-US investments, and

¹ Underwater endowments are those in which the market value is less than the contributed value.

by vintage year of investment. Real Return strategies will be diversified by asset class and manager. Absolute Return Strategies will be diversified by manager, investment strategy, and geographic location including U.S. and non U.S. managers.

In an effort to optimize and efficiently utilize due diligence research and diversification within the alternative asset classes, which includes Private Equity, Real Return, Absolute Return and Real Estate, a “fund of funds” (“FOF”) investment structure will generally be used. ~~Investing in an individual manager will need the approval of the Committee.~~

Asset Allocation

The Committee has established asset class targets and ranges as follows:

Asset Class	Investment Policy	
	Target	Range
Broad U.S. Equities	20 26%	15-25 21-31%
Broad Non-U.S. Equities	20%	15-25%
Total Equities	4046%	35-4541-51%
Private Equity	7%	3-9 1-9%
Real Return	10 7%	8-12 5-9%
Absolute Return	20 10%	15-25 8-12%
Real Estate	8 12%	6-10 10-14%
Total Alternatives	4536%	35-5031-41%
Fixed-Income	1518%	12-1815-20%
Total	100%	

Rebalancing

The Committee intends to maintain the actual asset class allocations within the target ranges outlined above. Allocations relative to targets will be reviewed at least on a quarterly basis to determine if rebalancing transfers between asset classes are necessary. In general, Staff will direct new endowment gifts to undertarget asset classes.

Commitments to Private Equity and Real Estate

Staff, assisted by the Consultant, will complete annual forecasting and make appropriate commitments to successor funds of approved private equity and real estate managers to reach and maintain the approved policy allocation and ensure diversification across vintage year, strategy, geography, etc.

Liquidity

The Endowment is intended to provide a stream of annual income to the University in perpetuity. As a result, the Endowment has a long-term orientation. In addition, the withdrawal rate from the Endowment fund is well defined, predictable, and of modest size relative to the total assets, ~~so the Endowment's need for liquidity is significantly lower than other institutional investors.~~ Staff, assisted by the Consultant, is responsible for managing the liquidity of the portfolio to fund spending distributions and capital calls while maintaining the appropriate market exposure.

Proxy Voting

The Committee delegates full authority for proxy voting to its investment managers for the securities under their discretionary authority and requires the investment managers to vote all proxies in the best interest of the Endowment. In addition, when requested, the managers will report to the Committee on their proxy-voting policies and activities on the Endowment's behalf.

Proxy voting related to governance issues regarding investment managers hired to manage Endowment assets, and their related investment legal structures, terms and conditions, will be voted on by the Staff in the best economic interest of the Endowment. The Staff may solicit assistance of the Consultant on governance issues.

Transaction Costs

The Committee requires the investment managers, in their capacity as fiduciaries, to manage the transactions costs they incur on the Endowment's behalf in the best interests of the University. When requested, the managers will report to the Committee on the transactions costs incurred and the brokers used on the Endowment's behalf.

Transition Management

Transitions between investment managers are an important and inevitable element of portfolio management, typically resulting from manager terminations or changes to the investment strategy of the portfolio. The optimal method to use in executing a transition may vary significantly from one transition to another based on the types of assets involved and the timeframe in question. Generally, the Endowment's objective in a manager transition is to implement the change in a cost-effective, timely manner while maintaining the appropriate market exposure. It is imperative to note that the cost of transition is not commissions alone, but also bid/ask spread, market impact and opportunity cost. The market impact cost is the effect trading will have on the market price of the shares being traded. The opportunity cost, sometimes referred to as implementation shortfall, is the cost of market movements over the time it takes to trade. Efforts should be made to minimize the total cost rather than any single cost component. Selecting a transition manager can be done at the Staff's discretion with the assistance of the Consultant. Use of futures contracts and exchange traded funds may be required in order to maintain appropriate market exposure during a transition.

VII. Performance Evaluation

Endowment performance will be monitored and reviewed over full market cycles, generally three to five years, at three levels; total Endowment, asset class and individual manager. All three levels will include a passive index and peer group measurement review. Performance will be reviewed on a gross and net return basis and will include risk and risk adjusted returns.

Performance Benchmarks

The total Endowment performance will be measured against:

1. CPI plus ~~4.5%~~ 5% real return
2. A Policy Benchmark consisting of passive indexes reflecting the Endowments "strategic target" asset allocation percentages. [See Appendix 2 for the Summary of Endowment Investment Manager Structure & Benchmarks.](#)
3. An Active Benchmark consisting of passive indexes reflecting the Endowments "actual" asset allocation percentages
4. A peer group universe of similar plans

The asset class performance will be measured against:

1. The asset class' core passive index. [See Appendix 2 for the Summary of Endowment Investment Manager Structure & Benchmarks.](#)
2. A peer group universe of similar asset classes

The individual managers' performance will be measured against:

1. The managers' specific passive indexes. ~~identified in the investment manager guidelines located in the addendum of the Policy~~ [See Appendix 2 for the Summary of Endowment Investment Manager Structure & Benchmarks.](#)
2. A peer group universe of similar investment styles

Performance Expectations

It is expected within each level the Endowment, the asset class, and the individual managers should exceed the passive index return and should be above median against the appropriate peer group universes [over full market cycles.](#)

It is expected that risk (and risk adjusted returns) will be in line with the risk associated with the

specific passive index benchmarks: [over full market cycles](#).

VIII. Investment Manager Structure

Below is the investment manager structure and corresponding target asset allocations as established by the Investment Committee:

<u>Manager</u>	<u>Investment Strategy</u>	<u>Target Allocation</u>
<i>Broad U.S. Equity:</i>		
State Street, Boston, MA	— Passive Russell 1000 (Large-Cap)	23.95%
Wellington, Boston, MA	— Active Russell 2000 (Small-Cap)	-2.05%
<i>Total Broad U.S. Equity</i>		26.00%
<i>Broad Non-U.S. Equity:</i>		
Capital Guardian, Los Angeles, CA	— Active MSCI ACW Ex U.S. — Core	10.00%
Gartmore, London, ENG	— Active MSCI ACW Ex U.S. — Growth	-5.00%
Mondrian, London, ENG	— Active MSCI ACW Ex U.S. — Value	-5.00%
<i>Total Broad Non-U.S. Equity</i>		20.00%
<i>Private Equity:</i>		
Commonfund Capital, Wilton, CT	— Private Equity Fund of Funds (“FOF”)	2.94%
Pantheon Ventures, San Fran., CA	Private Equity FOF	2.94%
Siguler Guff, New York, NY	Opportunistic Private Equity FOF	0.56%
Drum Capital, Stamford, CT	Opportunistic Private Equity FOF	0.56%
Fort Washington, Cincinnati, OH	Regional Venture Capital	0.00% ²
Chrysalis Ventures, Louisville, KY	Regional Venture Capital	0.00% ¹
<i>Total Private Equity</i>		7.00%
<i>Real Return:</i>		
PIMCO, Newport Beach, CA	Real Return FOF	5.25%
Wellington, Boston, MA	Real Return FOF	1.75%
<i>Total Real Return</i>		7.00%
<i>Absolute Return:</i>		
GAM, London, ENG	Core Absolute Return FOF	4.00%
Grosvenor, Chicago, IL	Core Absolute Return FOF	4.00%
Berens, New York, NY	Opportunistic Absolute Return FOF	2.00%
<i>Total Absolute Return</i>		10.00%

² The Committee has committed \$2 million and \$1 million to Fort Washington and Chrysalis, respectively, to enhance the total return for the Endowment and provide for leadership in economic development for the Commonwealth of Kentucky.

<i>Real Estate:</i>		
UBS, Hartford, CT	Core Real Estate	4.00%
Multiple managers:³	Value Added Real Estate	4.00%
—TA Associates, Boston, MA		
—Wrightwood Capital, Chicago, IL		
Multiple managers TBD	Opportunistic Real Estate	4.00%
<i>Total Real Estate</i>		<i>12.00%</i>
<i>Fixed Income:</i>		
PIMCO, Newport Beach, CA	Core Plus Fixed Income	9.00%
Reams, Columbus, IN	Core Plus Fixed Income	9.00%
<i>Total Fixed Income</i>		<i>18.00%</i>

~~The target manager allocations shown above may be revised from time to time as a result of changes in the composition of the capital markets or the styles of individual managers. In addition, the allocations may be revised as a result of risk modeling analysis.~~

~~Definitions of the investment strategies are located in the addendum of the Policy.~~

~~³ The Committee has currently approved commitments to two managers in this strategy, however the Committee plans to make commitments to additional managers over the next few years in order to reach the target allocation of 4%.~~

APPENDIX 1
Kentucky Uniform Prudent Management of Institutional Funds Act
(KRS 273.600 to KRS 273.645)

273.600 Definitions for KRS 273.600 to 273.645.

In KRS 273.600 to 273.645:

(1) "Charitable purpose" means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community;

(2) "Endowment fund" means an institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. The term does not include assets that an institution designates as an endowment fund for its own use;

(3) "Gift instrument" means a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund;

(4) "Institution" means:

(a) A person, other than an individual, organized and operated exclusively for charitable purposes;

(b) A government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or

(c) A trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated;

(5) "Institutional fund" means a fund held by an institution exclusively for charitable purposes. The term does not include:

(a) Program-related assets;

(b) A fund held for an institution by a trustee that is not an institution; or

(c) A fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund;

(6) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity;

(7) "Program-related asset" means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment; and

(8) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 1, effective July 15, 2010.

273.605 Standard of conduct in managing and investigating institutional fund.

(1) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.

(2) In addition to complying with duty of loyalty imposed by law other than in KRS 273.600 to 273.645, each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

(3) In managing and investing an institutional fund, an institution:

(a) May incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution; and

(b) Shall make a reasonable effort to verify facts relevant to the management and investment of the fund.

(4) An institution may pool two (2) or more institutional funds for purposes of management and investment.

(5) Except as otherwise provided by a gift instrument, the following rules apply:

(a) In managing and investing an institutional fund, the following factors, if relevant, shall be considered:

1. General economic conditions;

2. The possible effect of inflation or deflation;

3. The expected tax consequences, if any, of investment decisions or strategies;

4. The role that each investment or course of action plays within the overall investment portfolio of the fund;

5. The expected total return from income and the appreciation of investments;

6. Other resources of the institution;

7. The needs of the institution and the fund to make distributions and to preserve capital; and

8. An asset's special relationship or special value, if any, to the charitable purposes of the institution;

(b) Management and investment decisions about an individual asset shall be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution;

(c) Except as otherwise provided by law other than KRS 273.600 to 273.645, an institution may invest in any kind of property or type of investment consistent with this section; Page 2 of 2

(d) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification;

(e) Within a reasonable time after receiving property, an institution shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio in order to bring the institutional fund into compliance with the purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of KRS 273.600 to 273.645; and

(f) A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 2, effective July 15, 2010.

273.610 Appropriation for expenditure or accumulation of endowment -- Rules of construction.

(1) Subject to the intent of a donor expressed in the gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. In making a determination to appropriate or accumulate, the institution shall act in good faith,

with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

- (a) The duration and preservation of the endowment fund;
- (b) The purposes of the institution and the endowment fund;
- (c) General economic conditions;
- (d) The possible effect of inflation or deflation;
- (e) The expected total return from income and the appreciation of investments;
- (f) Other resources of the institution; and
- (g) The investment policy of the institution.

(2) To limit the authority to appropriate for expenditure or accumulate under subsection (1) of this section, a gift instrument must specifically state the limitation.

(3) Terms in a gift instrument designating a gift as an endowment, or a direction or authorization in the gift instrument to use only "income," "interest," "dividends," or "rents, issues, or profits," or "to preserve the principal intact," or words of similar import:

(a) Create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund; and

(b) Do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (1) of this section.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 3, effective July 15, 2010.

273.615 Delegation of management and investment functions.

(1) Subject to any specific limitation set forth in a gift instrument or in law other than KRS 273.600 to 273.645, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances. An institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in:

- (a) Selecting an agent;
- (b) Establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and
- (c) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(2) In performing a delegated function, an agent owes a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.

(3) An institution that complies with subsection (1) of this section is not liable for the decisions or actions of an agent to which the function was delegated.

(4) By accepting delegation of a management or investment function from an institution that is subject to the laws of the Commonwealth, an agent submits to the jurisdiction of the courts of the Commonwealth in all proceedings arising from or related to the delegation or the performance of the delegated function.

(5) An institution may delegate management and investment functions to its committees, officers, or employees as authorized by law of the Commonwealth other than KRS 273.600 to 273.645.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 4, effective July 15, 2010.

273.620 Release or modification of restrictions on management, investment, or purpose.

(1) If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

(2) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The institution shall notify the Attorney General of the application, and the Attorney General shall be given an opportunity to be heard. To the extent practicable, any modification shall be made in accordance with the donor's probable intention.

(3) If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purpose expressed in the gift instrument. The institution shall notify the Attorney General of the application, and the Attorney General shall be given an opportunity to be heard.

(4) If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, sixty (60) days after notification to the Attorney General, may release or modify the restriction, in whole or part, if:

(a) The institutional fund subject to the restriction has a total value of less than fifty thousand dollars (\$50,000);

(b) More than twenty (20) years have elapsed since the fund was established; and

(c) The institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 5, effective July 15, 2010.

273.625 Reviewing compliance with KRS 273.600 to 273.645.

Compliance with KRS 273.600 to 273.645 is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, and not by hindsight.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 6, effective July 15, 2010.

273.630 Application of KRS 273.600 to 273.645 to existing institutional funds.

KRS 273.600 to 273.645 apply to an institutional fund existing on or established after July 15, 2010. As applied to institutional funds existing on July 15, 2010, KRS 273.600 to 273.645 govern only decisions made or actions taken on or after that date.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 7, effective July 15, 2010.

273.635 Relation of KRS 273.600 to 273.645 to the Electronic Signatures in Global and National Commerce Act.

KRS 273.600 to 273.645 modify, limit, and supersede the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. secs. 7001 et seq., but does not modify, limit, or supersede Section 101 of that act, 15 U.S.C. sec. 7001(a), or authorize electronic delivery of any of the notices described in Section 103 of that act, 15 U.S.C. sec. 7003(b).

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 8, effective July 15, 2010.

273.640 Uniformity of application and construction of the Kentucky Uniform Prudent Management of Institutional Funds Act.

In applying and construing this uniform act, consideration shall be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 9, effective July 15, 2010.

273.645 Short title for KRS 273.600 to 273.645.

KRS 273.600 to 273.645 may be cited as the Kentucky Uniform Prudent Management of Institutional Funds Act.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 10, effective July 15, 2010.

APPENDIX 2

Summary of Endowment Investment Manager Structure & Benchmarks

UNIVERSITY OF KENTUCKY
SUMMARY OF ENDOWMENT INVESTMENT MANAGER STRUCTURE & BENCHMARKS

MANAGER NAME	HEADQUARTERS	INVESTMENT STRATEGY¹	POLICY TARGET	POLICY RANGE	BENCHMARK
<u>Broad U.S. Equity:</u>					
State Street	Boston, MA	Passive Russell 1000 (Large-cap)	18.40%		Russell 1000 Index
Wellington	Boston, MA	Active Russell 2000 (Small-cap)	1.60%		Russell 2000 Index
		Total Broad U.S. Equity	20.00%	15.0-25.0%	Dow Jones U.S. Total Stock Market Index
<u>Broad Non-U.S. Equity:</u>					
Capital Guardian	Los Angeles, CA	Active MSCI ACW ex-U.S. - Core	10.00%		MSCI All Country World ex-U.S. Index
New Manager TBA ²	London, ENG	Active MSCI ACW ex-U.S. - Growth	5.00%		MSCI All Country World ex-U.S. Growth Index
Mondrian	London, ENG	Active MSCI ACW ex-U.S. - Value	5.00%		MSCI All Country World ex-U.S. Value Index
		Total Broad Non-U.S. Equity	20.00%	15.0-25.0%	MSCI All Country World ex-U.S. Index
		TOTAL EQUITIES	40.00%	35.0-45.0%	N/A
<u>Private Equity:</u>					
Multiple Managers ³ :					
Commonfund Capital	Wilton, CT	Private Equity Fund-of-Funds ("FOF")	5.95%	3.0-9.0%	Venture Economics All Private Equity Index
Pantheon Ventures	San Francisco, CA				
Multiple Managers ³ :					
Drum Capital	Stamford, CT	Opportunistic Private Equity FOF	1.05%	0.00-1.35%	Venture Economics All Private Equity Index
Siguler Guff	New York, NY				
Chrysalis Ventures ⁴	Louisville, KY	Regional Venture Capital	0.00%		Venture Economics All Private Equity Index
Fort Washington ⁴	Cincinnati, OH	Regional Venture Capital	0.00%		Venture Economics All Private Equity Index
		Total Private Equity	7.00%	3.0-9.0%	Venture Economics All Private Equity Index
<u>Real Return:</u>					
PIMCO	Newport Beach, CA	Real Return FOF (All Asset All Authority)	6.00%		All Asset Composite Index
Wellington	Boston, MA	Real Return FOF (Diversified Inflation Hedges)	4.00%		Wellington Diversified Inflation Hedges Composite Index
		Total Real Return	10.00%	8.0-12.0%	60%/All Asset Comp. Index/40% Wellington DIH Comp. Index
<u>Absolute Return:</u>					
Grosvenor	Chicago, IL	Core Absolute Return FOF	10.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
Grosvenor	Chicago, IL	Opportunistic Absolute Return FOF	2.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
GAM	London, ENG	Core Absolute Return FOF	5.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
Berens	New York, NY	Opportunistic Absolute Return FOF	3.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
		Total Absolute Return	20.00%	15.0-25.0%	Hedge Fund Net Fund-of-Funds Multi-Strategy Index
<u>Real Estate:</u>					
UBS	Hartford, CT	Core Real Estate	4.00%	6.0-10.0%	National Council on Real Estate Investment Fiduciaries Index - 1%
Multiple Managers ³ :					
TA Associates	Boston, MA	Value-Added/Opportunistic Real Estate	4.00%	0.0-5.0%	National Council on Real Estate Investment Fiduciaries Index
Wrightwood Capital	Chicago, IL				
New Manager TBA ²	TBA				
New Manager TBA ²	TBA				
		Total Real Estate	8.00%	6.0-10.0%	National Council on Real Estate Investment Fiduciaries Index
		TOTAL ALTERNATIVES	45.00%	35.0-50.0%	N/A
<u>Fixed Income:</u>					
PIMCO	Newport Beach, CA	Core-Plus Fixed Income	7.00%		Barclays Capital Aggregate Bond Index
PIMCO	Newport Beach, CA	Unconstrained Fixed Income	3.00%		3-Month LIBOR + 3%
Reams	Columbus, IN	Core-Plus Fixed Income	3.00%		Barclays Capital Aggregate Bond Index
Reams	Columbus, IN	Low Duration Fixed Income	2.00%		Barclays Capital 1-5 Year Government/Credit Index
		TOTAL FIXED INCOME	15.00%	12.0-18.0%	Barclays Capital Aggregate Bond Index
		TOTAL POOLED INVESTMENTS	100.00%		Policy Benchmark

¹ Investment strategy definitions located in Appendix 3 of the Endowment Investment Policy.

² New manager to be announced upon approval by Investment Committee and/or execution of contract.

³ Multiple managers will be used to reach the target allocation for the investment strategy and target allocations for managers within this strategy will not be established.

⁴ The Committee has committed \$1 million and \$2 million to Chrysalis Ventures and Fort Washington, respectively, to enhance the total return for the Endowment and provide for leadership in economic development in the Commonwealth of Kentucky.

APPENDIX 3
Investment Strategy Definitions

INVESTMENT STRATEGY DEFINITIONS

Broad U.S. Equity Strategies

- Passive Russell 1000 (Large-Cap): Passive strategy that invests in the large-cap segment of the U.S. equity universe. The Russell 1000 index includes approximately 1,000 of the largest securities based on market capitalization and is a subset of the Russell 3000 index, which is a broad U.S. equity market index. The Russell 1000 represents approximately 92% of the U.S. equity market. The objective of a passive strategy is to match the return of the index.
- Active Russell 2000 (Small-Cap): Active strategy that invests in the small-cap segment of the U.S. equity universe. The Russell 2000 index includes approximately 2,000 of the smallest securities based on market capitalization and is a subset of the Russell 3000 index, which is a broad U.S. equity market index. The Russell 2000 represents approximately 8% of the U.S. equity market. The objective of an active strategy is to exceed the return of the index.

Broad Non-U.S. Equity Strategy

- Active MSCI All Country World ex-U.S.: Active strategy that invests in stocks in the broad non-U.S. equity universe (i.e. companies domiciled in countries other than the U.S.). The MSCI All Country World ex-U.S. index consists of approximately 2,000 securities across 47 markets, with emerging markets representing approximately 18%. MSCI attempts to capture approximately 85% of the market capitalization in each country. The objective of an active strategy is to exceed the return of the index.
 - Core: Strategy designed to have broad exposure to style (growth vs. value) and sector.
 - Growth: Strategy focusing on stocks that offer better-than-average expected earnings or growth potential. Common characteristics typically include a low dividend yield and high price to book/earnings ratios.
 - Value: Strategy focusing on stocks that are considered to be undervalued as they trade at a lower price relative to fundamentals (i.e. dividends, earnings, sales, etc.). Common characteristics typically include a high dividend yield and low price to book/earnings ratios.

Private Equity Strategy

- Private Equity Fund-of-Funds: Strategy that invests in various venture capital and leveraged buyout partnerships in the U.S. and non U.S. countries. The fund-of-funds approach provides access to top-tier private equity partnerships and enhanced diversification. Assets invested in the strategy are illiquid with a typical investment time horizon of seven or more years.
 - Core: Fully diversified fund by manager, strategy and geography.
 - Opportunistic: Non-core fund designed to capture excess returns due to current market opportunities, such as distressed/ special situation funds, emerging markets funds, or other specialized and/or geographically concentrated funds.

Real Return Strategy

- Real Return Fund-of-Funds: Strategy that typically invests in various real return assets including treasury inflation protected securities (TIPS), commodities, currency, REITS, timber, infrastructure and global natural resources. Strategy can also include equity and fixed income investments, and involve global tactical asset allocation among the various asset classes/strategies. The objective of real return investments is to provide a hedge against inflation. A real return strategy targets a return exceeding inflation by a premium, such as C.P.I. plus 5%. The fund-of-funds approach provides instant diversification among various real return assets.

Absolute Return Strategy

- Absolute Return Fund-of-Funds: Strategy that invests in a diversified range of hedge funds. Hedge funds are private, unregulated investment partnerships that execute a broad range of investment strategies across a broad range of securities. The objective of absolute return investments is to provide consistent positive returns with relatively low correlation to other asset classes. The fund-of-funds approach provides access to professional expertise in selecting and monitoring individual hedge funds, access to high quality, institutional hedge funds and instant diversification. Assets invested in the strategy typically have quarterly liquidity, however managers usually reserve the right to suspend liquidations under poor economic and market conditions.
 - Core: Fully diversified fund by manager, strategy and geography.
 - Opportunistic: Non-core fund designed to capture excess returns due to current market opportunities, such as currency trading funds, emerging markets funds, or other specialized and/or geographically concentrated funds.

Real Estate Strategies

- Core Real Estate: Strategy that invests in high quality, stabilized properties in economically diversified metropolitan areas. Properties are substantially leased and provide predictable income and cash flow, with limited potential for significant capital appreciation. Strategy includes four major property types as follows: office, retail, residential and industrial. Assets invested in the strategy typically have quarterly liquidity, however managers usually reserve the right to suspend liquidations under poor economic and market conditions.
- Value Added/Opportunistic Real Estate:
 - Value Added: Strategy that invests in existing properties that require redevelopment, releasing and/or repositioning. Strategy includes the four major property types (office, retail, residential and industrial) plus lodging. Investment return is derived from both rental income and property appreciation. Assets invested in the strategy are illiquid with a typical investment time horizon of seven or more years.

- Opportunistic: Strategy that involves development properties and/or existing properties that require extensive redevelopment and releasing. Strategy involves all property types including niche sectors such as healthcare, senior housing, etc., and can include investment in properties outside the U.S. Investment return is derived mainly from property appreciation. Assets invested in the strategy are illiquid with a typical investment time horizon of seven or more years.

Fixed Income Strategies

- **Core-Plus Fixed Income:** Strategy that invests the majority of the portfolio in high quality, U.S. dollar denominated, investment grade fixed income securities similar to those in the Barclays Capital Aggregate Bond Index, including government/agency bonds, commercial and residential mortgage-backed bonds, asset-backed bonds and corporate bonds. Additionally, the strategy allows for investment in higher risk securities including non-investment grade, non-U.S. dollar denominated and emerging market bonds, but only to the extent allowed by the manager's guidelines.
- **Unconstrained Fixed Income:** Absolute return-oriented strategy that invests primarily in high quality, U.S. dollar denominated, and investment grade fixed income securities without sector or instrument limitations. The investment opportunity set includes government/agency bonds, commercial and residential mortgage-backed bonds, asset-backed bonds, corporate bonds (both investment grade and high yield), non-U.S. and emerging market bonds and currency. The strategy is designed to offer the traditional benefits of a core bond approach but with higher alpha potential and the opportunity to mitigate downside risk to a greater degree than what is reasonably possible from traditional active fixed income management approaches.
- **Low Duration Fixed Income:** Strategy that invests in a diverse set of short-term, high quality bonds which seeks to achieve low volatility and attractive returns relative to its benchmark (typically the Merrill Lynch 1-3 Year Treasury Index or Barclays Capital 1-5 Year Government/Credit Index). Investments include mortgage-backed securities, treasuries, corporates, and international fixed income. Additionally, the strategy allows for investment in higher risk, non-investment grade securities, but only to the extent allowed by the manager's guidelines. The strategy duration is typically less than three years.

CLEAN VERSION

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

ENDOWMENT INVESTMENT POLICY

Amended September 14, 2010

University of Kentucky
University of Kentucky Research Foundation
University of Kentucky Athletic Association
The Fund for Advancement of Education and Research in the UK Medical Center
University of Kentucky Mining Engineering Foundation, Inc.
University of Kentucky Gluck Equine Research Foundation, Inc.
University of Kentucky Humanities Foundation, Inc.
University of Kentucky Center on Aging Foundation, Inc.

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I. General

The University of Kentucky Endowment (“Endowment”) is an aggregation of funds comprised of gifts from donors and grants from the Commonwealth of Kentucky with the requirement they be held in perpetuity to generate income now and in the future. The income supports scholarships, chairs, professorships, basic research, as well as academic and public service programs, as defined by the individual endowment agreements. The Endowment is expected to provide fiscal stability since the principal is invested and income is generated year after year.

The University of Kentucky has a fiduciary responsibility to prudently manage and preserve the purchasing power of the Endowment, as well as the individual endowment funds, in order to evenly support present and future beneficiaries. This fiduciary responsibility constitutes both a legal and moral obligation to donors and the Commonwealth of Kentucky who intend that their gifts and grants provide support for the University in perpetuity.

The Endowment also includes other funds set aside by the Board of Trustees with the expectation that they be invested on a long-term basis.

II. Purpose of the Investment Policy

In general, the purpose of this policy is to outline a philosophy and attitude which will guide the management of the investment assets toward the desired results. It is intended to be sufficiently specific to be meaningful, yet flexible enough to be practical.

This investment policy is set forth by the Investment Committee (“Committee”) of the University of Kentucky Board of Trustees in order to:

- a. Define and assign the responsibilities.
- b. Establish a clear understanding of the investment goals and objectives of the Endowment assets.
- c. Offer guidance and limitations regarding the investment of Endowment assets.
- d. Establish a basis of evaluating investment results.
- e. Manage the Endowment’s assets according to industry best practices and applicable laws.

The investment policy will be reviewed annually by the Committee and investment staff.

III. Roles and Responsibilities

Responsibilities of the Investment Committee

The Board of Trustees has established the Investment Committee with members appointed annually

by the Chair of the Board of Trustees. The Committee is responsible for the review and oversight of the Endowment investments of the University of Kentucky and its affiliated corporations.

Governing Regulation II, A (6) (f) of the University of Kentucky sets forth the specific responsibilities of the Investment Committee as follows:

Under delegation from the Board of Trustees, and consistent with KRS 164A.550 through 164A.630, the Investment Committee is responsible for review and oversight of the endowment investment programs of the University and its affiliated corporations. These responsibilities include: formulating and reviewing investment policies; appointing, monitoring and evaluating investment managers and consultants; and reviewing and approving plans for the general management of the endowment funds of the University.

The membership of the Committee shall include five members from the Board of Trustees. Each member shall be appointed by the Chair of the Board of Trustees. A quorum of the Committee members must be present in order to conduct business.

In addition to voting members, the Investment Committee may, from time to time, have the Chair of the Board of Trustees appoint, upon recommendation of the University President, Community Advisory Members to assist it in its functions by providing specialized advice and support. Said Community Advisory Members shall be selected on the basis of their expertise in such areas as investment management and finance. The appointments of Community Advisory Members to the Investment Committee shall be for three years and may be reappointed for an unlimited number of three year terms. The maximum number of Community Advisory Members authorized at any one time shall be three (3).

The Investment Committee Chair reports to the Board of Trustees after each meeting of the Committee on the performance results of endowment investments. Policies of the Committee are implemented by the Office of the Treasurer in carrying out the day-to-day operations of the University's endowment funds.

Responsibilities of Investment Staff and Endowment Advisory Group

Investment Staff

Investment staff ("Staff") will consist of the University's Vice President for Financial Operations and Treasurer and the Assistant Treasurer for Investments. Staff is responsible for executing the policies and decisions enacted by the Committee and the general daily activities and administration of the Endowment assets. The Staff will prepare analysis and recommendations for the Committee on development of policies and guidelines, selection of an appropriate long-term asset allocation, and selecting an appropriate manager structure. The Staff will issue requests for proposals and provide recommendations to the Committee as to the managers most appropriate for managing the Endowment's assets. The Staff will maintain summaries of the investment guidelines for the various investment managers and periodically provide to the Committee.

Endowment Advisory Group

An Endowment Advisory Group of senior University administrators and faculty will be established by the President to advise the Vice President for Financial Operations and Treasurer on various matters pertaining to the prudent management of individual endowment funds.

Responsibilities of Investment Consultant

The Committee may engage an independent Investment Consultant ("Consultant") to assist the Committee and Staff in developing policies and guidelines, selecting an appropriate long-term asset allocation, selecting an appropriate manager structure, identifying investment managers, evaluating investment performance, and offering other services as requested. The Consultant will prepare quarterly and annual assessments of investment performance that include results for the total endowment and each individual investment manager compared to appropriate market indices and manager universes. The Consultant will also periodically provide in-depth and detailed analysis of each manager's portfolio.

IV. Delegation of Authority

The Committee may delegate the following investment related activities to qualified industry experts, but will be responsible for the selection and oversight of the vendors.

Investment Custodian

The Committee will hire a Custodian for the University's endowment investments to establish and maintain direct account relationships with each investment manager and perform standard custodial functions, including security safekeeping, collection of income, settlement of trades, collection of proceeds of maturing securities, distribution of income, and daily investment of cash. The Custodian will provide monthly account statements and other reports as requested by the Staff.

Investment Managers

The Committee will delegate the selection, buying and selling of individual securities to qualified industry experts. Each individual investment manager will exercise discretion over assets in accordance with specified investment guidelines.

Investment managers that utilize separate accounts to manage Endowment assets will adhere to specific investment manager guidelines established by Staff with the assistance of the Consultant. Each investment manager using a separate account is required to summarize its holdings and transactions on a monthly basis.

Investment managers that utilize a mutual fund investment structure, a commingled trust fund structure or a limited partnership structure will have discretion to manage the assets in accordance with the policies and guidelines outlined in the respective mutual fund's prospectus, the commingled trust fund's offering memorandum or limited partnership's private placement memorandum.

A summary of the investment manager structure and benchmarks is provided in Appendix 2.

V. Financial and Investment Objectives

The Investment Committee has established the following financial and investment objectives for the Endowment:

1. To preserve the purchasing power of the endowment assets and the related revenue stream over time to evenly allocate support between current and future beneficiaries (intergenerational equity).
2. To earn an average annual real return, after inflation and expenses, of at least 4.5% per year over full economic market cycles.

Kentucky Uniform Prudent Management of Institutional Funds Act (KRS 273.600 to 273.645)

Endowment assets will be managed by the Investment Committee in accordance with the provisions of the Kentucky Uniform Prudent Management of Institutional Funds Act (KRS 273.600 to 273.645), included in Appendix 1.

Spending Rate and Management Fee

The Investment Committee has established a target annual spending rate of 4.25% of the average market value of the Endowment over the preceding 60 months to establish financial equilibrium for the Endowment by creating a balance between annual spending and the expected real (after inflation) return on assets. As described below, the Endowment will be assessed an annual management fee of .25% of the current market value (assessed monthly) to support administrative costs. The target spending rate and management fee in concert with the target asset allocation policy are intended to support current and future program needs and allow the Endowment value to grow at a rate at least equal to annual inflation.

The above target spending rate and management fee policies will be phased in as follows:

- In FY 2010-11, the spending rate and management fee will be reduced from 4.5% and .5% to 4.375% and .375%, respectively.
- In FY 2011-12, the spending rate and management fee will be reduced to 4.25% and .25%, respectively.

The target spending rate and management fee established by the Investment Committee represent maximum amounts that can be withdrawn annually from individual endowment funds. The Vice President for Financial Operations and Treasurer may reduce or suspend withdrawals from individual endowment funds that are underwater¹.

¹ Underwater endowments are those in which the market value is less than the contributed value.

VI. Investment Policies

Diversification

The Committee will invest in different asset classes and engage multiple investment managers to ensure proper diversification of the Endowment. Investment diversification is essential to limit risks that include return volatility, the magnitude of potential losses, and manager underperformance. Equity investments will be diversified by market capitalization (company size), style (growth or value), industry, and country of domicile (as it will include non-U.S. based companies). Fixed income investments will be diversified by market sector, maturity, credit quality and issuer. Real estate investments will be diversified by property type, geographic location and investment style. Private equity investments will be diversified by strategy, including multiple venture capital, leveraged buyout, and special situation funds, by geographical allocation including U.S. and non-US investments, and by vintage year of investment. Real Return strategies will be diversified by asset class and manager. Absolute Return Strategies will be diversified by manager, investment strategy, and geographic location including U.S. and non U.S. managers.

In an effort to optimize and efficiently utilize due diligence research and diversification within the alternative asset classes, which includes Private Equity, Real Return, Absolute Return and Real Estate, a "fund of funds" ("FOF") investment structure will generally be used.

Asset Allocation

The Committee has established asset class targets and ranges as follows:

Asset Class	Investment Policy	
	Target	Range
Broad U.S. Equities	20%	15-25%
Broad Non-U.S. Equities	20%	15-25%
Total Equities	40%	35-45%
Private Equity	7%	3-9%
Real Return	10%	8-12%
Absolute Return	20%	15-25%
Real Estate	8%	6-10%
Total Alternatives	45%	35-50%
Fixed-Income	15%	12-18%
Total	100%	

Rebalancing

The Committee intends to maintain the actual asset class allocations within the target ranges outlined above. Allocations relative to targets will be reviewed at least on a quarterly basis to determine if rebalancing transfers between asset classes are necessary. In general, Staff will direct new endowment gifts to undertarget asset classes.

Commitments to Private Equity and Real Estate

Staff, assisted by the Consultant, will complete annual forecasting and make appropriate commitments to successor funds of approved private equity and real estate managers to reach and maintain the approved policy allocation and ensure diversification across vintage year, strategy, geography, etc.

Liquidity

The Endowment is intended to provide a stream of annual income to the University in perpetuity. As a result, the Endowment has a long-term orientation. In addition, the withdrawal rate from the Endowment fund is well defined, predictable, and of modest size relative to the total assets. Staff, assisted by the Consultant, is responsible for managing the liquidity of the portfolio to fund spending distributions and capital calls while maintaining the appropriate market exposure.

Proxy Voting

The Committee delegates full authority for proxy voting to its investment managers for the securities under their discretionary authority and requires the investment managers to vote all proxies in the best interest of the Endowment. In addition, when requested, the managers will report to the Committee on their proxy-voting policies and activities on the Endowment's behalf.

Proxy voting related to governance issues regarding investment managers hired to manage Endowment assets, and their related investment legal structures, terms and conditions, will be voted on by the Staff in the best economic interest of the Endowment. The Staff may solicit assistance of the Consultant on governance issues.

Transaction Costs

The Committee requires the investment managers, in their capacity as fiduciaries, to manage the transactions costs they incur on the Endowment's behalf in the best interests of the University. When requested, the managers will report to the Committee on the transactions costs incurred and the brokers used on the Endowment's behalf.

Transition Management

Transitions between investment managers are an important and inevitable element of portfolio management, typically resulting from manager terminations or changes to the investment strategy of the portfolio. The optimal method to use in executing a transition may vary significantly from one transition to another based on the types of assets involved and the timeframe in question. Generally, the Endowment's objective in a manager transition is to implement the change in a cost-effective, timely manner while maintaining the appropriate market exposure. It is imperative to note that the cost of transition is not commissions alone, but also bid/ask spread, market impact and opportunity cost. The market impact cost is the effect trading will have on the market price of the shares being traded. The opportunity cost, sometimes referred to as implementation shortfall, is the cost of market movements over the time it takes to trade. Efforts should be made to minimize the total cost rather than any single cost component. Selecting a transition manager can be done at the Staff's discretion with the assistance of the Consultant. Use of futures contracts and exchange traded funds may be required in order to maintain appropriate market exposure during a transition.

VII. Performance Evaluation

Endowment performance will be monitored and reviewed over full market cycles, generally three to five years, at three levels; total Endowment, asset class and individual manager. All three levels will include a passive index and peer group measurement review. Performance will be reviewed on a gross and net return basis and will include risk and risk adjusted returns.

Performance Benchmarks

The total Endowment performance will be measured against:

1. CPI plus 4.5% real return
2. A Policy Benchmark consisting of passive indexes reflecting the Endowments "strategic target" asset allocation percentages. See Appendix 2 for the Summary of Endowment Investment Manager Structure & Benchmarks.
3. An Active Benchmark consisting of passive indexes reflecting the Endowments "actual" asset allocation percentages
4. A peer group universe of similar plans

The asset class performance will be measured against:

1. The asset class' core passive index. See Appendix 2 for the Summary of Endowment Investment Manager Structure & Benchmarks.
2. A peer group universe of similar asset classes

The individual managers' performance will be measured against:

1. The managers' specific passive indexes. See Appendix 2 for the Summary of Endowment Investment Manager Structure & Benchmarks.
2. A peer group universe of similar investment styles

Performance Expectations

It is expected within each level the Endowment, the asset class, and the individual managers should exceed the passive index return and should be above median against the appropriate peer group universes over full market cycles.

It is expected that risk (and risk adjusted returns) will be in line with the risk associated with the specific passive index benchmarks over full market cycles.

APPENDIX 1

Kentucky Uniform Prudent Management of Institutional Funds Act
(KRS 273.600 to KRS 273.645)

273.600 Definitions for KRS 273.600 to 273.645.

In KRS 273.600 to 273.645:

- (1) "Charitable purpose" means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community;
- (2) "Endowment fund" means an institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. The term does not include assets that an institution designates as an endowment fund for its own use;
- (3) "Gift instrument" means a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund;
- (4) "Institution" means:
 - (a) A person, other than an individual, organized and operated exclusively for charitable purposes;
 - (b) A government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or
 - (c) A trust that had both charitable and noncharitable interests, after all noncharitable interests have terminated;
- (5) "Institutional fund" means a fund held by an institution exclusively for charitable purposes. The term does not include:
 - (a) Program-related assets;
 - (b) A fund held for an institution by a trustee that is not an institution; or
 - (c) A fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund;
- (6) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity;
- (7) "Program-related asset" means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment; and
- (8) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 1, effective July 15, 2010.

273.605 Standard of conduct in managing and investigating institutional fund.

- (1) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.
- (2) In addition to complying with duty of loyalty imposed by law other than in KRS 273.600 to 273.645, each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- (3) In managing and investing an institutional fund, an institution:
 - (a) May incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution; and

(b) Shall make a reasonable effort to verify facts relevant to the management and investment of the fund.

(4) An institution may pool two (2) or more institutional funds for purposes of management and investment.

(5) Except as otherwise provided by a gift instrument, the following rules apply:

(a) In managing and investing an institutional fund, the following factors, if relevant, shall be considered:

1. General economic conditions;
2. The possible effect of inflation or deflation;
3. The expected tax consequences, if any, of investment decisions or strategies;
4. The role that each investment or course of action plays within the overall investment portfolio of the fund;
5. The expected total return from income and the appreciation of investments;
6. Other resources of the institution;
7. The needs of the institution and the fund to make distributions and to preserve capital; and
8. An asset's special relationship or special value, if any, to the charitable purposes of the institution;

(b) Management and investment decisions about an individual asset shall be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution;

(c) Except as otherwise provided by law other than KRS 273.600 to 273.645, an institution may invest in any kind of property or type of investment consistent with this section; Page 2 of 2

(d) An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification;

(e) Within a reasonable time after receiving property, an institution shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio in order to bring the institutional fund into compliance with the purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of KRS 273.600 to 273.645; and

(f) A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 2, effective July 15, 2010.

273.610 Appropriation for expenditure or accumulation of endowment -- Rules of construction.

(1) Subject to the intent of a donor expressed in the gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. In making a determination to appropriate or accumulate, the institution shall act in good faith,

with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

- (a) The duration and preservation of the endowment fund;
 - (b) The purposes of the institution and the endowment fund;
 - (c) General economic conditions;
 - (d) The possible effect of inflation or deflation;
 - (e) The expected total return from income and the appreciation of investments;
 - (f) Other resources of the institution; and
 - (g) The investment policy of the institution.
- (2) To limit the authority to appropriate for expenditure or accumulate under subsection (1) of this section, a gift instrument must specifically state the limitation.
- (3) Terms in a gift instrument designating a gift as an endowment, or a direction or authorization in the gift instrument to use only "income," "interest," "dividends," or "rents, issues, or profits," or "to preserve the principal intact," or words of similar import:
- (a) Create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund; and
 - (b) Do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection (1) of this section.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 3, effective July 15, 2010.

273.615 Delegation of management and investment functions.

(1) Subject to any specific limitation set forth in a gift instrument or in law other than KRS 273.600 to 273.645, an institution may delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances. An institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in:

- (a) Selecting an agent;
- (b) Establishing the scope and terms of the delegation, consistent with the purposes of the institution and the institutional fund; and
- (c) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(2) In performing a delegated function, an agent owes a duty to the institution to exercise reasonable care to comply with the scope and terms of the delegation.

(3) An institution that complies with subsection (1) of this section is not liable for the decisions or actions of an agent to which the function was delegated.

(4) By accepting delegation of a management or investment function from an institution that is subject to the laws of the Commonwealth, an agent submits to the jurisdiction of the courts of the Commonwealth in all proceedings arising from or related to the delegation or the performance of the delegated function.

(5) An institution may delegate management and investment functions to its committees, officers, or employees as authorized by law of the Commonwealth other than KRS 273.600 to 273.645.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 4, effective July 15, 2010.

273.620 Release or modification of restrictions on management, investment, or purpose.

(1) If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund. A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution.

(2) The court, upon application of an institution, may modify a restriction contained in a gift instrument regarding the management or investment of an institutional fund if the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The institution shall notify the Attorney General of the application, and the Attorney General shall be given an opportunity to be heard. To the extent practicable, any modification shall be made in accordance with the donor's probable intention.

(3) If a particular charitable purpose or a restriction contained in a gift instrument on the use of an institutional fund becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purpose expressed in the gift instrument. The institution shall notify the Attorney General of the application, and the Attorney General shall be given an opportunity to be heard.

(4) If an institution determines that a restriction contained in a gift instrument on the management, investment, or purpose of an institutional fund is unlawful, impracticable, impossible to achieve, or wasteful, the institution, sixty (60) days after notification to the Attorney General, may release or modify the restriction, in whole or part, if:

(a) The institutional fund subject to the restriction has a total value of less than fifty thousand dollars (\$50,000);

(b) More than twenty (20) years have elapsed since the fund was established; and

(c) The institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 5, effective July 15, 2010.

273.625 Reviewing compliance with KRS 273.600 to 273.645.

Compliance with KRS 273.600 to 273.645 is determined in light of the facts and circumstances existing at the time a decision is made or action is taken, and not by hindsight.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 6, effective July 15, 2010.

273.630 Application of KRS 273.600 to 273.645 to existing institutional funds.

KRS 273.600 to 273.645 apply to an institutional fund existing on or established after July 15, 2010. As applied to institutional funds existing on July 15, 2010, KRS 273.600 to 273.645 govern only decisions made or actions taken on or after that date.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 7, effective July 15, 2010.

273.635 Relation of KRS 273.600 to 273.645 to the Electronic Signatures in Global and National Commerce Act.

KRS 273.600 to 273.645 modify, limit, and supersede the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. secs. 7001 et seq., but does not modify, limit, or supersede Section 101 of that act, 15 U.S.C. sec. 7001(a), or authorize electronic delivery of any of the notices described in Section 103 of that act, 15 U.S.C. sec. 7003(b).

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 8, effective July 15, 2010.

273.640 Uniformity of application and construction of the Kentucky Uniform Prudent Management of Institutional Funds Act.

In applying and construing this uniform act, consideration shall be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 9, effective July 15, 2010.

273.645 Short title for KRS 273.600 to 273.645.

KRS 273.600 to 273.645 may be cited as the Kentucky Uniform Prudent Management of Institutional Funds Act.

Effective: July 15, 2010

History: Created 2010 Ky. Acts ch. 34, sec. 10, effective July 15, 2010.

APPENDIX 2

Summary of Endowment Investment Manager Structure & Benchmarks

**UNIVERSITY OF KENTUCKY
SUMMARY OF ENDOWMENT INVESTMENT MANAGER STRUCTURE & BENCHMARKS**

MANAGER NAME	HEADQUARTERS	INVESTMENT STRATEGY¹	POLICY TARGET	POLICY RANGE	BENCHMARK
<u>Broad U.S. Equity:</u>					
State Street	Boston, MA	Passive Russell 1000 (Large-cap)	18.40%		Russell 1000 Index
Wellington	Boston, MA	Active Russell 2000 (Small-cap)	1.60%		Russell 2000 Index
		Total Broad U.S. Equity	20.00%	15.0-25.0%	Dow Jones U.S. Total Stock Market Index
<u>Broad Non-U.S. Equity:</u>					
Capital Guardian	Los Angeles, CA	Active MSCI ACW ex-U.S. - Core	10.00%		MSCI All Country World ex-U.S. Index
New Manager TBA ²	London, ENG	Active MSCI ACW ex-U.S. - Growth	5.00%		MSCI All Country World ex-U.S. Growth Index
Mondrian	London, ENG	Active MSCI ACW ex-U.S. - Value	5.00%		MSCI All Country World ex-U.S. Value Index
		Total Broad Non-U.S. Equity	20.00%	15.0-25.0%	MSCI All Country World ex-U.S. Index
		TOTAL EQUITIES	40.00%	35.0-45.0%	N/A
<u>Private Equity:</u>					
Multiple Managers ³ :					
Commonfund Capital	Wilton, CT	Private Equity Fund-of-Funds ("FOF")	5.95%	3.0-9.0%	Venture Economics All Private Equity Index
Pantheon Ventures	San Francisco, CA				
Multiple Managers ³ :					
Drum Capital	Stamford, CT	Opportunistic Private Equity FOF	1.05%	0.00-1.35%	Venture Economics All Private Equity Index
Siguler Guff	New York, NY				
Chrysalis Ventures ⁴	Louisville, KY	Regional Venture Capital	0.00%		Venture Economics All Private Equity Index
Fort Washington ⁴	Cincinnati, OH	Regional Venture Capital	0.00%		Venture Economics All Private Equity Index
		Total Private Equity	7.00%	3.0-9.0%	Venture Economics All Private Equity Index
<u>Real Return:</u>					
PIMCO	Newport Beach, CA	Real Return FOF (All Asset All Authority)	6.00%		All Asset Composite Index
Wellington	Boston, MA	Real Return FOF (Diversified Inflation Hedges)	4.00%		Wellington Diversified Inflation Hedges Composite Index
		Total Real Return	10.00%	8.0-12.0%	60%/All Asset Comp. Index/40% Wellington DIH Comp. Index
<u>Absolute Return:</u>					
Grosvenor	Chicago, IL	Core Absolute Return FOF	10.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
Grosvenor	Chicago, IL	Opportunistic Absolute Return FOF	2.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
GAM	London, ENG	Core Absolute Return FOF	5.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
Berens	New York, NY	Opportunistic Absolute Return FOF	3.00%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
		Total Absolute Return	20.00%	15.0-25.0%	Hedge Fund Net Fund-of-Funds Multi-Strategy Index
<u>Real Estate:</u>					
UBS	Hartford, CT	Core Real Estate	4.00%	6.0-10.0%	National Council on Real Estate Investment Fiduciaries Index - 1%
Multiple Managers ³ :					
TA Associates	Boston, MA	Value-Added/Opportunistic Real Estate	4.00%	0.0-5.0%	National Council on Real Estate Investment Fiduciaries Index
Wrightwood Capital	Chicago, IL				
New Manager TBA ²	TBA				
New Manager TBA ²	TBA				
		Total Real Estate	8.00%	6.0-10.0%	National Council on Real Estate Investment Fiduciaries Index
		TOTAL ALTERNATIVES	45.00%	35.0-50.0%	N/A
<u>Fixed Income:</u>					
PIMCO	Newport Beach, CA	Core-Plus Fixed Income	7.00%		Barclays Capital Aggregate Bond Index
PIMCO	Newport Beach, CA	Unconstrained Fixed Income	3.00%		3-Month LIBOR + 3%
Reams	Columbus, IN	Core-Plus Fixed Income	3.00%		Barclays Capital Aggregate Bond Index
Reams	Columbus, IN	Low Duration Fixed Income	2.00%		Barclays Capital 1-5 Year Government/Credit Index
		TOTAL FIXED INCOME	15.00%	12.0-18.0%	Barclays Capital Aggregate Bond Index
		TOTAL POOLED INVESTMENTS	100.00%		Policy Benchmark

¹ Investment strategy definitions located in Appendix 3 of the Endowment Investment Policy.

² New manager to be announced upon approval by Investment Committee and/or execution of contract.

³ Multiple managers will be used to reach the target allocation for the investment strategy and target allocations for managers within this strategy will not be established.

⁴ The Committee has committed \$1 million and \$2 million to Chrysalis Ventures and Fort Washington, respectively, to enhance the total return for the Endowment and provide for leadership in economic development in the Commonwealth of Kentucky.

APPENDIX 3
Investment Strategy Definitions

INVESTMENT STRATEGY DEFINITIONS

Broad U.S. Equity Strategies

- **Passive Russell 1000 (Large-Cap):** Passive strategy that invests in the large-cap segment of the U.S. equity universe. The Russell 1000 index includes approximately 1,000 of the largest securities based on market capitalization and is a subset of the Russell 3000 index, which is a broad U.S. equity market index. The Russell 1000 represents approximately 92% of the U.S. equity market. The objective of a passive strategy is to match the return of the index.
- **Active Russell 2000 (Small-Cap):** Active strategy that invests in the small-cap segment of the U.S. equity universe. The Russell 2000 index includes approximately 2,000 of the smallest securities based on market capitalization and is a subset of the Russell 3000 index, which is a broad U.S. equity market index. The Russell 2000 represents approximately 8% of the U.S. equity market. The objective of an active strategy is to exceed the return of the index.

Broad Non-U.S. Equity Strategy

- **Active MSCI All Country World ex-U.S.:** Active strategy that invests in stocks in the broad non-U.S. equity universe (i.e. companies domiciled in countries other than the U.S.). The MSCI All Country World ex-U.S. index consists of approximately 2,000 securities across 47 markets, with emerging markets representing approximately 18%. MSCI attempts to capture approximately 85% of the market capitalization in each country. The objective of an active strategy is to exceed the return of the index.
 - Core: Strategy designed to have broad exposure to style (growth vs. value) and sector.
 - Growth: Strategy focusing on stocks that offer better-than-average expected earnings or growth potential. Common characteristics typically include a low dividend yield and high price to book/earnings ratios.
 - Value: Strategy focusing on stocks that are considered to be undervalued as they trade at a lower price relative to fundamentals (i.e. dividends, earnings, sales, etc.). Common characteristics typically include a high dividend yield and low price to book/earnings ratios.

Private Equity Strategy

- **Private Equity Fund-of-Funds:** Strategy that invests in various venture capital and leveraged buyout partnerships in the U.S. and non U.S. countries. The fund-of-funds approach provides access to top-tier private equity partnerships and enhanced diversification. Assets invested in the strategy are illiquid with a typical investment time horizon of seven or more years.
 - Core: Fully diversified fund by manager, strategy and geography.
 - Opportunistic: Non-core fund designed to capture excess returns due to current market opportunities, such as distressed/ special situation funds, emerging markets funds, or other specialized and/or geographically concentrated funds.

Real Return Strategy

- **Real Return Fund-of-Funds:** Strategy that typically invests in various real return assets including treasury inflation protected securities (TIPS), commodities, currency, REITS, timber, infrastructure and global natural resources. Strategy can also include equity and fixed income investments, and involve global tactical asset allocation among the various asset classes/strategies. The objective of real return investments is to provide a hedge against inflation. A real return strategy targets a return exceeding inflation by a premium, such as C.P.I. plus 5%. The fund-of-funds approach provides instant diversification among various real return assets.

Absolute Return Strategy

- **Absolute Return Fund-of-Funds:** Strategy that invests in a diversified range of hedge funds. Hedge funds are private, unregulated investment partnerships that execute a broad range of investment strategies across a broad range of securities. The objective of absolute return investments is to provide consistent positive returns with relatively low correlation to other asset classes. The fund-of-funds approach provides access to professional expertise in selecting and monitoring individual hedge funds, access to high quality, institutional hedge funds and instant diversification. Assets invested in the strategy typically have quarterly liquidity, however managers usually reserve the right to suspend liquidations under poor economic and market conditions.
 - Core: Fully diversified fund by manager, strategy and geography.
 - Opportunistic: Non-core fund designed to capture excess returns due to current market opportunities, such as currency trading funds, emerging markets funds, or other specialized and/or geographically concentrated funds.

Real Estate Strategies

- **Core Real Estate:** Strategy that invests in high quality, stabilized properties in economically diversified metropolitan areas. Properties are substantially leased and provide predictable income and cash flow, with limited potential for significant capital appreciation. Strategy includes four major property types as follows: office, retail, residential and industrial. Assets invested in the strategy typically have quarterly liquidity, however managers usually reserve the right to suspend liquidations under poor economic and market conditions.
- **Value Added/Opportunistic Real Estate:**
 - Value Added: Strategy that invests in existing properties that require redevelopment, releasing and/or repositioning. Strategy includes the four major property types (office, retail, residential and industrial) plus lodging. Investment return is derived from both rental income and property appreciation. Assets invested in the strategy are illiquid with a typical investment time horizon of seven or more years.

- **Opportunistic:** Strategy that involves development properties and/or existing properties that require extensive redevelopment and releasing. Strategy involves all property types including niche sectors such as healthcare, senior housing, etc., and can include investment in properties outside the U.S. Investment return is derived mainly from property appreciation. Assets invested in the strategy are illiquid with a typical investment time horizon of seven or more years.

Fixed Income Strategies

- **Core-Plus Fixed Income:** Strategy that invests the majority of the portfolio in high quality, U.S. dollar denominated, investment grade fixed income securities similar to those in the Barclays Capital Aggregate Bond Index, including government/agency bonds, commercial and residential mortgage-backed bonds, asset-backed bonds and corporate bonds. Additionally, the strategy allows for investment in higher risk securities including non-investment grade, non-U.S. dollar denominated and emerging market bonds, but only to the extent allowed by the manager's guidelines.
- **Unconstrained Fixed Income:** Absolute return-oriented strategy that invests primarily in high quality, U.S. dollar denominated, and investment grade fixed income securities without sector or instrument limitations. The investment opportunity set includes government/agency bonds, commercial and residential mortgage-backed bonds, asset-backed bonds, corporate bonds (both investment grade and high yield), non-U.S. and emerging market bonds and currency. The strategy is designed to offer the traditional benefits of a core bond approach but with higher alpha potential and the opportunity to mitigate downside risk to a greater degree than what is reasonably possible from traditional active fixed income management approaches.
- **Low Duration Fixed Income:** Strategy that invests in a diverse set of short-term, high quality bonds which seeks to achieve low volatility and attractive returns relative to its benchmark (typically the Merrill Lynch 1-3 Year Treasury Index or Barclays Capital 1-5 Year Government/Credit Index). Investments include mortgage-backed securities, treasuries, corporates, and international fixed income. Additionally, the strategy allows for investment in higher risk, non-investment grade securities, but only to the extent allowed by the manager's guidelines. The strategy duration is typically less than three years.