

IC 1

Office of the Treasurer
June 10, 2013

Members, Investment Committee

REVISED ENDOWMENT INVESTMENT POLICY

Recommendation: that the Investment Committee approve the attached Endowment Investment Policy.

Background: The University's current Endowment Investment Policy was last approved by the Investment Committee on December 10, 2012. The changes approved in December 2012 included establishment of a new hybrid spending policy and new spending distribution policies for certain underwater endowment funds and newly established endowment funds.

Based on a review performed by Staff, in consultation with the Investment Committee Chair and investment consultant, R.V. Kuhns & Associates, the following changes are recommended:

- A revised asset allocation designed to achieve a 7.5% long-term average annual return, as follows:

	<u>Current Target Allocation</u>	<u>Proposed Target Allocation</u>	<u>Change</u>
Equities:			
Broad US Equity	20%	12%	-8%
Broad International Equity	20%	12%	-8%
Total Equities	40%	24%	-16%
Fixed Income	15%	10%	-5%
Alternatives:			
Long-Biased Long/Short Equity	--	14%	+14%
Private Equity	7%	12%	+5%
Global Tactical Asset Allocation	--	8%	+8%
Absolute Return	20%	10%	-10%
Diversified Inflation Strategies	10%	10%	--
Real Estate	8%	12%	+4%
Total Alternatives	45%	66%	+21%

- Revised manager structure and strategy definitions related to the revised asset allocation (appendices 2 and 3 of the policy, respectively).
- Addition of language to clarify that the Vice President for Financial Operations and Treasurer has authority to approve exceptions of the policy to suspend spending distributions and management fee withdrawals on certain quasi and term endowments that are underwater by more than 20%.
- Other minor changes as noted throughout the attached policy.

Action taken: Approved Disapproved Other _____

REDLINED DRAFT

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

ENDOWMENT INVESTMENT POLICY

Amended June 10, 2013~~December 10, 2012~~

University of Kentucky
University of Kentucky Research Foundation
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 invested in perpetuity to generate a reliable and steadily growing revenue stream to support the mission of the University now and in the future. The revenue stream, or total return spending distributions, 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 for long-term growth and total return spending distributions are generated year after year.

The University of Kentucky has a fiduciary responsibility to prudently manage and preserve the long-term 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 formally reviewed at least 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, E, (2) (e) 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.

In addition to the Trustee members, the Investment Committee may, from time to time, have the Chair of the Board of Trustees appoint, upon recommendation of the University President, non-voting 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. Staff will assist the Committee with selection and oversight of the vendors and execute required contracts and applicable renewals.

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 or assets to qualified industry experts. Each individual investment manager will exercise discretion over the securities or 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 long-term 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%~~4.0% 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 Policy

The Investment Committee has established a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending will be calculated by taking a weighted average comprising 60 percent of the prior year's spending, adjusted for inflation¹, and 40% of the amount that results when the target annual spending rate of 4.0% is applied to the average market value of the Endowment over the preceding 36 months. The spending amount determined by the formula will be constrained so that the calculated rate is at least 3%, and not more than 6%, of the current Endowment market value.

The hybrid spending formula is depicted below:

$$60\% * (\text{Prior Year Spending} * [1 + \text{Annual Percent Change in CPI-U}]) \\ + 40\% * (4\% * \text{Average Market Value for Preceding 36 Months})$$

Note: the calculated spending rate must fall between 3% and 6% of the current market value of the Endowment.

¹ Inflation will be measured by the U.S. Department of Labor Bureau of Labor Statistics Consumer Price Index for All Urban Consumers (CPI-U).

The hybrid spending policy will be phased in as follows:

- Fiscal year 2013-14 will serve as a transition year to the new policy and spending will be based on 4.0% of the average market value for the preceding 60 months.
- The new hybrid policy will be fully implemented in fiscal year 2014-15.

Management Fee

Eligible endowments will be assessed an annual management fee of .25% of the current market value (assessed monthly) to support administrative costs.

Underwater Endowment Funds²

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 underwater.

Effective for FY 2013-14 and thereafter, spending and management fee withdrawals will be suspended on all endowments underwater by more than 20%. Endowments underwater more than 10% will undergo a formal review by the Office of the Treasurer and appropriate College Dean to determine the appropriate level of spending in accordance the following factors set forth in the Kentucky Uniform Prudent Management of Institutional Funds Act:

- the duration and preservation of the endowment fund;
- the purposes of the institution and the endowment fund;
- general economic conditions;
- the possible effect of inflation or deflation;
- the expected total return from income and the appreciation of investments;
- other resources of the institution;
- the investment policy of the institution.

The Vice President for Financial Operations and Treasurer has authority to approve exceptions of the policy to suspend spending distributions and management fee withdrawals on certain quasi and term endowments that are underwater by more than 20%.

New Endowment Funds

Effective for FY 2013-14 and thereafter, spending distributions on new endowment funds will be delayed for at least one year in order to build a spending reserve.

² 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, issuer and country of domicile. 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-U.S. investments; and by vintage year of investment. Real Return Investments will be diversified by asset class and strategy. Absolute Return investments will be diversified by manager, investment strategy, and geographic location including U.S. and non-U.S. managers. Real estate investments will be diversified by property type, geographic location and investment strategy.

In an effort to optimize and efficiently utilize due diligence research and diversification, a “fund of funds” (“FOF”) investment structure will generally be used for Private Equity, Real Return and Absolute Return investments.

Asset Allocation

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

<u>Asset Class</u>	<u>Investment Policy</u>	
	<u>Target</u>	<u>Range</u>
<u>Equities</u>		
<u>Broad U.S. Equities</u>	<u>12%</u>	<u>8-24%</u> ³
<u>Broad Non-U.S. Equities</u>	<u>12%</u>	<u>4-24%</u> ³
<u>Total Equities</u>	<u>24%</u>	<u>18-36%</u> ³
<u>Fixed Income</u>	<u>10%</u>	<u>5-20%</u> ⁴
<u>Alternatives</u>		
<u>Long-Biased Long/Short Equity</u>	<u>14%</u>	<u>7-21%</u>
<u>Private Equity</u>	<u>12%</u>	<u>6-18%</u>
<u>Global Tactical Asset Allocation</u>	<u>8%</u>	<u>4-12%</u>
<u>Absolute Return</u>	<u>10%</u>	<u>5-15%</u>
<u>Diversified Inflation Strategies</u>	<u>10%</u>	<u>5-15%</u>
<u>Real Estate</u>	<u>12%</u>	<u>6-18%</u>
<u>Total Alternatives</u>	<u>66%</u>	<u>44-77%</u>

³ Larger upside can be used to hold dollars during a transition of assets or pending an allocation to an illiquid strategy.

⁴ Larger upside can be used to hold dollars during a transition of assets or for defensive positioning of the portfolio.

Total	100%	
	Investment Policy	
Asset Class	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%	5-9%
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

Rebalancing is the term that describes the periodic movement of funds from one asset or asset class to another for the purpose of realigning the assets with the asset allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic rebalancing will reduce portfolio volatility and increase portfolio return over the long term. However, excessively tight ranges and frequent rebalancing can lead to unnecessary transaction costs.

The Committee has chosen to adopt a rebalancing policy that is governed by allocation ranges rather than time periods. The ranges, specified in the table above, are a function of the volatility and liquidity of each asset class and the proportion of the total fund allocated to the asset class. While the allocation to all asset classes remains within these limits, Staff will first use cash flows, as available, to maintain the overall allocation as close as possible to the target. When an asset class violates the lower or upper limits, public market funds will be actively rebalanced back to the target.

When any one of the public market asset classes hits a trigger point, the entire fund may be rebalanced back to asset class target allocations with the understanding that it may be impractical to return the real estate and private equity classes precisely to target in the short term. Accordingly, qualitative considerations (e.g., transaction costs, liquidity needs, investment time horizons, etc.) will be considered in determining the potential timing and extent of rebalancing real estate and private equity portfolios.

Staff is responsible for developing and implementing a rebalancing plan that is appropriate for existing market conditions, with a primary objective of minimizing transaction costs and portfolio disruptions. Managers on the Watch List will not receive additional allocations without Committee approval. In the event an allocation trigger point is not reached, Staff may still make minor changes among asset classes

and within individual asset classes, as needed, to more effectively implement the program and to maintain proper exposure to the approved asset allocation and asset class portfolio structures. Staff will report the results of all rebalancing activity to the Investment Committee at the regular meetings.

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%~~4.0% 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;

(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 AND BENCHMARKS

<u>MANAGER NAME</u>	<u>HEADQUARTERS</u>	<u>INVESTMENT STRATEGY¹</u>	<u>POLICY TARGET</u>	<u>POLICY RANGE</u>	<u>BENCHMARK</u>
<u>Broad U.S. Equity:</u>					
Northern Trust	Boston, MA	Passive Russell 1000 (Large-cap)	18.4%		Russell 1000 Index
Wellington	Boston, MA	Active Russell 2000 (Small-cap)	1.6%		Russell 2000 Index
		Total Broad U.S. Equity	20.0%	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	10.0%		MSCI All Country World ex-U.S. Index
Mondrian	London, ENG	Active MSCI ACW ex-U.S. - Value	5.0%		MSCI All Country World ex-U.S. Value Index
William Blair	Chicago, IL	Active MSCI ACW ex-U.S. - Growth	5.0%		MSCI All Country World ex-U.S. Growth Index
		Total Broad Non-U.S. Equity	20.0%	15.0-25.0%	MSCI All Country World ex-U.S. Index
		TOTAL EQUITIES	40.0%	35.0-45.0%	N/A
<u>Private Equity:</u>					
Multiple Managers ² :		Private Equity Fund-of-Funds ("FOF")	7.0%	5.0-9.0%	Venture Economics All Private Equity Index
Commonfund Capital	Wilton, CT				Venture Economics All Private Equity Index
Drum Capital	Stamford, CT				Venture Economics All Private Equity Index
NB Alternatives	Dallas, TX				Venture Economics All Private Equity Index
Pantheon Ventures	San Francisco, CA				Venture Economics All Private Equity Index
Siguler Guff	New York, NY				Venture Economics All Private Equity Index
Chrysalis Ventures ³	Louisville, KY	Regional Venture Capital	0.0%		Venture Economics All Private Equity Index
Fort Washington ³	Cincinnati, OH	Regional Venture Capital	0.0%		Venture Economics All Private Equity Index
		Total Private Equity	7.0%	5.0-9.0%	Venture Economics All Private Equity Index
<u>Real Return:</u>					
PIMCO	Newport Beach, CA	Real Return FOF (All Asset All Authority)	6.0%		All Asset Composite Index
Wellington	Boston, MA	Real Return FOF (Diversified Inflation Hedges)	4.0%		Wellington Diversified Inflation Hedges Composite Index
		Total Real Return	10.0%	8.0-12.0%	60%/All Asset Comp. Index/40% Wellington DIH Comp. Index
<u>Absolute Return:</u>					
Grosvenor	Chicago, IL	Core/Oppportunistic Absolute Return FOF	12.0%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
Prisma	New York, NY	Core Absolute Return FOF	5.0%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
Berens	New York, NY	Opportunistic Absolute Return FOF	3.0%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
		Total Absolute Return	20.0%	15.0-25.0%	Hedge Fund Net Fund-of-Funds Multi-Strategy Index
<u>Real Estate:</u>					
UBS	Hartford, CT	Core Real Estate	4.0%	3.0-5.0%	National Council on Real Estate Investment Fiduciaries Index - 1%
Multiple Managers ² :		Non-Core Real Estate	4.0%	3.0-5.0%	National Council on Real Estate Investment Fiduciaries Index
Contrarian Capital	Greenwich, CT				National Council on Real Estate Investment Fiduciaries Index
SC Capital Partners	Singapore				National Council on Real Estate Investment Fiduciaries Index
TA Associates	Boston, MA				National Council on Real Estate Investment Fiduciaries Index
WestRiver Capital	New York, NY				National Council on Real Estate Investment Fiduciaries Index
Wrightwood Capital	Chicago, IL				National Council on Real Estate Investment Fiduciaries Index
		Total Real Estate	8.0%	6.0-10.0%	National Council on Real Estate Investment Fiduciaries Index
		TOTAL ALTERNATIVES	45.0%	35.0-50.0%	N/A
<u>Fixed Income:</u>					
PIMCO	Newport Beach, CA	Core-Plus Fixed Income	5.0%		Barclays Capital Aggregate Bond Index
PIMCO	Newport Beach, CA	Unconstrained Fixed Income	5.0%		3-Month LIBOR + 3%
Reams	Columbus, IN	Core-Plus Fixed Income	3.0%		Barclays Capital Aggregate Bond Index
Reams	Columbus, IN	Low Duration Fixed Income	2.0%		Barclays Capital 1-5 Year Government/Credit Index
		TOTAL FIXED INCOME	15.0%	12.0-18.0%	Barclays Capital Aggregate Bond Index
		TOTAL POOLED INVESTMENTS	100.0%		Policy Benchmark

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

² 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.

³ 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.

UNIVERSITY OF KENTUCKY
SUMMARY OF ENDOWMENT INVESTMENT MANAGER STRUCTURE AND BENCHMARKS

<u>MANAGER NAME</u>	<u>HEADQUARTERS</u>	<u>INVESTMENT STRATEGY¹</u>	<u>POLICY TARGET</u>	<u>POLICY RANGE</u>	<u>BENCHMARK</u>
Broad U.S. Equity²: Northern Trust	Chicago, IL	Passive Russell 1000 (Large-cap)	11.0%		Russell 1000 Index
Wellington	Boston, MA	Active Russell 2000 (Small-cap)	1.0%		Russell 2000 Index
		Total Broad U.S. Equity²	12.0%	8.0-24.0%	Dow Jones U.S. Total Stock Market Index
Broad Non-U.S. Equity³: Mondrian	London, ENG	Active MSCI ACWI ex-U.S. - Value	6.0%		MSCI All Country World ex-U.S. Value Index
William Blair	Chicago, IL	Active MSCI ACW ex-U.S. - Growth	6.0%		MSCI All Country World ex-U.S. Growth Index
		Total Broad Non-U.S. Equity³	12.0%	4.0-24.0%	MSCI All Country World ex-U.S. Index
		TOTAL EQUITIES	24.0%	18.0-36.0%	N/A
Fixed Income: PIMCO	Newport Beach, CA	Core-Plus Fixed Income	2.5%		Barclays US Aggregate Bond Index
PIMCO	Newport Beach, CA	Unconstrained Fixed Income	2.5%		3-Month LIBOR + 3%
Reams	Columbus, IN	Core-Plus Fixed Income	2.5%		Barclays US Aggregate Bond Index
Reams	Columbus, IN	Unconstrained Fixed Income	2.5%		3-Month LIBOR + 3%
		TOTAL FIXED INCOME	10.0%	5.0-20.0%	Barclays US Aggregate Bond Index
Long-Biased Long/Short Equity⁴: Berenis	New York, NY	Long-Biased Long/Short Equity	4.0%		Hedge Fund Net Equity Hedge Aggregate Index
Prisma	New York, NY	Long-Biased Long/Short Equity	4.0%		Hedge Fund Net Equity Hedge Aggregate Index
Wellington	Boston, MA	Long-Biased Long/Short Equity	4.0%		Hedge Fund Net Equity Hedge Aggregate Index
Grosvenor	Chicago, IL	Long-Biased Long/Short Equity	2.0%		Hedge Fund Net Equity Hedge Aggregate Index
		Total Long-Biased Long/Short Equity⁴	14.0%	7.0-21.0%	Hedge Fund Net Equity Hedge Aggregate Index
Private Equity: Multiple Managers ⁵ : Commonfund Capital Drum Capital NB Alternatives Pantheon Ventures Siguler Guff	Wilton, CT Stamford, CT Dallas, TX San Francisco, CA New York, NY	Private Equity FOF	12.0%		Venture Economics All Private Equity Index Venture Economics All Private Equity Index Venture Economics All Private Equity Index Venture Economics All Private Equity Index Venture Economics All Private Equity Index
Chrysalis Ventures ⁶	Louisville, KY	Regional Venture Capital	0.0%		Venture Economics All Private Equity Index
Fort Washington ⁶	Cincinnati, OH	Regional Venture Capital	0.0%		Venture Economics All Private Equity Index
		Total Private Equity	12.0%	6.0-18.0%	Venture Economics All Private Equity Index

<u>MANAGER NAME</u>	<u>HEADQUARTERS</u>	<u>INVESTMENT STRATEGY¹</u>	<u>POLICY TARGET</u>	<u>POLICY RANGE</u>	<u>BENCHMARK</u>
<u>Global Tactical Asset Allocation (GTAA):</u> PIMCO	Newport Beach, CA	GTAA (All Asset All Authority)	4.0%		All Asset Composite Index
New Manager TBD ⁷	TBD	GTAA	4.0%	4.0-12.0%	Benchmark TBD ⁸
		Total Global Tactical Asset Allocation	8.0%		Benchmark TBD⁸
<u>Absolute Return:</u> Grosvenor	Chicago, IL	Core/Opportunistic Absolute Return FOF	10.0%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
		Total Absolute Return	10.0%	5.0-15.0%	Hedge Fund Net Fund-of-Funds Multi-Strategy Index
<u>Diversified Inflation Strategies (DIS):</u> Wellington	Boston, MA	DIS (Diversified Inflation Hedges)	7.0%		Wellington Diversified Inflation Hedges Composite Index
New Manager(s) TBD ⁷	TBD	Illiquid, Closed-End DIS	3.0%		Benchmark TBD ⁸
		Total Diversified Inflation Strategies	10.0%	5.0-15.0%	Benchmark TBD⁸
<u>Real Estate:</u> UBS	Hartford, CT	Core Real Estate	5.0%		NCREIF ⁸ Open-End Diversified Core Index
		Non-Core Real Estate	7.0%		NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index
		Total Real Estate	12.0%	6.0-18.0%	42% NCREIF⁸ Open-End Diversified Core Index + 58% NCREIF⁸ Property Index
		TOTAL ALTERNATIVES	66.0%	44.0-77.0%	N/A
		TOTAL POOLED INVESTMENTS	100.0%		Policy Benchmark

¹ Investment strategy definitions located in Appendix 3 of the Endowment Investment Policy.
² Enhanced passive products of existing managers to be considered for up to 50% of the total US Equity allocation.
³ Emerging markets, small-cap and/or concentrated strategies of Mondrian and William Blair to be considered for up to 50% of the total non-US Equity allocation.
⁴ Existing managers expected to be used for the Long-Biased Long-Short Equity mandate, however percentages shown may vary.
⁵ 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.
⁶ 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.
⁷ Request for Proposals to be issued to hire one or more managers for this mandate.
⁸ Benchmark for manager and overall asset class to be determined upon selection of new manager.
⁹ National Council of Real Estate Investment Fiduciaries



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 Strategies

- **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 ~~1,800~~^{2,000} securities across ~~454~~⁷ markets, with emerging markets representing approximately ~~24~~¹⁸%. MSCI attempts to capture approximately ~~88~~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.

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.

Alternative Strategies ~~Private Equity Strategy~~

- Long-Biased Long/Short Equity: Strategy that primarily involves taking long and short positions in a portfolio of equities. A long position is buying a stock with the expectation that the stock will increase in value. A short position in a stock is borrowing a stock from an investor, selling it to another investor with the expectation that the stock will decrease in value. The short portfolio serves to partially hedge the long equity portfolio exposure. Long-biased long/short equity strategies typically are invested in a diversified portfolio of hedge fund limited partnerships (LPs), in a fund-of-funds that owns a portfolio of hedge fund LPs, or some combination of direct LP and fund-of-fund investments. Long/short equity strategies are often referred to as "directional" hedge funds as they typically have a net long exposure to equity markets. In other words, directional long/short equity strategies have a positive beta, but that beta typically is less than that of a fully invested long-only equity portfolio. With long/short equity funds, the primary source of alpha and risk is active equity investing. Long-biased managers attempt to deliver alpha on top of their stock selection decisions by varying the amount of net equity exposure.
- Private Equity: Strategy that primarily invests in a range of equity investments that are not traded on a public exchange. Investments typically have less liquidity, higher risk and higher expected return than public equity investments. Investments typically are made within a limited partnership (LP) fund structure. Appropriate investments may include direct LP ownership or investment through a fund-of-funds that owns a diversified portfolio of LP investments. The fund-of-funds approach in private equity may provide access to top-tier private equity partnerships and enhanced diversification that may be unavailable through direct LP investments. Assets invested in private equity strategy typically are illiquid, with a typical investment time horizon of seven or more years.
- 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.
- Global Tactical Asset Allocation (GTAA): Strategy designed to capture inefficiencies across multiple asset or sub-asset classes. GTAA strategies are based on the belief that relative returns across market sectors will periodically diverge from equilibrium levels, allowing the opportunity for excess returns from overweighting those asset classes that are expected to outperform on a relative basis in the near term and underweighting those asset classes expected to underperform in the near term. Asset classes included in

GTAA products typically span a wide spectrum, and liquid GTAA strategies typically involve low levels of leverage, shorting, and illiquid asset class exposure. Unlike traditional active strategy managers that need expertise in one particular asset class, GTAA managers need a solid understanding of several asset classes and their interrelationships to be successful. GTAA investments are in mutual funds, commingled funds or separate accounts. GTAA investments typically have daily liquidity.

- **Diversified Inflation Strategies:** Strategy that typically invests in various real or inflation-sensitive assets including treasury inflation protected securities (TIPS), commodities, currency, REITS, timber, infrastructure and global natural resources. The strategies can also include equity and fixed income investments, and involve global tactical asset allocation among the various asset classes/strategies. The primary objective of these strategies is to provide a hedge against inflation. Funds typically target a return exceeding inflation by a premium, such as C.P.I. plus 5%. Diversified Inflation Strategy investments can be made in a wide range of investments depending on the area of focus of the investment. Investments made by liquid or relatively illiquid depending on the nature of the underlying investment.

- **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 is designed to provide a stable return stream with less volatility than equity investments and higher long-term return than fixed income investments. Absolute Return strategies typically are invested in a diversified portfolio of hedge fund limited partnerships, in a fund-of-funds that owns a portfolio of hedge fund LPs, or some combination of direct LP and fund-of-fund investments. . A fund-of-funds approach may provide access to professional expertise in selecting and monitoring individual hedge funds, access to high quality, institutional hedge funds and instant diversification. Absolute return investments differ from long biased long-short equity in that they will have not have a meaningful long equity bias in their holdings over most time periods. Absolute return encompasses 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. Assets invested in the strategy typically have quarterly or annual liquidity. Managers may reserve the right to suspend liquidations under poor economic and market conditions.

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.
- **Non-Core Real Estate:** Value added and opportunistic real estate strategies:
 - 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 DRAFT

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

ENDOWMENT INVESTMENT POLICY

Amended June 10, 2013

University of Kentucky
University of Kentucky Research Foundation
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 invested in perpetuity to generate a reliable and steadily growing revenue stream to support the mission of the University now and in the future. The revenue stream, or total return spending distributions, 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 for long-term growth and total return spending distributions are generated year after year.

The University of Kentucky has a fiduciary responsibility to prudently manage and preserve the long-term 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 formally reviewed at least 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, E, (2) (e) 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.

In addition to the Trustee members, the Investment Committee may, from time to time, have the Chair of the Board of Trustees appoint, upon recommendation of the University President, non-voting 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. Staff will assist the Committee with selection and oversight of the vendors and execute required contracts and applicable renewals.

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 or assets to qualified industry experts. Each individual investment manager will exercise discretion over the securities or 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 long-term 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 Policy

The Investment Committee has established a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending will be calculated by taking a weighted average comprising 60 percent of the prior year's spending, adjusted for inflation¹, and 40% of the amount that results when the target annual spending rate of 4.0% is applied to the average market value of the Endowment over the preceding 36 months. The spending amount determined by the formula will be constrained so that the calculated rate is at least 3%, and not more than 6%, of the current Endowment market value.

The hybrid spending formula is depicted below:

$$60\% * (\text{Prior Year Spending} * [1 + \text{Annual Percent Change in CPI-U}]) \\ + 40\% * (4\% * \text{Average Market Value for Preceding 36 Months})$$

Note: the calculated spending rate must fall between 3% and 6% of the current market value of the Endowment.

¹ Inflation will be measured by the U.S. Department of Labor Bureau of Labor Statistics Consumer Price Index for All Urban Consumers (CPI-U).

The hybrid spending policy will be phased in as follows:

- Fiscal year 2013-14 will serve as a transition year to the new policy and spending will be based on 4.0% of the average market value for the preceding 60 months.
- The new hybrid policy will be fully implemented in fiscal year 2014-15.

Management Fee

Eligible endowments will be assessed an annual management fee of .25% of the current market value (assessed monthly) to support administrative costs.

Underwater Endowment Funds²

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 underwater.

Effective for FY 2013-14 and thereafter, spending and management fee withdrawals will be suspended on all endowments underwater by more than 20%. Endowments underwater more than 10% will undergo a formal review by the Office of the Treasurer and appropriate College Dean to determine the appropriate level of spending in accordance the following factors set forth in the Kentucky Uniform Prudent Management of Institutional Funds Act:

- the duration and preservation of the endowment fund;
- the purposes of the institution and the endowment fund;
- general economic conditions;
- the possible effect of inflation or deflation;
- the expected total return from income and the appreciation of investments;
- other resources of the institution;
- the investment policy of the institution.

The Vice President for Financial Operations and Treasurer has authority to approve exceptions of the policy to suspend spending distributions and management fee withdrawals on certain quasi and term endowments that are underwater by more than 20%.

New Endowment Funds

Effective for FY 2013-14 and thereafter, spending distributions on new endowment funds will be delayed for at least one year in order to build a spending reserve.

² 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, issuer and country of domicile. 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-U.S. investments; and by vintage year of investment. Real Return Investments will be diversified by asset class and strategy. Absolute Return investments will be diversified by manager, investment strategy, and geographic location including U.S. and non-U.S. managers. Real estate investments will be diversified by property type, geographic location and investment strategy.

In an effort to optimize and efficiently utilize due diligence research and diversification, a “fund of funds” (“FOF”) investment structure will generally be used for Private Equity, Real Return and Absolute Return investments.

Asset Allocation

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

Asset Class	Investment Policy	
	Target	Range
Equities		
Broad U.S. Equities	12%	8-24% ³
Broad Non-U.S. Equities	12%	4-24% ³
Total Equities	24%	18-36%³
Fixed Income	10%	5-20%⁴
Alternatives		
Long-Biased Long/Short Equity	14%	7-21%
Private Equity	12%	6-18%
Global Tactical Asset Allocation	8%	4-12%
Absolute Return	10%	5-15%
Diversified Inflation Strategies	10%	5-15%
Real Estate	12%	6-18%
Total Alternatives	66%	44-77%
Total	100%	

³ Larger upside can be used to hold dollars during a transition of assets or pending an allocation to an illiquid strategy.

⁴ Larger upside can be used to hold dollars during a transition of assets or for defensive positioning of the portfolio.

Rebalancing

Rebalancing is the term that describes the periodic movement of funds from one asset or asset class to another for the purpose of realigning the assets with the asset allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic rebalancing will reduce portfolio volatility and increase portfolio return over the long term. However, excessively tight ranges and frequent rebalancing can lead to unnecessary transaction costs.

The Committee has chosen to adopt a rebalancing policy that is governed by allocation ranges rather than time periods. The ranges, specified in the table above, are a function of the volatility and liquidity of each asset class and the proportion of the total fund allocated to the asset class. While the allocation to all asset classes remains within these limits, Staff will first use cash flows, as available, to maintain the overall allocation as close as possible to the target. When an asset class violates the lower or upper limits, public market funds will be actively rebalanced back to the target.

When any one of the public market asset classes hits a trigger point, the entire fund may be rebalanced back to asset class target allocations with the understanding that it may be impractical to return the real estate and private equity classes precisely to target in the short term. Accordingly, qualitative considerations (e.g., transaction costs, liquidity needs, investment time horizons, etc.) will be considered in determining the potential timing and extent of rebalancing real estate and private equity portfolios.

Staff is responsible for developing and implementing a rebalancing plan that is appropriate for existing market conditions, with a primary objective of minimizing transaction costs and portfolio disruptions. Managers on the Watch List will not receive additional allocations without Committee approval. In the event an allocation trigger point is not reached, Staff may still make minor changes among asset classes and within individual asset classes, as needed, to more effectively implement the program and to maintain proper exposure to the approved asset allocation and asset class portfolio structures. Staff will report the results of all rebalancing activity to the Investment Committee at the regular meetings.

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;

(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 AND BENCHMARKS**

<u>MANAGER NAME</u>	<u>HEADQUARTERS</u>	<u>INVESTMENT STRATEGY¹</u>	<u>POLICY TARGET</u>	<u>POLICY RANGE</u>	<u>BENCHMARK</u>
<u>Broad U.S. Equity²</u> Northern Trust	Chicago, IL	Passive Russell 1000 (Large-cap)	11.0%		Russell 1000 Index
Wellington	Boston, MA	Active Russell 2000 (Small-cap)	1.0%		Russell 2000 Index
		Total Broad U.S. Equity²	12.0%	8.0-24.0%	Dow Jones U.S. Total Stock Market Index
<u>Broad Non-U.S. Equity³</u> Mondrian	London, ENG	Active MSCI ACW ex-U.S. - Value	6.0%		MSCI All Country World ex-U.S. Value Index
William Blair	Chicago, IL	Active MSCI ACW ex-U.S. - Growth	6.0%		MSCI All Country World ex-U.S. Growth Index
		Total Broad Non-U.S. Equity³	12.0%	4.0-24.0%	MSCI All Country World ex-U.S. Index
		TOTAL EQUITIES	24.0%	18.0-36.0%	N/A
<u>Fixed Income:</u> PIMCO	Newport Beach, CA	Core-Plus Fixed Income	2.5%		Barclays US Aggregate Bond Index
PIMCO	Newport Beach, CA	Unconstrained Fixed Income	2.5%		3-Month LIBOR + 3%
Reams	Columbus, IN	Core-Plus Fixed Income	2.5%		Barclays US Aggregate Bond Index
Reams	Columbus, IN	Unconstrained Fixed Income	2.5%		3-Month LIBOR + 3%
		TOTAL FIXED INCOME	10.0%	5.0-20.0%	Barclays US Aggregate Bond Index
<u>Long-Biased Long/Short Equity⁴</u> Berenis	New York, NY	Long-Biased Long/Short Equity	4.0%		Hedge Fund Net Equity Hedge Aggregate Index
Prisma	New York, NY	Long-Biased Long/Short Equity	4.0%		Hedge Fund Net Equity Hedge Aggregate Index
Wellington	Boston, MA	Long-Biased Long/Short Equity	4.0%		Hedge Fund Net Equity Hedge Aggregate Index
Grosvenor	Chicago, IL	Long-Biased Long/Short Equity	2.0%		Hedge Fund Net Equity Hedge Aggregate Index
		Total Long-Biased Long/Short Equity⁴	14.0%	7.0-21.0%	Hedge Fund Net Equity Hedge Aggregate Index
<u>Private Equity:</u> Multiple Managers ⁵ Commonfund Capital Drum Capital NB Alternatives Pantheon Ventures Siguler Guff	Wilton, CT Stamford, CT Dallas, TX San Francisco, CA New York, NY	Private Equity FOF	12.0%		Venture Economics All Private Equity Index Venture Economics All Private Equity Index Venture Economics All Private Equity Index Venture Economics All Private Equity Index Venture Economics All Private Equity Index
Chrysalis Ventures ⁶	Louisville, KY	Regional Venture Capital	0.0%		Venture Economics All Private Equity Index
Fort Washington ⁶	Cincinnati, OH	Regional Venture Capital	0.0%		Venture Economics All Private Equity Index
		Total Private Equity	12.0%	6.0-18.0%	Venture Economics All Private Equity Index

<u>MANAGER NAME</u>	<u>HEADQUARTERS</u>	<u>INVESTMENT STRATEGY¹</u>	<u>POLICY TARGET</u>	<u>POLICY RANGE</u>	<u>BENCHMARK</u>
<u>Global Tactical Asset Allocation (GTAA):</u> PIMCO	Newport Beach, CA	GTAA (All Asset All Authority)	4.0%		All Asset Composite Index
New Manager TBD ⁷	TBD	GTAA	4.0%	4.0-12.0%	Benchmark TBD ⁸
		Total Global Tactical Asset Allocation	8.0%		Benchmark TBD⁸
<u>Absolute Return:</u> Grosvenor	Chicago, IL	Core/Opportunistic Absolute Return FOF	10.0%		Hedge Fund Net Fund-of-Funds Multi-Strategy Index
		Total Absolute Return	10.0%	5.0-15.0%	Hedge Fund Net Fund-of-Funds Multi-Strategy Index
<u>Diversified Inflation Strategies (DIS):</u> Wellington	Boston, MA	DIS (Diversified Inflation Hedges)	7.0%		Wellington Diversified Inflation Hedges Composite Index
New Manager(s) TBD ⁷	TBD	Illiquid, Closed-End DIS	3.0%		Benchmark TBD ⁸
		Total Diversified Inflation Strategies	10.0%	5.0-15.0%	Benchmark TBD⁸
<u>Real Estate:</u> UBS	Hartford, CT	Core Real Estate	5.0%		NCREIF ⁸ Open-End Diversified Core Index
		Non-Core Real Estate	7.0%		NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index NCREIF ⁸ Property Index
		Total Real Estate	12.0%	6.0-18.0%	42% NCREIF⁸ Open-End Diversified Core Index + 58% NCREIF⁸ Property Index
		TOTAL ALTERNATIVES	66.0%	44.0-77.0%	N/A
		TOTAL POOLED INVESTMENTS	100.0%		Policy Benchmark

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

² Enhanced passive products of existing managers to be considered for up to 50% of the total US Equity allocation.

³ Emerging markets, small-cap and/or concentrated strategies of Mondrian and William Blair to be considered for up to 50% of the total non-US Equity allocation.

⁴ Existing managers expected to be used for the Long-Biased Long-Short Equity mandate, however percentages shown may vary.

⁵ 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.

⁶ 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.

⁷ Request for Proposals to be issued to hire one or more managers for this mandate.

⁸ Benchmark for manager and overall asset class to be determined upon selection of new manager.

⁹ National Council of Real Estate Investment Fiduciaries

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 Strategies

- **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 1,800 securities across 45 markets, with emerging markets representing approximately 24%. MSCI attempts to capture approximately 88% of the market capitalization in each country. The objective of an active strategy is to exceed the return of the index.
 - 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.

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.

Alternative Strategies

- **Long-Biased Long/Short Equity:** Strategy that primarily involves taking long and short positions in a portfolio of equities. A long position is buying a stock with the expectation that the stock will increase in value. A short position in a stock is borrowing a stock from an investor, selling it to another investor with the expectation that the stock will decrease in value. The short portfolio serves to partially hedge the long equity portfolio exposure. Long-biased long/short equity strategies typically are invested in a diversified portfolio of hedge fund limited partnerships (LPs), in a fund-of-funds that owns a portfolio of hedge fund LPs, or some combination of direct LP and fund-of-fund investments. Long/short equity strategies are often referred to as “directional” hedge funds as they typically have a net long exposure to equity markets. In other words, directional long/short equity strategies have a positive beta, but that beta typically is less than that of a fully invested long-only equity portfolio. With long/short equity funds, the primary source of alpha and risk is active equity investing. Long-biased managers attempt to deliver alpha on top of their stock selection decisions by varying the amount of net equity exposure.
- **Private Equity:** Strategy that primarily invests in a range of equity investments that are not traded on a public exchange. Investments typically have less liquidity, higher risk and higher expected return than public equity investments. Investments typically are made within a limited partnership (LP) fund structure. Appropriate investments may include direct LP ownership or investment through a fund-of-funds that owns a diversified portfolio of LP investments. The fund-of-funds approach in private equity may provide access to top-tier private equity partnerships and enhanced diversification that may be unavailable through direct LP investments. Assets invested in private equity strategy typically are illiquid, with a typical investment time horizon of seven or more years.
- **Global Tactical Asset Allocation (GTAA):** Strategy designed to capture inefficiencies across multiple asset or sub-asset classes. GTAA strategies are based on the belief that relative returns across market sectors will periodically diverge from equilibrium levels, allowing the opportunity for excess returns from overweighting those asset classes that are expected to outperform on a relative basis in the near term and underweighting those asset classes expected to underperform in the near term. Asset classes included in GTAA products typically span a wide spectrum, and liquid GTAA strategies typically involve low levels of leverage, shorting, and illiquid asset class exposure. Unlike traditional active strategy managers that need expertise in one particular asset class, GTAA managers need a solid understanding of several asset classes and their interrelationships to be successful. GTAA investments are in mutual funds, commingled funds or separate accounts. GTAA investments typically have daily liquidity.
- **Diversified Inflation Strategies:** Strategy that typically invests in various real or inflation-sensitive assets including treasury inflation protected securities (TIPS), commodities, currency, REITS, timber, infrastructure and global natural resources. The strategies can also include equity and fixed income investments, and

involve global tactical asset allocation among the various asset classes/strategies. The primary objective of these strategies is to provide a hedge against inflation. Funds typically target a return exceeding inflation by a premium, such as C.P.I. plus 5%. Diversified Inflation Strategy investments can be made in a wide range of investments depending on the area of focus of the investment. Investments made by liquid or relatively illiquid depending on the nature of the underlying investment.

- **Absolute Return:** Strategy is designed to provide a stable return stream with less volatility than equity investments and higher long-term return than fixed income investments. Absolute Return strategies typically are invested in a diversified portfolio of hedge fund limited partnerships, in a fund-of-funds that owns a portfolio of hedge fund LPs, or some combination of direct LP and fund-of-fund investments. . A fund-of-funds approach may provide access to professional expertise in selecting and monitoring individual hedge funds, access to high quality, institutional hedge funds and instant diversification. Absolute return investments differ from long biased long-short equity in that they will have not have a meaningful long equity bias in their holdings over most time periods. Absolute return encompasses 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. Assets invested in the strategy typically have quarterly or annual liquidity. Managers may reserve the right to suspend liquidations under poor economic and market conditions.

- **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.

- **Non-Core Real Estate:** Value added and opportunistic real estate strategies:
 - 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.