Kentucky Retirement Systems

Statement of Investment Policy-Pension Fund

This statement of investment policy is issued by the Board of Trustees of Kentucky Retirement Systems (Systems) in connection with investing the pension funds of the Kentucky Employees Retirement System, the County Employees Retirement System and the State Police Retirement System. This document supersedes all prior documents entitled Statement of Investment Policy.

I. The Board of Trustees

The Kentucky Retirement Systems is a "Qualified Pension Plan" under Section 401 of the Internal Revenue Code and is administered by a board of nine trustees. Three trustees are appointed by the Governor of the Commonwealth of Kentucky, two trustees are elected by the membership of the Kentucky Employees Retirement System, two trustees are elected by the membership of the County Employees Retirement System, and one trustee is elected by the membership of the State Police Retirement System. The Secretary of the Personnel Cabinet is an ex-officio trustee.

The Board of Trustees authorizes and directs the appointment of an Investment Committee with full power to act for the board in the acquisition, sale and management of the securities and funds of the Systems in accordance with the provisions of the Statutes and Investment Policy of the Board. The Board shall review the actions of the Investment Committee at each quarterly Board meeting.

II. The Investment Committee

The Investment Committee consists of five members of the Board of Trustees appointed by the chairperson of the Board of Trustees. The committee acts on behalf of the board on investment related matters.

The Investment Committee has the following oversight responsibilities:

A. Assure compliance with this policy and all applicable laws and regulations.

B. Approve the selection and termination of service providers.

C. Meet quarterly to evaluate whether this policy, the investment activities and management controls and processes continue to be consistent with meeting the Systems' goals. Mandate actions necessary to maintain the overall effectiveness of the program.

D. Review assessment of investment program management processes and procedures, and this policy relative to meeting stated goals.

III. Staff Responsibilities

The Chief Investment Officer is responsible for administration of investment assets of the Systems consistent with the policies, guidelines and limits established by the law, this Statement of Investment

Policy and the Investment Committee.

The Chief Investment Officer receives direction from and reports to the Investment Committee and the Executive Director of the Systems on all investment matters, including but not limited to the following:

A. Maintaining the diversification and risk exposure of the funds consistent with policies and guidelines.
B. Monitoring and assessing service providers, including annual on site visits, to assure that they meet expectations and conform to policies and guidelines.
C. Assess and report on the performance and risk exposure of the overall investment program relative to goals, objectives, policies and guidelines.
D. Recommend changes to service providers, statutes, policies or guidelines as needed to maintain a productive relationship between the investment program and its goals; act as liaison on all investment related matters.
E. Communicating with the mass media and other agencies, entities or institutions regarding investment related issues.
F. Identify issues for consideration by the Investment Committee and prepare recommendations regarding such matters.

The Chief Investment Officer or designee is authorized to execute trades on fixed income and equities and to execute proxies for the Board consistent with this Policy.

To carry out this Policy and investment related decisions of the Board, the Chief Investment Officer or designee is authorized to execute agreements and other necessary or proper documents pertaining to investment managers, consultants, investment related transactions or other investment functions.

IV. Service Providers

A. Investment Managers

In instances where the Investment Committee has determined it is desirable to employ the services of an external Investment Manager, the following shall be applicable:

1. Investment Managers shall be qualified to serve as fiduciaries to the Systems and shall generally have been in the business of investment management for large United States institutional investors for at least three to five years.
2. Investment Managers shall manage assets in accordance with this Policy and additional guidelines established by contract, as may be modified from time to time.

B. Custody Bank

The Board shall hire custodians and other agents who will be fiduciaries to the Systems and who will assume responsibility for the safekeeping and accounting of all assets held on behalf of the Systems and other duties as agreed to by contract.

C. Investment Consultants

Qualified independent investment consultants may be retained by the Systems for asset allocation studies, asset allocation recommendations, performance reviews, manager searches and other investment related consulting functions and duties as set forth by contract.

D. Selection

Qualified investment managers, custody banks, investment consultants and other service providers shall be selected by the Investment Committee or Chief Investment Officer as required. The selection shall be based upon the demonstrated ability of the professional(s) to provide the required expertise or assistance. In order to create an efficient and effective process, the Investment Committee or Chief Investment Officer may, in their sole discretion, utilize RFI, RFP, third party proprietary software or database, review of existing service provider capabilities or any combination of these or other methods to select a service provider. Relevant criteria for the selection of investment managers are contained in the Transactions Procedures statement.

All contact and communication with service providers seeking a business relationship with the Systems shall be directed to the Chief Investment Officer. However, this rule is not applicable to existing service providers if the contact or communication is in response to an information request from the Investment Committee or if it is incidental contact not related to specific Systems business

V. Investment Philosophy

The Trustees of the Kentucky Retirement Systems recognize their fiduciary duty not only to invest the Systems' funds in formal compliance with the Prudent Person Rule but also to manage those funds in continued recognition of the basic long term nature of those systems. The Trustees interpret this to mean, in addition to the specific guidelines and restrictions set forth in this document that the assets of the three systems shall be actively managed -- that is, investment decisions regarding the particular asset classes, strategies, and securities to be purchased or sold shall be the result of the conscious exercise of discretion.

The Trustees recognize that, commensurate with their overall objective of maximizing long-range return while maintaining a high standard of portfolio quality and consistency of return, it is necessary that proper diversification of assets be maintained both across and within the classes of securities held to minimize/mitigate overall portfolio risk. Consistent with carrying out their Fiduciary Responsibilities and the concept of Modern Portfolio Theory, the Trustees will not systematically exclude any investments in companies, industries, countries, or geographic areas. Within this context of active management and the necessity for adherence to proper diversification, the Trustees rely upon appropriate professional advice.

The Trustees and other fiduciaries shall discharge their duties with respect to the Systems: (1) solely in the interest of the participants and beneficiaries; (2) for the exclusive purpose of providing benefits to participants and beneficiaries; (3) with the care, skill and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose; (4) impartially; (5) incurring and paying appropriate and reasonable expenses of administration and (6) in accordance with a good faith interpretation of the laws, regulations and other instruments governing the Systems.

Additionally, the Trustees and other fiduciaries shall not engage in any transaction which results in a substantial diversion of the Systems income or assets without adequate security and reasonable rate of return to a disqualified person or in any other prohibited transaction described in Internal Revenue Code Section 503(b).

VI. Investment Objectives

The Board of Trustees realizes that prudent investment management is a duty. In fulfillment of this duty the Board of Trustees recognizes that while long-term objectives are important, it is also necessary that short-term benchmarks be used to assess the periodic performance of the investment program.

Accordingly, the Board of Trustees has established the following investment objectives:

- Long-Term:
  - The total assets of the Systems should achieve a return measured over two market cycles (estimated to be six to ten years) which exceeds the actuarially required rate of return of 7.75%, which consists of two components; an inflation component and a real return component. The current assumption for the rate of inflation is 3.5% and the real return component is 4.25%.
  - In addition to the actuarially required rate of return benchmark, the total fund return should exceed the return achieved by its blended performance benchmark.
- Short-Term:
  - The returns of the particular asset classes of the managed funds of the Systems, measured on a year-to-year basis, should exceed the returns achieved by comparable passive market indices as described in the section of this statement entitled "Standards of Measurement."

VII. Derivative Securities and Leveraging

Derivative Securities

Investment managers may invest in derivative securities, or strategies which make use of derivative investments, for exposure, cost efficiency and risk management purposes, if such investments do not cause the portfolio to be leveraged beyond a 100% invested position. Examples of such derivatives include, but are not limited to, foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), futures, options, and swaps.

Investments in derivative securities which are subject to large or unanticipated changes in duration or cash flows, such as interest only (IO), principal only (PO), inverse floater, or structured note securities are permitted only to the extent authorized in an alternative investment offering memorandum or agreement. Investment managers may make use of such instruments/securities for defensive risk mitigation or hedging purposes.

Investments in securities such as collateralized mortgage obligation (CMO) and planned amortization class (PAC) issues are allowed if, in the judgment of the investment manager, they are not expected to be subject to large or unanticipated changes in duration or cash flows. Investment managers may make use of derivative securities for defensive or hedging purposes.

Any derivative security shall be sufficiently liquid that it can be expected to be sold at, or near, its most recently quoted market price.

Leveraging

Leveraging for purposes of enhancing yield is expressly prohibited except for investments in alternative assets and absolute return investments. Investment managers of alternative investments or absolute return strategies/investments are granted the authority to engage in positive leverage to the extent authorized in their offering memorandum or agreement.

The above is not intended to limit the Systems from borrowing to cover short-term cash flow needs nor prohibit the Systems from loaning securities in accordance with a securities lending agreement.

VIII. Asset Allocation Guidelines

In establishing asset allocation guidelines the Board recognizes that each system has its own capacity to tolerate investment volatility, or risk. Therefore, each system has been studied and asset allocation guidelines established on a system by system basis. Starting with fiscal year 1994-95 the Board will cause the asset allocation guidelines of each system to be studied again. Subsequent to that study, the Board will cause additional studies of the asset allocation guidelines to be performed at approximate five year intervals in conjunction with the System's Actuarial Experience Study.

The intent of the Board of Trustees in allocating funds to the investment managers is for the investment managers to fully invest the funds. However, the Board of Trustees is aware that from time to time the investment manager will require a portion of the allocated funds to be held in cash provided the cash holdings do not exceed three percent (3%) of the manager's allocation for any given quarter, unless such cash holdings are an integral part of a fixed income manager's investment strategy.

The actual asset class allocation of the Pension Funds will be reviewed monthly by staff relative to its target asset class allocation. Staff shall reallocate the assets when the actual asset class allocation is within one percentage point of the allowable range boundary, but may reallocate when the actual asset class allocation exceeds the target asset class allocation by a margin of +/- 1 percentage points. See Appendix A for current asset allocation.

In keeping with its responsibility as trustee and wherever consistent with its fiduciary responsibility, the board encourages the investment of the fund's assets in investments, funds, and securities of corporations which provide a positive contribution to the economy of the Commonwealth of Kentucky. However, where any security is not a prohibited investment under the governing laws and policies, discretion will be granted to the appointed investment managers in the selection of such securities and timing of transactions consistent with the following guidelines and restrictions.

A. Domestic Equity Investments

Investment may be made in common stock, securities convertible into common stock, preferred stock of publicly traded companies on stock markets or any other type of security contained in a manager's benchmark. Each individual domestic equity account shall have a comprehensive set of investment guidelines prepared, which contains a listing of permissible investments, portfolio restrictions and standards of performance for the account.

The internally managed equity index funds are intended, consistent with the governing plan documents, to gain exposure to a broad asset sector to replicate the characteristics of the asset class, to minimize administrative expenses and to help achieve overall portfolio objectives. These objectives can be achieved through several management techniques, including but not limited to, portfolio optimization, non-reinvestment of index dividends and other management techniques intended to help achieve the objectives of the entire pension fund.

B. International Equity Investments

Investment may be made in common stock, securities convertible into common stock, preferred stock of publicly traded companies on stock markets, or any other type of security contained in a manager's benchmark. Each individual international equity account shall have a comprehensive set of investment guidelines prepared, which contains a listing of permissible investments, portfolio restrictions and standards of performance for the account.

The internally managed equity index funds are intended, consistent with the governing plan documents, to gain exposure to a broad asset sector to replicate the characteristics of the asset class, to minimize administrative expenses and to help achieve overall portfolio objectives. These objectives can be achieved through several management techniques, including but not limited to, portfolio optimization, non-reinvestment of index dividends and other management techniques intended to help achieve the objectives of the entire pension fund.

C. Fixed Income Investments

Fixed Income investments will be similar in type to those securities found in the KRS fixed income benchmarks and the characteristics of the KRS fixed income portfolio will be similar to the KRS fixed income benchmarks. The fixed income accounts may include, but are not limited to the following fixed income securities: U.S. Government and Agency bonds, investment grade U.S. corporate credit, investment grade non-U.S. corporate credit, non-investment grade U.S. corporate credit including both bonds and bank loans, non-investment grade non U.S. corporate credit including bonds and bank loans, municipal bonds, non-U.S. sovereign debt, mortgages including residential mortgage backed securities, commercial mortgage backed securities, and whole loans, asset-backed securities, and emerging market debt including both sovereign EMD and corporate EMD.

Each individual fixed income account shall have a comprehensive set of investment guidelines prepared, which contains a listing of permissible investments, portfolio restrictions, risk parameters, and standards of performance for the account.

D. Alternative Investments

Subject to specific approval of the Investment Committee of the Board of Trustees, investments may be made for the purpose of creating a diversified portfolio of alternative investments. Examples of such investments include, but are not limited to, venture capital partnerships, private equity, leveraged buyouts and funds, private debt, timberland, oil and gas partnerships, commodities and private placements. While it is expected that the majority of these assets will be invested within the United States, a portion has been allocated to non-US investments. These non-U.S. investments are not restricted by geography.

It is expected that these investments will typically be structured as Limited Partnerships, with KRS serving as one of the Limited Partners, but not as a General Partner. It is also expected that KRS will not engage in direct investments or co-investments, in which the System would purchase majority control in individual corporate entities.

Funds that are committed to said Limited Partnerships, but not yet drawn down by the General Partner, will be invested in the Systems' internally managed equity funds, or in investments/instruments indicative of the risk/reward characteristics of these funds that closely match those of the Limited Partnerships.

The following sub-asset allocations, based on invested value, are to be consistent with the overall asset allocation of the Total Pension Fund, as well as the investable universe within private equity. The ranges reflect long-term averages, once the 5% allocation to Alternatives has been fully committed. During the initial investment period, approximately four to six years, it is expected that sub-category allocations may fall outside the approved ranges.

Sub-Category	**Target Allocations**	**Ranges**
Venture Capital	20.0%	10-30%
Buyouts	45.0%	30-50%
Debt-Related	20.0%	10-30%
International	15.0%	0-20%

E. Real Estate Investments

Subject to specific approval of the Investment Committee of the Board of Trustees, Investments may be made in equity and debt real estate for the purpose of achieving the highest total rate of return possible consistent with a prudent level of risk. Allowable real estate investments include open-end and closed-end commingled real estate funds, joint venture investments, public and private REITs (real estate investment trusts), public real estate operating companies, and real estate related debt . The target allocation for this asset class is 5% of the aggregate portfolio.

Real estate investments will be allocated across the core, enhanced/value added, and opportunistic categories.

F. Cash Equivalent Securities

Selection of particular short-term instruments, whether viewed as liquidity reserves or as investment vehicles, should be determined primarily by the safety and liquidity of the investment and only secondarily by the available yield. The following short-term investment vehicles are considered acceptable:

Publicly traded investment grade corporate bonds, variable rate demand notes, government and agency bonds, mortgages, and collective STIFs, money market funds or instruments (including, but not limited to, certificates of deposit, bank notes, deposit notes, bankers' acceptances and commercial paper) and repurchase agreements relating to the above instruments. Instruments may be selected from among those having an investment grade rating at the time of purchase by at least one recognized bond rating service. In cases where the instrument has a split rating, the higher of the two ratings shall prevail. All instruments shall have a maturity at the time of purchase that does not exceed two years. Repurchase agreements shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur.

The Systems' fixed income managers that utilize cash equivalent securities as an integral part of their investment strategy are exempt from the permissible investments contained in the preceding paragraph. Permissible short-term investments for fixed income managers shall be included in the investment manager's investment guidelines.

Absolute Return Program

Subject to specific approval of the Investment Committee of the Board of Trustees, investments may be made for the purpose of creating a diversified portfolio of absolute return investments. Examples of such investments include, but are not limited to, fund of hedge funds, multi-strategy hedge funds, and single strategy hedge funds. The objective of the absolute return strategy is to preserve capital and deliver positive (absolute) returns under most market conditions. It is anticipated that the returns from this program should largely be uncorrelated to market movements in both the equity and fixed income markets (systematic risk) and primarily be based on manager skill; therefore, helping to diversify the overall KRS portfolio. It is intended that this program be structured so that risk should be specific to each manager, not to the systematic risk of the markets. By emphasizing absolute, rather than relative returns, and utilizing a wider range of investment techniques, such as leverage, short selling and derivatives to achieve their objectives, hedge funds are expected to deliver an absolute return with a risk level between that of stocks and bonds. As such, the objective of the Absolute Return Program is designed to help reduce the volatility of the overall KRS portfolio while seeking to enhance returns in a variety of market environments.

KRS does not consider Absolute Return Strategies to be a separate asset class, but rather a set of strategies utilizing public and private securities and instruments.

The list of absolute return strategies that the KRS absolute return portfolio may utilize via direct hedge funds or fund of hedge funds include, but are not limited to:

- **Convertible Arbitrage:** Investment strategy that is long convertible securities and short the underlying equities
- **Distressed Securities:** Invests long (and some short) securities of companies that are in reorganizations, bankruptcies, or some other corporate restructuring

- **Emerging Markets:** Investment in securities of companies in developing or "emerging" countries - primarily long
- **Growth Funds:** Investment in a portfolio or "core" holdings in growth stocks. Many of these portfolios are hedged by shorting and utilizing options
- **Macro Funds:** The investment philosophy is based on shifts in global economies. Derivatives are often used to speculate on currency and interest rate moves
- **Market Neutral:** Strategy that attempts to lockout or "neutralize" market risk
- **Market Timing:** Allocation of assets among investments primarily switching between mutual funds and money markets
- **Merger Arbitrage:** Invests in event-driven situations of corporations, such as leveraged buy-outs, mergers, and hostile takeovers. Managers purchase stock in the firm being taken over and, in some situations, sell short the stock of the acquiring company
- **Multistrategies:** Specific portions are utilized for separate strategies, e.g., growth, convertible arbitrage, and market neutral
- **Opportunistic:** Investment theme is dominated by events that are seen as special situations or opportunities to capitalize from price fluctuations or imbalances
- **Sector Funds:** Invest in companies in sectors of the economy, e.g., financial institutions or bio-technologies. These funds invest in both long and short securities and will utilize options
- **Short Selling:** Short selling of securities
- **Derivative Funds:** These funds invest in derivative instruments such as futures and options with the aim of achieving high returns
- **Commodity Funds:** These funds invest in shares of companies that operate in commodity related industries or hold physical commodities such as bullion
- **CTA:** A fund that is a Commodity Trading Advisor's account where the trades are generally focused in commodity futures, options, and foreign exchange with a high degree of leverage
- **Short Bias:** A fund that consistently maintains a net short position to the overall market

The target allocation for absolute return investments, as approved by the KRS Investment Committee, is up to 5% of the KRS aggregate portfolio.

IX. Standards of Measurement

Performance Measurement

The Kentucky Retirement Systems ("KRS") overall fund performance is measured relative to the KRS Pension Total Fund Benchmark. The benchmark is calculated by means of a weighted average methodology. This method is consistent with industry-wide standards and the practices utilized by the CFA Institute. It is the product of the various component weights (i.e., asset classes' percentages) by their respective performance (returns). Thus, it stands to reason that larger asset classes have a greater impact on the overall performance calculation than do the lesser weighted asset classes. The Fund's weighted average performance result is then compared to the KRS Total Fund Benchmark (again, a weighted average measure of acceptable indices). Due to market fluctuations and acceptable divergence, the asset classes' weights (percentages) are often not equivalent to the benchmark's weights. Therefore, the performance may indicate that the Funds have outperformed (underperformed) relative to their respective benchmarks, even when the preponderance of lesser weighted categories have underperformed (outperformed) their indices.

KRS measures its asset classes, sub-asset classes, sectors, strategies, portfolios, and instruments (investment) performance with indexes that are recognized and published (e.g., S&P 500 & Barclays Aggregate Bond Index). These indices are determined to be appropriate measures of investments and composites of investments with identical or similar investments profiles, characteristics, and strategies. The benchmarks and indexes are intended to be objective, investable, replicable, representative and measurable of the investment mandate and, developed from publicly available information that is acceptable to KRS and the investment manager/advisor as the neutral position consistent with the underlying investor status. KRS' investment consultant and staff recommend the benchmarks and indexes. These measures shall be subject to the annual review and approval of the KRS Investment Committee and ratification of the Kentucky Retirement Systems' Board of Trustees.

The KRS Total Fund Benchmark and sub-components, indexes, are described in Appendix B.

The following represent the standards of measurement to be used as guidelines for the various classes of investments of the Kentucky Retirement Systems. They are to be computed and expressed on a time-weighted total return basis:

A. Domestic Equity Allocation

<u>*Total Domestic Equity Allocation:*</u> The Total Domestic Equity Allocation shall be benchmarked to the KRS Domestic Equity Index and comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, the Total Domestic Equity Allocation should exceed the returns of the KRS Domestic Equity Index.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, the Total Domestic Equity Allocation should exceed the KRS Domestic Equity Index, compare favorably on a risk-adjusted basis, and generate returns that rank above the median return of a relevant peer group. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the Index.

<u>*Individual Equity Portfolios:*</u> Individual portfolios shall be assigned a market goal or benchmark that is representative of the style or market capitalization of the assignment. Individual equity accounts should comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, individual portfolios should exceed the returns of their market goal or benchmark.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, individual portfolios should exceed the return of their market goal or benchmark, compare favorably on a risk-adjusted basis, and generate returns that rank above the median return of a relevant peer group. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the benchmark.

B. International Equities

Total International Equity Allocation: The Total International Equity Allocation shall be benchmarked to the KRS International Equity and comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, the Total International Equity Allocation should exceed the returns of the KRS International Equity Index.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, the Total International Equity Allocation should exceed the KRS International Equity Index, compare favorably on a risk-adjusted basis, and generate returns that rank above the median return of a relevant peer group. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the Index.

Individual International Equity Portfolios: Individual portfolios shall be assigned a market goal or benchmark that is representative of the style or market capitalization of the assignment. Individual equity accounts should comply with the following Standards:

- Short-term:
  - For periods less than five years or a full market cycle, individual portfolios should exceed the returns of their market goal or benchmark.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, individual portfolios should exceed the return of their market goal or benchmark, compare favorably on a risk-adjusted basis, and generate returns that rank above the median return of a relevant peer group. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the benchmark.

C. Fixed Income Allocation

Total Fixed Income Allocation: The Total Fixed Income Allocation shall be benchmarked to the KRS Total Fixed Income Index and comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, the Total Fixed Income Allocation should exceed the returns of the KRS Total Fixed Income Index.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, the Total Fixed Income Allocation should exceed the KRS Total Fixed Income Index, compare favorably on a risk-adjusted basis, and generate returns that rank above the median return of a relevant peer group. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the Index.

Individual Fixed Income Portfolios: Individual portfolios shall be assigned a market goal or benchmark that is representative of the style or market capitalization of the assignment. Individual portfolios should comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, individual portfolio accounts should exceed the returns of their market goal or benchmark.

- Intermediate & Long-term
  - For periods greater than five years or one market cycle, individual portfolios should exceed the return of their market goal or benchmark, compare favorably on a risk-adjusted basis, and generate returns that rank above the median return of a relevant peer group. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the benchmark.

D. Fixed Income - TIPS

Total TIPS Allocation: The Total TIPS Allocation shall be benchmarked to the KRS TIPS Index and comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, the Total TIPS Allocation should exceed the returns of the KRS TIPS Index.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, the Total TIPS Allocation should exceed the KRS TIPS Index and compare favorably on a risk-adjusted basis. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the Index.

Individual TIPS Portfolios: Individual portfolios shall be assigned a market goal or benchmark that is representative of the style or market capitalization of the assignment. Individual portfolios should comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, individual portfolio accounts should exceed the returns of their market goal or benchmark.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, individual portfolios should exceed the return of their market goal or benchmark and compare favorably on a risk-adjusted basis. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the benchmark.

E. Alternative Investments

The Total Alternative Investment allocation is benchmarked to multiple indices. For interim reporting periods, the Total Alternative Investment Allocation shall be measured against the KRS Alternative Index. The KRS Alternative Index is a blended index composed of public market constituents.

Alternative investments are illiquid and long term in nature; as such, public indices do not serve as a true benchmark. Given this circumstance leads to the possibility of large short term performance discrepancies, KRS more appropriately measures its alternative investments based on a preponderance of indices. In order to address differences between the long-term performance and biases introduced by life cycle stage dependent return profiles inherent to many alternative investments, on an annual basis, the Total Alternative Investment allocation and its underlying investments will be compared to other investments with similar strategies and of the same vintage year as reported by Venture Economics.

Over the long term, KRS will use a specified index plus risk premium approach.

Total Alternative Investment Allocation: The Total Alternative Investment Allocation shall have a performance benchmark that consists of the KRS Alternative Investment Index. Alternative Investment sub-class segments shall be assigned a performance benchmark and comply with relevant Standards.

Venture Capital

Description: Venture capital investments are seed stage, early stage, later stage, and expansion stage investments. Investments are often made in years one through five and distributions typically occur in years four through ten, or longer.

Investment Constraints: Over the life of the fund, no more than 35% of total net assets of an individual partnership may be invested in securities or obligations of foreign entities issued outside the U.S. No more than 50% of total net assets of an individual partnership may be invested in a single segment within a particular industry.

Performance Standards:

- Short-term
  - Venture Capital investments should earn a Net IRR that place the investment above the median Net IRR of other similar venture capital funds, of the same vintage year, as reported by Venture Economics.
- Intermediate & Long-term
  - Venture Capital investments should earn a Net IRR that exceeds the KRS Venture Capital Index (annualized) and that place the investment above the median Net IRR of other similar venture capital funds, of the same vintage year, as reported by Venture Economics.

Buyouts

Description: Buyout investments typically involve the purchase of a control position (primarily majority positions, with some minority positions) in an established company. Leverage may be used. Investments are often made in years one through four and distributions typically occur in years three through six.

Investment Constraints: Over the life of the fund, no more than 35% of total net assets of an individual partnership may be invested in securities or obligations of foreign entities issued outside the U.S. No more than 50% of total net assets of an individual partnership may be invested in a single segment within a particular industry.

Performance Standards:

- Short-term
  - Buyout investments should earn a Net IRR that place the investment above the median Net IRR of other similar buyout funds, of the same vintage year, as reported by Venture Economics.
- Intermediate & Long-term

- Buyout investments should earn a Net IRR that exceeds the KRS Private Equity Index (annualized) and that place the investment above the median Net IRR of other similar buyout funds, of the same vintage year, as reported by Venture Economics.

Debt-Related

Description: Debt-related investments combine a debt instrument, which provides a current yield, with an equity participation in warrants, etc. Investments are typically made in years one through three and provide current income combined with capital appreciation supplied by the warrants or other "equity kickers".

Investment Constraints: Over the life of the fund, no more than 35% of total net assets of an individual partnership may be invested in securities or obligations of foreign entities issued outside the U.S. Investments may be made in equity or debt related real estate assets. The General Partner may not purchase securities on margin or otherwise borrow funds for the purposes of purchasing securities.

Performance Standards:

- Short-term
  - Debt-related investments should earn a Net IRR that place the investment above the median Net IRR of other similar debt-related funds, of the same vintage year, as reported by Venture Economics.
- Intermediate & Long-term
  - Debt-related investments should earn a Net IRR that exceeds the KRS Private Equity Index (annualized) and that place the investment above the median Net IRR of other similar debt-related funds, of the same vintage year, as reported by Venture Economics.

International

Specific International guidelines will follow the sections covering buyout, venture capital, and debt related investments. However, international investments are exempt from the investments constraints prohibiting investments outside of the U.S. as these investments are expected to hold majority of their assets outside of the U.S.

To ensure prudent diversification and due to unique characteristics of international private equity markets, it is expected that the international exposure will be provided by fund-of-fund vehicles, and targeted direct partnership vehicles.

F. Real Estate

The Total Real Estate allocation of the fund shall be benchmarked to the KRS Total Real Estate Index.

REITS

Description: A portfolio which invests in a pool of publicly traded real estate securities, providing capital appreciation, inflation protection, and current income.

Investment Constraints: The strategy must invest in real estate securities trade on public exchanges in the United State, Europe, or Asia.

Benchmark: KRS REIT Index

Core Private Real Estate

Description: Direct private investment in equity and debt real estate funds, private REITs, join ventures, and partnerships. Core real estate funds typically provide more current income than Value-Added/Opportunistic real estate but less potential for capital appreciation. Core also typically uses less leverage (debt financing) than Value-Added/Opportunistic real estate.

Investment Constraints: No more than 50% leverage may be used at the portfolio level.

Benchmark: Target total returns of 7% to 9% per year (net of fees and promoted interest), with a high proportion of the total return to be generated from current income and a small proportion of the total return generated from appreciation.

Value-Added/Opportunistic Private Real Estate

Description: Direct private investment in equity and debt real estate funds, private REITs, joint ventures, and partnerships. Opportunistic and enhanced/value-added funds typically provide less current income than core real estate, and use more leverage (debt financing) than core real estate.

Investment Constraints: Value-Added: Leverage is generally limited to 65% loan to value. Opportunistic: Leverage can be 75% loan to value or higher in certain cases.

Benchmark: Value-Added: Target returns for value added investments are 9% to 12% per year (net of fees and promoted interest). Opportunistic: Generated returns in excess of 12% (net of fees and promoted interest) in order to compensate for the additional risk commensurate with the increased risk compared to core property investments

G. Cash Equivalents Allocation

Total Cash Equivalents Allocation: The Total Cash Equivalents Allocation shall be benchmarked to the KRS Cash Index and comply with the following Standards:

- Short-term
  - For periods less than five years or a full market cycle, the Total Cash Equivalents Allocation should exceed the returns of the KRS Cash Index.
- Intermediate & Long-term
  - For periods greater than five years or one market cycle, the Total Cash Equivalents Allocation should exceed the KRS Cash Index and compare favorably on a risk-adjusted basis. Volatility, as measured by the standard deviation of monthly returns, should be comparable to the Index.

X. Investments Performance Review Procedures

On a timely basis, but not less than quarterly, the Investment Committee, on behalf of the Board of Trustees, will review the performance of the portfolio for determination of compliance with this

Statement of Investment Policy. On an annual basis, a comprehensive review of each asset class and underlying portfolios shall be conducted by the staff and presented to the Investment Committee. The review shall consist of an organizational, performance and compliance assessment.

The Compliance Officer shall perform tests each month to assure compliance with the restrictions imposed by this policy. These tests shall be performed at the asset class and total fund level. Quarterly, the Compliance Officer shall prepare a report to the Investment Committee detailing the restrictions tested, exceptions, the cause of the exception and the subsequent resolution. The Investment Committee shall report the findings to the Board of Trustees at the next regularly scheduled meeting.

The following restrictions shall be tested monthly:

- The amount of stock in the domestic or international equity allocation in any single corporation shall not exceed 5% of the aggregate market value of the Systems' assets.
- The amount of stock held in the domestic or international equity allocation shall not exceed 3% of the outstanding shares of any single corporation.
- The amount of stock in any one industry in the domestic equity allocation shall not exceed 10% of the aggregate market value of the Systems' assets.
- The amount invested in emerging markets shall not exceed 30% of the Systems' international equity assets. Investments in emerging markets shall be made primarily in countries included in the MSCI Emerging Markets Index. Investment in "frontier" markets (those countries not included in the MSCI EM Index) shall not exceed 10% of the System's international equity assets.
- The duration of the total fixed income portfolio shall not deviate from the KRS Fixed Income Index by more than 10%.
- The duration of the TIPS portfolio shall not deviate from the KRS TIPS by more than 10%.
- The amount invested in the debt of a single corporation shall not exceed 5% of the total market value of the Systems' assets.
- No public fixed income manager shall invest more than 5% of the market value of assets held in any single issue short term instrument, with the exception of U.S. Government issued, guaranteed or agency obligations.
- The amount invested in SEC Rule 144a securities shall not exceed 7.5% of the market value of the aggregate market value of the Systems' fixed income investments.

The Chief Investment Officer shall develop a comprehensive set of investment guidelines for each externally managed account. These guidelines should ensure, at the total fund and asset class level, that the restrictions set forth above are preserved. The Compliance Officer shall perform tests each month to assure compliance with the guidelines. Quarterly, the Compliance Officer shall prepare a report to the Investment Committee detailing the restrictions tested, exceptions, the cause of the exception and the subsequent resolution. The Investment Committee shall report the findings to the Board of Trustees at the next regularly scheduled meeting

XI. Additional Items

A. Proxy Voting

The Board of Trustees reserves the right to direct the Chief Investment Officer, or designee, to vote proxies in accordance with the Investment Committee Proxy Voting Policy, which is hereby incorporated by reference.

B. Brokerage Policy

The Investment Committee brokerage policy is hereby incorporated by reference.

C. Transactions Procedures

The Investment Committee transaction procedures are hereby incorporated by reference.

D. Securities Litigation Policy and Procedures

The Investment Committee securities litigation policy and procedures are hereby incorporated by reference.

E. Securities Lending Guidelines

The Investment Committee securities lending policy and procedures are hereby incorporated by reference.

F. Securities Trading Policy for Trustees and Employees

The Kentucky Retirement Systems trading policy for Trustees and employees is hereby incorporated by reference.

As Adopted By
The Board of Trustees
Kentucky Retirement Systems
May 20, 2010

Randy Overstreet Date 5/20/10
Randy Overstreet
Chair, Board of Trustees

Vince Lang Date 5/20/10
Vince Lang
Chair, Investment Committee

Kentucky Retirement Systems
Appendix A: Addendum to the Statement of Investment Policy
Pension Fund – Asset Allocation

This addendum to the investment policy is issued by the Board of Trustees of Kentucky Retirement Systems (Systems) in connection with investing the pension funds of the Kentucky Employees Retirement System, the County Employees Retirement System and the State Police Retirement System. This document supersedes all prior documents entitled Addendum to the Statement of Investment Policy.

I. Asset Allocation

KRS Pension Fund - Asset Allocation

Asset Class	Target	Allowable Range
Domestic Equity	30.0%	20-50%
International Equity	20.0%	10-30%
Fixed Income - TIPS *	10.0%	0-15%
Fixed Income - Market *	20.0%	12-32%
Fixed Income - High Yield *	5.0%	0-10%
Alternative Investments	12.0%	1-15%
Cash Equivalents *	3.0%	1-15%

* At no time will the Systems' assets have less than 18% of the total allocated to the combination of fixed income and cash equivalents.

As adopted by the Board of Trustees Kentucky Retirement Systems: May 20, 2010

Randy Overstreet Date 5/20/10
Randy Overstreet
Chair, Board of Trustees

Vince Lang Date 5/20/10
Vince Lang
Chair, Investment Committee

Kentucky Retirement Systems

Appendix B: Addendum to the Statement of Investment Policy
Pension Fund – Performance Index Key

This addendum to the investment policy is issued by the Board of Trustees of Kentucky Retirement Systems (Systems) in connection with investing the pension funds of the Kentucky Employees Retirement System, the County Employees Retirement System and the State Police Retirement System. This document supersedes all prior documents entitled Addendum to the Statement of Investment Policy.

I. Performance Index Key

KRS Pension Fund Index	
S&P 500	6.00%
S&P 1500	27.20%
Russell 2000	4.00%
MSCI World Ex-US	12.00%
MSCI AWCI Ex-US	4.00%
MSCI EM	2.00%
MSCI AWCI Ex-US Small Cap	2.00%
Barclays Capital Aggregate	20.00%
Barclays Capital TIPS Index	10.00%
BC High Yield Corp	9.80%
Cit Grp 3-mos Treasury	3.00%

KRS Domestic Equity Index	
S&P 500	20.00%
S&P 1500 (Total)	67.00%
Russell 2000	13.00%

KRS International Equity Index	
MSCI World Ex-US	60.00%
MSCI AWCI Ex-US	20.00%
MSCI Emerging Market	10.00%
MSCI AWCI Ex-US Small Cap	10.00%

KRS Total Equity Index	
S&P 500	12.00%
S&P 1500 (Total)	40.00%
Russell 2000	8.00%
MSCI World Ex-US	24.00%
MSCI AWCI Ex-US	8.00%
MSCI Emerging Market	4.00%
MSCI AWCI Ex -US Small Cap	4.00%

KRS Core Fixed Income Index	
Barclays Capital Aggregate	100.00%

KRS High Yield Index	
Barclays Capital High Yield Corp	100.00%

KRS TIPS Index	
Barclays Capital TIPS Index	100.00%

KRS Total Fixed Income Index	
Barclays Capital Aggregate	57.14%
Barclays Capital High Yield Corp	14.29%
Barclays Capital TIPS Index	28.57%

KRS Alternatives Index	
Barclays Capital High Yield Corp	40.00%
S&P 1500 (Total)	60.00%

KRS Venture Capital Index	
Russell 3000 + 500 bps	100.00%

KRS Private Equity Index	
Russell 3000 + 300 bps	100.00%

KRS Total Real Estate Index	
NCREIF Index	100.00%

KRS REIT Index	
EPRA/NAREIT Global Index	100.00%

KRS Cash Index	
Cit Grp 3-mos Treasury	100.00%

As adopted by the Board of Trustees Kentucky Retirement Systems: May 20, 2010

Randy Overstreet Date 5/20/10
Randy Overstreet
Chair, Board of Trustees

Vince Lang Date 5/20/10
Vince Lang
Chair, Investment Committee