Kentucky Hospital Association
Retirement Plan

Investment Policy Statement

ORGANIZATION

The plan referred to herein is a non-contributory defined benefit pension plan, covering employees of Kentucky Hospital Association and its subsidiaries.

PURPOSE

The purpose of this investment policy statement is to define the investment objectives of the Kentucky Hospital Association Retirement Plan. It will be used as a guideline by the Retirement Plan Committee, Finance and Budget Committee and all investment managers overseeing any portion of these assets.

INVESTMENT OBJECTIVES

The following investment objectives, listed in priority order, will be applied in the management of the Association's funds.

1. **SAFETY** – The primary objective of the Association investment activities is the protection of Association funds. This Preservation of Principal will be accomplished by setting procedures to control risks and diversify investments among specific security types, maturities and financial institutions.

2. **YIELD** – The Association will strive to maximize the return in a way that is consistent with the objectives presented above.

INVESTMENT PERFORMANCE GOALS

The following investment objectives shall be monitored by the Committee and/or staff on a quarterly basis and it is intended that they be achieved, <u>net of fees, over five-year moving periods</u>.

1. The total return is expected to exceed the Consumer Price Index plus 5 percentage points annually.

2. The total return is expected to exceed a Balanced Index composed of 60% equities and 40% fixed income.

3. The total return is expected to maintain volatility (beta) of no more than 1.20 times that of the Balanced Index and maintain a positive risk-adjusted performance (alpha).

EVALUATION OF INVESTMENT MANAGERS

The investment managers will be reviewed on an ongoing basis and will be evaluated based upon the following criteria:

1. Continuity of personnel and practices at the firm.
2. Adherence to the philosophy and style which were articulated to Kentucky Hospital Association at, or subsequent to, the time the investment manager was retained.
3. Ability to exceed the investment performance (net of fees) of other investment managers who adhere to the same or similar style.
4. Ability to exceed the investment performance objectives (net of fees) stated below:

Balanced Managers

a) The total return of each manager's portion of these assets is expected to exceed that of a Balanced Index composed of a mix of the Standard & Poor's 500 Stock Index (domestic equities) and the Lehman Brothers Intermediate Government/Corporate Bond Index (fixed income) in the following percentages: 60% S&P 500 Index & 40% LB Intermediate Government/Corporate Index.

b) Each manager is expected to maintain volatility (beta) of no more than 1.20 times that of the Balanced Index and maintain a positive risk-adjusted performance (alpha).

c) Each manager will be evaluated versus a universe of balanced managers and is expected to rank in the top one-half of this universe over a 5-year period.

Equity Managers

a) The total return of each manager's portion of these assets shall exceed that of the manager's corresponding index: either the Standard & Poor's 500 Stock Index (domestic large-cap), the Russell 2000 Index (domestic small-cap), or the Europe, Australia and Far East Index (international).

b) Each manager is expected to maintain volatility (beta) of no more than 1.20 times that of the manager's corresponding index: either the Standard & Poor's 500 Stock Index (domestic large-cap), the Russell 2000 Index (domestic small-cap), or the Europe, Australia and Far East Index (international) and is expected to maintain a positive risk-adjusted performance (alpha).

c) Each manager will be evaluated versus a universe of equity managers with a similar investment style and is expected to rank in the top one-half of this universe over a 5-year period.

Fixed Income Managers

a) The total return of each manager's portion of these assets shall exceed that of the Lehman Brothers Intermediate Government/Corporate Bond Index.

b) Each manager is expected to maintain volatility (beta) of no more than 1.20 times that of the Lehman Brothers Intermediate Government/Corporate Bond Index and is expected to maintain a positive risk-adjusted performance (alpha).

c) Each manager will be evaluated versus a universe of fixed income managers and is expected to rank in the top one-half of this universe over a 5-year period.

For all investment managers, performance will be monitored (net of fees) using a five-year moving average. However, the Committee may evaluate any investment manager over a shorter-term basis using the criteria in this section and make any necessary changes regarding investment management.

ASSET ALLOCATION

The allocation of funds among the various investment categories shall be determined by the Committee and monitored on a quarterly basis to reflect the following structures for each plan.

Investment Category	Minimum	Target Mix	Maximum
Fixed Income	30%	40%	50%
Equities	50	60	70

PRUDENCE AND ETHICAL STANDARDS

1. The "prudent person" standard shall be used by investment officials in the management of the overall investment portfolio. Personnel included in the Association's investment activities shall not be held personally liable for changes in market value, credit risk or other investment risks inherent in the portfolio, or damages and losses incurred by the Association, while acting in good faith on behalf of the Association utilizing the Prudent Investor Rule. The Association will defend same against third party claims arising from all investment activities carried out in the due course of business.

2. The "prudent person" standard is herewith understood to mean the following:

   Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probably income to be derived therefrom.

AUTHORIZED INSTRUMENTS

The Association shall utilize the following classes and types of investments when investing and reinvesting Association funds in its control or possession:

1. **U.S. Government Securities**; Negotiable direct obligations, or obligations the principal and interest of which are unconditionally guaranteed by, the United States Government. Such securities will include the following:
   a) Treasury Bills
   b) Treasury Notes
   c) Treasury Bonds
   d) Treasury Strips

2. **U.S. Federal Agencies**; Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by United States agencies, provided such obligations are backed by the *full faith and credit* of the United States Government. Such securities will include the following:
   a) Government National Mortgage Association (GNMA)
   b) GNMA – guaranteed mortgage-backed bonds
   c) GNMA – guaranteed pass-through obligations

3. **U.S. Federal Instrumentalities**; Bonds, debentures, notes or other evidences of indebtedness (such as Collateralized Mortgage, Obligations for 3 and 4 below) issued or guaranteed by United States Government agencies which are *non-full faith and credit* agencies limited to the following:
   a) Federal Farm Credit Bank (FFCB)
   b) Federal Home Loan Bank or its district banks (FHLB)
   c) Federal National Mortgage Association (FNMA)
   d) Federal Home Loan Mortgage Corporation (Freddie-Macs) including Federal Home Loan Mortgage Corporation participation certificates.

4. **International Securities**; Non-dollar denominated investments including Eurobonds, foreign bonds, floating rate notes, Euro-commercial paper, foreign equities (including American Depository Receipts (ADRs) are authorized for use.

Outstanding international securities shall not comprise more than 10% of any investment manager's portfolio unless that investment manager has been specifically directed by an appropriate oversight committee to invest solely in international or global securities.

5. **Certificates of Deposit**; Non-negotiable interest bearing time certificates of deposit or savings accounts in banks organized under the laws of this state, in national banks organized under the laws of the United States and doing business and situated in this state, in savings and loan associations which are under state supervision or in federal savings and loan associations located in this state and organized under federal law and federal supervision, provided that any such deposits are secured by a public depository authorized under Kentucky statutes.

6. **Repurchase Agreements** which are comprised of only those securities authorized in Sections 1, 2 and 3.

7. **Banker's Acceptances** which are issued by the top 100 banks according to the American Banker's yearly report.

8. **Commercial Paper** which is rated, at the time of purchase, A-1 by Standard and Poor's and P-1 by Moody's.

9. **Corporate Obligations** issued, assumed or guaranteed by any solvent institution created or existing under the laws of the United States, or of Canada, or of any state, province, district, or territory, which are not in default as to principal or interest and if no obligation of the institution has been in default as to principal or interest during the five (5) years preceding the investment. These obligations must be rated "A" or higher by Standard & Poor's and Moody's.

10. **Preferred or Common Stock** of any solvent institution organized and existing under the laws of the United States or Canada, or of any state or province thereof.

11. **Mutual Funds**; Securities of or, other interests in, any open-end or closed-end management type investment company or investment trust registered under the Investment Company Act of 1940, 15 U.S.C. SS 80 a-1 et seq., as amended from time to time, provided the portfolio of such investment company or investment trust is limited to only those securities authorized in Sections 1 through 9 above. Further provided such investment company or investment trust takes delivery of such collateral either directly or through an authorized custodian.

RISK AND DIVERSIFICATION

Adequate diversity will be necessary to minimize market risk. The Association will diversify use of investment instruments to avoid incurring unreasonable risks inherent in over-weighting the portfolio in specific instruments, individual financial institutions or maturities.

INVESTMENT MANAGER GUIDELINES AND RESTRICTIONS

1. Each investment manager shall have full investment discretion with regard to market timing and security selection, as it pertains to the established guidelines.

2. Any investment manager shall immediately notify management in writing of any material changes in its investment strategy, ownership, organizational structure, financial condition or senior personnel.

3. The investment managers should be prepared to meet with Kentucky Hospital Association at least semi-annually.

4. Statements should be supplied quarterly by the investment manager to designated principals of Kentucky Hospital Association, including (a) the fund composition (asset mix at cost and at market), (b) listings of the portfolio holdings at both cost and at market, and (c) all cash transactions, including buys, sells and sources of interests and dividends.

5. Securities transactions should be entered into on the basis of best execution, which normally means best realized price.

6. There shall be no investments deemed to be in violation of the Prohibited Transactions Standards of The Employment Retirement Income Securities Act (See ERISA Section 406).

7. There shall be no investments in (a) privately placed or non-marketable securities or (b) lettered, legend or other so-called "restricted" stock.

8. Any investment manager's fixed income portfolio must have a weighted average credit rating of AA or better by Standard & Poor's or Aa or better by Moody's rating services. Also, no investment manager shall purchase a security rated below investment grade (BBB or Baa).

9. If any security held in an investment manager's portfolio becomes an unauthorized investment subsequent to purchase, the investment manager must immediately notify management and submit a written analysis of the security to the Committee providing a recommendation for holding or disposing of such security.

10. Each investment manager must assure that the total exposure to any individual issuer shall not exceed 5% of the manager's portfolio, at aggregate cost value, with the exception of securities issued by the U.S. Government (and its agencies).

11. Securities are to be diversified both as to sectors and industries as well as to number of holdings with no more than 30% of the portfolio at the time of purchase invested in securities of corporations in any one industry. Also, concentrating in industries or companies all of which are sensitive to a single economic or political event or investment idea should be avoided.

12. Investment Maturity/Duration: "Maturity" shall mean the time from valuation date to the date of expected repayment of principal; "duration", the present value weighted average time to full recovery of principal and interest payments, shall mean Macauley's duration adjusted for implied options. Investment managers shall make these estimations for all issues, particularly self-amortizing issues.

    a) The duration of any Retirement Plan fixed income portfolio shall be between 2 and 5 years.
    b) The maturity of individual fixed income issues shall be restricted to 15 years unless self-amortizing in which case the average life is to be 15 years or less.

PENSION COMMITTEE REVIEW

This statement of investment policy shall be reviewed annually. Investment performance will be reported to the Committee on a quarterly basis. Outside investment managers are welcome to provide suggestions regarding appropriate adjustments to this statement or the manner in which investment performance is reviewed.