COMMONWEALTH OF KENTUCKY
COUNTY OF FRANKLIN CIRCUIT COURT
DIVISION I
Case No. 21-CI-00020

TIA TAYLOR, ASHLEY HALL-NAGY and BOBBY ESTES, as Members and Beneficiaries of Trust Funds of the KENTUCKY RETIREMENT SYSTEM, Its Pension Funds and Insurance Trusts on Behalf of all Tier 3 Members/Beneficiaries — PLAINTIFFS

vs.

FIRST AMENDED CLASS ACTION COMPLAINT BY "TIER 3" MEMBERS OF THE KENTUCKY RETIREMENT SYSTEMS PLEADING A CLASS ACTION FOR TIER 3 MEMBERS/ BENEFICIARIES OF THE KENTUCKY RETIREMENT SYSTEM

DEMAND FOR JURY TRIAL

KKR & CO., L.P., HENRY R. KRAVIS, GEORGE R. ROBERTS, PRISMA CAPITAL PARTNERS, L.P., GIRISH REDDY, BLACKSTONE GROUP L.P., BLACKSTONE GROUP INC., BLACKSTONE ALTERNATIVE ASSET MANAGEMENT, L.P., J. TOMILSON HILL, STEPHEN A. SCHWARZMAN, PACIFIC ALTERNATIVE ASSET MANAGEMENT COMPANY, LLC, JANE BUCHAN, R.V. KUHNS & ASSOCIATES, INC., CAVANAUGH MACDONALD CONSULTING, LLC, ICE MILLER, LLP, WILLIAM S. COOK, MICHAEL RUDZIK and KKR & CO. INC. — DEFENDANTS

ELECTRONICALLY FILED

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I. INTRODUCTION AND OVERVIEW

1. This is a class action brought on behalf of current and former Tier 3 members of the Kentucky Retirement Systems ("KRS")[1] asserting their ***direct claims*** (*i.e.*, not derivative claims) against the Defendants for breaching fiduciary and other duties; aiding and abetting breaches of fiduciary and other duties by other persons; conspiracy; and (with regard to certain Defendants) civil violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961–1968. Plaintiffs Tia Taylor, Ashley Hall-Nagy and Bobby Estes seek to certify a class and to recover, for the class, compensatory damages, punitive and/or treble damages, equitable relief, attorneys' fees and associated expenses, pre- and post-judgment interest and such other relief as may be available in connection with the facts to be proved at trial.

2. Plaintiffs are individuals in "Tier 3" of the KRS pension and insurance plans/trusts, which is a classification denoting rights, benefits and obligations common to persons hired on or after January 1, 2014 by public employers participating in KRS (and to certain "Tier 2" members who have voluntarily opted into Tier 3). The class consists of all persons who are or have been Tier 3 members or beneficiaries to the date hereof, and who have been damaged by the conduct alleged herein.

3. The Defendants are the "Hedge Fund Sellers,"[2] who created and sold billions of unsuitable, high-risk, high-fee funds of hedge funds to KRS and certain of KRS's investment and fiduciary advisors, each of whom (a) participated in the

[1] KRS has recently been renamed the Kentucky Public Pension Authority ("KPPA"). References to "KRS" mean and include, as context requires, Kentucky Retirement Systems, KPPA, CERS, KERS and SPRS.

[2] "Hedge Fund Sellers" means KKR, Prisma, Blackstone, and PAAMCO, and their top officers as further defined below.

transactions, actions and omissions complained of, (b) induced the Trustee of the plans/trusts[3] (acting through certain KRS officers, employees and trustees) to breach trust and other duties as alleged, (c) aided and abetted each other and the Trustee to breach duties as alleged, and/or (d) pursued a conspiracy and common course of conduct and joint enterprise aiding and abetting and damaging Plaintiffs and the Tier 3 class members. The claims made are based on Kentucky pension law, trust law, common law, other Kentucky statutory laws and the federal RICO statute.

4. In the wake of the Financial Crisis of 2008-09, in which KRS lost billions of dollars on toxic mortgage-backed securities and other exotic Wall Street investments, thus deepening its severely underfunded status, KRS's trustees and investment staff decided to make huge bets on ***even more exotic and opaque Wall Street products***, especially hedge funds, as they sought to invest their way back to financial health despite explicit warnings that doing so would entail ***unreasonable risk***. They took these unreasonable risks knowingly, in a long-shot effort to avoid the political pain and consequences that would flow from the need to make up the losses with ever greater portions of taxpayer funds. *Forbes* wrote the following on June 28, 2018:

Kentucky Retirement Systems: A Case Study of Politicizing Pensions

> Kentucky is in the midst of a financial crisis. The Kentucky Retirement System (KRS), is responsible for the pensions of more than 365,000 current and retired state and local government employees, … and at least one recent headline said it succinctly: "***Unfunded Pensions Could Spell Disaster for Kentucky***."

[3] The KRS board of trustees was the legislatively-designated "Trustee" of the KRS trust funds.

> This is not new. The KRS Board of Trustees has been trying to deal with this looming pension crisis since the mid-2000s.
>
> ***
>
> Leaders of KRS are required through their fiduciary duty to provide "accurate and truthful information regarding KRS financial and actuarial condition." Trustees instead took the moral low-ground and mislead pensioners — all for the sake of politics. By hiding the true status of the fund, these officials were able to hold their offices and coerce the public into believing that they were acting in the best interest of the people. ***In reality***, ***KRS leadership acted only in self-interest***, ***leaving future generations in the state to pay for their mistakes because of poor investment decisions***.

Former Governor Bevin agreed, stating: "***This was a morally negligent and irresponsible thing to do***," … "***criminal***" and KRS's CEO "***should be in jail***."

5. Opportunistic Wall Street hedge funds were well aware of the political and financial quandary in which KRS and other public pension funds found themselves at that time — and well prepared to take advantage of it by marketing Goldilocks-type products to the funds, hedge fund products designed to support the ***high-return/low-risk fantasy needed to forestall demands for more taxpayer funding***. In an opinion piece entitled *Hedge-Fund Mediocrity Is the Best Magic Trick (Never have so many investors paid so much for such uninspiring returns)*,[4] financial writer Barry Ritholtz neatly summed up the mutually supportive dishonesty of hedge fund titans in search of over-sized profits and public pension officials in search of a way to kick the pension funding can down the road:

> Hedge funds have accumulated $3 trillion, with a substantial portion of it coming from public pensions. That these funds

[4] Barry Ritholtz, *Hedge-Fund Mediocrity Is the Best Magic Trick*, BLOOMBERG OPINION, Feb. 15, 2018, *available at* https://www.bloomberg.com/opinion/articles/2018-02-15/hedge-funds-underperform-yet-keep-attracting-pension-fund-money (last visited July 6, 2021).

don't deliver outperformance is almost beside the point. ***What they are selling is an inflated estimate of expected returns***. ***This serves a crucial purpose for elected officials***, ***letting them lower the annual contributions states and municipalities must make to the pension plans for government employees***. It is a dodge that everyone goes along with. When the bill comes due in a few decades, this will cost taxpayers a bundle.

* * *

The continuing puzzle is why hedge funds continue to be so successful in selling their underperforming products, especially to public-pension plans. We have looked at the issue before, and have considered the principal-agent problem — in other words, those with no skin in the game make the investing decisions for those who do. Pondering that puzzle has led to a few surprising conclusions.

The best explanation I can find is this: Those who manage pension plans and pools of assets put money into hedge funds based on expected returns, not actual performance. The likely expected rates of return for hedge funds have proven to be works of fiction, fantasies made up out of whole cloth. There simply is no rational basis for making the claim that hedge funds will deliver an expected return higher than equities.

* * *

This is the heart of the problem. ***Pension-plan managers aren't dumb***; ***but as I noted at the start***, ***there is an obvious reason they intentionally buy a false promise of higher returns***.

In the end, taxpayers lose in three different ways: First, they pay much higher investment fees than they would via other available options — and those fees act as a drag on returns. Second, there's the outright underperformance mentioned above. And third, the public is on the hook for making up the unfulfilled promises made to state employees, including teachers, firefighters, police and other government workers.

The result is a ticking time bomb that will go off at some point and that can only be dealt with through either unimaginable tax increases or stiffing government employees who worked hard in the expectation they would have enough money for a secure retirement.

> In the past, I've summed up the bargain that hedge funds offer investors thusly: ***Come for the high fees***, ***stay for the underperformance***. It is funny because it was true, though I'd add one other element: Taxpayers and pension funds get duped in the process. There is no other explanation for why there is so much money parked in so many expensive funds with subpar returns.

6. KRS is possibly the most extreme example of what happens when relatively unsophisticated public pension trustees are driven by short-term political need into the grasp of greedy hedge fund titans. As described below in detail, the initial fund of hedge fund ("FoHF") purchases were ***greased with deep insider connections***. PAAMCO and its CEO Jane Buchan had deep ties to KRS's then-CIO Adam Tosh (who, not incidentally, assured Buchan well in advance that PAAMCO would be one of the funds that KRS would select). Prisma was, if anything, better positioned; former Prisma employee David Peden was on the KRS investment staff and able to help his friend and mentor Bill Cook — a senior executive and co-owner of Prisma — score the $400 million initial sale despite Prisma's small scale and short track record. Blackstone already had tentacles into the KRS investment staff through relationships formed around other, non-hedge fund, investments.

7. The Hedge Fund Sellers spent months creating and nurturing relationships of trust and confidence with KRS investment staff (and advisors) – becoming, in the words of PAAMCO's Buchan, "***trusted advisers***" — before sealing the deal. In other words, the Hedge Fund Sellers took on ***common law fiduciary duties*** as they worked to seduce the admittedly receptive KRS and were bound by these fiduciary duties when they negotiated and signed the Limited Partnership Agreements creating the hedge fund vehicles and the subsequent Subscription Agreements (all of

which agreements were deemed Confidential — secret — and thus remained hidden from public view until exposed during the *Mayberry* litigation). The Hedge Fund Sellers, however, violated those duties by among other things including unreasonable and, in some instances, unlawful provisions in those agreements, such as the provisions purporting to shift to KRS the responsibility for assessing "suitability," despite the Hedge Fund Sellers' knowledge that KRS had neither the information nor the expertise to make these suitability assessments. In other words, the Hedge Fund Sellers required provisions in the secret contracts that purported to have the effect of shifting fiduciary obligations from the Hedge Fund Sellers back onto KRS — while at the same time publicly stating that they acknowledged the fiduciary duties they had secretly tried to slip out of.

8. The Hedge Fund Sellers also built an ***unreasonably high***, ***indeed rapacious***, ***fee structure*** into their agreements, negotiated and collected in violation of fiduciary duties. To this day, the total fees paid to (or retained by) the Hedge Fund Sellers and their chosen sub-funds have never been revealed publicly, and the Hedge Fund Sellers have fought desperately to prevent public disclosure. Based on academic studies and the few available pieces of evidence, it is not unreasonable to assume that the hedge funds have charged fees of 50% or more of gross returns — in other words, the Hedge Fund Sellers kept as much as 50 cents or more of each dollar "earned."[5]

[5] While hedge fund fees are paid in cash, "returns" are often just on paper and sometimes disappear before the investments are liquidated.

9. After selling high "expected returns," the Hedge Fund Sellers' actual net returns[6] were ***disastrous***, especially in view of the already-wounded status of the KRS funds. Notwithstanding the high risk and illiquidity of these hedge fund investments, their net returns trailed even those of KRS's low-risk Fixed Income portfolio. Far from helping KRS invest its way out of trouble, these hedge fund investments created even more. ***Only the Hedge Fund Sellers got rich***; ***KRS just got taken***. But it must be repeated — KRS was ***willingly taken***. KRS's investment staff (including in particular Tosh and Peden) led the Board into this ill-begotten breach of trust. The Hedge Fund Sellers, with their insider connections, were willing and indeed eager accomplices, as (for their own financial gain) they participated with and induced the Trustee (acting through its trustees, officers and agents) to commit breaches of trust, and aided and abetted each other and the Trustee in the same. Moreover, the misrepresentation and deception practiced by Prisma, Reddy and Cook, in league with Peden, to disguise the fiduciary duty sleight-of-hand in the Prisma Subscription Agreements, constitutes a "predicate act" for purposes of RICO liability, all as discussed in detail below.

10. Not content with the original $400+ million KRS investment (and a subsequent add-on), Prisma, KKR, Reddy, Cook and other related Defendants schemed and conspired with Peden (by this time, CIO of KRS) to take control of the entire $1.4 billion KRS hedge fund portfolio by (a) liquidating the PAAMCO and Blackstone hedge fund investments (even though both had outperformed Prisma); (b) adding another $300 million to KKR Prisma's Daniel Boone vehicle (thus directly benefitting Reddy,

[6] The Hedge Fund Sellers' claims relating to amounts "returned" need to be examined on a cash, not accrual, basis if they are to be credited.

Cook, Rudzik and other former Prisma owners in connection with earn-out payments from KKR); and (c) installing KKR Prisma personnel inside KRS to run the $800 million direct hedge fund portfolio, reporting only to the already-compromised Peden. One result of this scheme, to the detriment of and damage to the Plaintiffs and the Class, was to ensure that KRS would remain fully invested in hedge funds even as other public funds ran for the exits. In connection with and to effectuate this scheme, KKR Prisma and KRS signed a Confidential (secret, non-public) Advisory Services Agreement ("ASA") dated June 1, 2015, and an Amended Advisory Services Agreement ("AASA") dated April 8, 2016, both of which ***explicitly permitted KKR Prisma to actively self-deal with KRS trust assets for the business and financial benefit of KKR and Prisma***. The ASA and the AASA — and the self-dealing activities conducted by KKR and Prisma under their secret terms — were illegal and constituted breaches of trust by the Trustee, induced and participated in by KKR, Prisma, Peden, Reddy, Cook, Rudzik, Kravis and Roberts. Plaintiffs do not yet know precisely how and to what effect KKR and/or Prisma employed the "***license to self-deal***" contained in the ASA/AASA, but it is reasonable to estimate that the real value thereof should be counted in the tens of millions of dollars (or more), for which they now need to account. David Eager, who as a KRS trustee made the motion to approve completion of the series of transactions and the investment of the additional $300 million in KKR Prisma's Daniel Boone, permitted the self-dealing to continue and the ASA/AASA to remain secret after he became Executive Director of KRS in August 2016. Eager thus became and remained complicit in the scheme. With Eager as its ED, KRS has done nothing to require an accounting of these illicit gains, or of the several hundred million in hedge fund fees charged by the Hedge Fund Sellers and their chosen sub-funds.

11. The scheme identified in the preceding paragraph was also a part of the RICO violation described in more detail below, including in connection with "honest services fraud" involving a bribery scheme and very possibly kickbacks as well.

II. EVENTS LEADING TO FILING OF THIS CLASS ACTION

12. In December 2017, a derivative action on behalf of KRS and Kentucky's taxpayers was commenced in this court by certain KRS members against numerous defendants including some of the defendants sued in this case ("*Mayberry* Action"). The original plaintiffs in the *Mayberry* Action asserted similar (but not identical) legal theories, based on many (but not all) of the facts alleged in this case against several (but not all) of the Defendants sued here. The original *Mayberry* Action was pleaded ***derivatively*** on behalf of KRS and Kentucky taxpayers, and asserted only Kentucky law claims.

13. In November 2018, this court upheld the substantive claims contained in the First Amended Complaint ("FAC") filed in the *Mayberry* Action. On interlocutory appeal, in July 2020, the Kentucky Supreme Court reversed, solely on the ground that the Plaintiffs, all Tier 1 KRS members, lacked "constitutional standing," because their pension benefits were guaranteed by the state *via* the so-called "Inviolable Contract." The Supreme Court concluded that, despite well-pleaded allegations of "significant misconduct" by the defendants and huge investment losses suffered by KRS, these individuals had suffered "no injury in fact."

14. Upon remand, certain Tier 1 Plaintiffs moved to file an amended derivative complaint asserting, among other things, alternate grounds to support constitutional standing. This Court denied the motion as a matter of discretion. This Court however

permitted the Kentucky Attorney General to intervene (with an intervening complaint copied almost *verbatim* from the *Mayberry* derivative complaint):

> The intervening Complaint tendered by the Attorney General ***mirrors*** the original claims of the Plaintiffs that allege extremely serious violation of fiduciary and other common law duties on the part of certain KRS Board members and advisors and the defendant hedge fund managers engaged by the Board to manage these retirement investments. If those allegations are true, thousands of public employees have had their retirement savings depleted by investments that included self-dealing, exorbitant fees, conflicts of interest, and risky non-prudent investment strategies.
>
> Under the law, the hedge fund managers and officers, directors and advisors to the Kentucky Retirement Systems, who allegedly breached their fiduciary duties to the public, must be held accountable. Any party that breached its fiduciary duties and engaged in reckless conduct, conflicts of interest or self-dealing should be held accountable under the law.
>
> * * *
>
> This Court does not believe that the Kentucky Supreme Court intended its ruling in *Overstreet* to be applied so as to provide a free pass, or "get out of jail free" card, for fiduciaries who breached their duties to the public and the taxpayers.
>
> * * *
>
> … the Court notes that while the Original Plaintiffs lack standing to pursue their claims … each iteration of their Complaint contains allegations of severe misconduct and breaches of fiduciary duties of Defendants related to management of KRS assets. The Kentucky Supreme Court observed as much in Overstreet, recognizing that "Plaintiffs allege significant misconduct." *Overstreet*, 603 S.W.3d at 266. Fiduciary duties exist in all circumstances where there is a "special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence." *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 485 (Ky. 1991) (quoting *Security Trust Co. v. Wilson*, 210 S.W.2d 336, 338 (Ky. 1948)).

> ***Serious breaches of fiduciary duties have been alleged in this case, and the Court believes that statute, case law, the Civil Rules, as well as principles of equity and public interest, require that the factual allegations in this case — and the defenses asserted by all Defendants — should be adjudicated on the merits.***

15. Tier 3 KRS members (Plaintiffs herein), whose benefits are not guaranteed by the Inviolable Contract, later sought to intervene in the Kentucky case to continue to assert the ***derivative*** claims on behalf of KRS. In June 2021, without addressing their constitutional standing, this court denied the Tier 3 motion, holding that the Attorney General could adequately represent the interests of the Commonwealth and of KRS, "including any and all damages for any claims that might otherwise be brought derivatively by … pension fund beneficiaries (regardless of whether such beneficiaries are classified as Tier 1, Tier 2, or Tier 3)"[7] and thus that additional derivative claims or claimants were unnecessary.

16. The Attorney General did ***not***, however, purport to assert ***direct — as opposed to derivative — claims on behalf of Tier 3 KRS members***.[8] Nor have the Tier 3 Plaintiffs (or any other plaintiffs) previously attempted to state direct (as opposed to derivative) claims for the damages they suffered directly as a result of the wrongdoing alleged herein. No court has ruled on the Tier 3 Plaintiffs' direct claims. The claims now being asserted by the Attorney General cannot and will not provide full

[7] Attorney General's Amended Intervening Complaint ¶ 3. *And see* ¶ 1, to the same effect.

[8] Moreover, any attempt by the Attorney General to assert those direct claims, or to attempt to foreclose them through claim or issue preclusion or otherwise, would meet serious Due Process and other Constitutional impediments.

and complete relief for the direct damages suffered by the Tier 3 Plaintiffs and class they seek to represent herein.

17. Where — as here — a trustee has committed a breach of trust, trust beneficiaries may prosecute in their own right an action against third persons who, for their own financial gain or advantage, induced the trustee to commit the breach of trust; actively participated with, aided or abetted the trustee in that breach; or received and retained trust property from the trustee in knowing breach of trust. In other words, third parties who induce the trustee to commit a breach of trust incur liability directly to the beneficiaries; it is primarily the beneficiaries who are wronged and they are entitled under long-standing common law principles to sue directly. The Tier 3 Plaintiffs (whose pension and other benefits are not guaranteed by the state and whose benefits vary based on investment returns and plan expenses) have suffered both injury in fact and damages. They file this class action to recover their and the other Tier 3 class members ***individual compensatory and punitive damages and RICO treble damages*** on claims not being litigated by the Attorney General, and also obtain the requested equitable relief.

III. OVERVIEW OF THE KRS DISASTER AND DAMAGE TO TIER 3 PLAN MEMBERS

A. Background, Summary of the Wrongdoing and the Near Destruction of KRS

18. To protect Kentucky workers (who would be ***required*** to contribute their own monies to these pension trusts), Kentucky (i) created KRS to be overseen by trustees via the Kentucky Pension Law ("KPL"), (ii) designated KRS's pension assets as "***trust funds***," KY. REV. STAT. § 386B.10-020; (iii) established (in part) the ***legal duties*** of trustees, officers and other fiduciaries who dealt with KRS's funds, KY. REV.

STAT. §§ 61.645(15), 61.650(1)(c)–(d), as well as their statutory liability. KY. REV. STAT. § 61.645(15)(e)–(f).

19. In 2000–2001, the KRS pension and insurance plans (referred to variously as the "Pension Plans" or "Plans" or "Trusts," "Trust Funds" or "Funds") overseen and managed by KRS for 390,000 present and former state and local government employees — police officers, clerks, janitors, prosecutors, correction officers, social workers, librarians, *etc.* — ***were over 100% fully funded***, ***in part*** with ***a*** $***2 billion surplus***.

20. As of 2016–2017 the KRS Funds/Plans were gravely impaired financially and in danger of failing. They had become the ***worst-funded public pension plans in the United States***. The largest of the Pension Plans (KERS non-hazardous), which was 139% funded in 2000, had only 13% of the money it needed to pay the billions of dollars it owed — had a mere one-tenth of the funding it had. Its insurance trust had just 36% of the monies it needs to cover billions in insurance obligations. This fund's assets had fallen to just $1.9 billion, yet it has to pay out almost $1.0 billion in benefits each year going forward for decades. The overall KRS funding deficit of $29–30 billion was much larger than the Funds' total assets of $17 billion. The collective KRS $2 billion surplus was gone and had been replaced by a $29 billion deficit. It is very likely that one or more of the Plans/Funds will fail in the future, and that spill-over effects will further impair all KRS Plans, leading to a systemwide restructuring and curtailments for all unprotected benefits, including the unguaranteed benefits of Tier 3 Members.

21. One KRS advisor stated that the largest Plan will be insolvent "***in very short order***." KRS's executive director has admitted the KRS funds were in a "***death spiral***" which it "***cannot invest itself out of***." Another official admitted in 2017 that

absent a massive taxpayer bailout, "***the funds will fail*** … ***the run-out date — the date when the fund would be depleted*** … ***has shrunk to two years and 10 months***." In 2019 the Kentucky Governor said the KRS Funds are "***essentially bankrupt***."[9]

22. The long course of egregious misconduct of the KRS trustees and officers ("T/Os") and Defendants caused the impaired financial condition — and severely underfunded status of the KRS funds, ultimately damaging the Tier 3 Plaintiffs. Not only has it substantially increased the risk that one or more of the KRS plans/trusts will fail, creating and enhancing the risk of the entire plan defaulting, this misconduct has also caused the named Plaintiffs and Tier 3 class members "injuries in fact" and monetary damages.

23. KRS currently administers plans with three differing benefit structures. Tier 1 and 2 Members are, in general, public employees hired before 2014. Tier 3 Members were hired after January 1, 2014.[10] Persons who became KRS members after January 1, 2014 — about 100,000 individuals, 20+% of all KRS plan participants — receive Tier 3 benefits. ***They have suffered individual injury and damage caused by poor investment returns*** (***involving inter alia defendants' hedge funds***) ***and wasteful expenses which have reduced/lowered their yearly*** "***upside***" ***credit and their ultimate pension benefits***, ***all the result of the***

[9] While the KRS funds remain badly financially impaired and dangerously underfunded, complete collapse has been avoided for the time being because of ***vastly increased*** employer contributions and ***increased support*** payments by the State, and because ***finally KRS halted its disastrous multi-billion-dollar hedge funds adventure***.

[10] Some former Tier 2 members have voluntarily opted into Tier 3 and are part of the class in that latter capacity.

ongoing scheme, ***conspiracy and common enterprise of Defendants as alleged herein — and already upheld by the court in Kentucky***. In addition to the damage the Tier 3s have already suffered, they face a real risk of cuts in, or even the complete elimination of, ***all their pension and insurance benefits***, ***none of which are protected by*** "***inviolable contract***" ***statutes***.

24. Each Named Plaintiff has ***already suffered individual injury***, ***and is continuing to suffer injury due to Defendants***' ***alleged misconduct which has caused damage to Tier 3 class members well into 2018–20***. ***The damage will continue in coming years***, ***including as a result of*** "***under compounding***" ***of their already diminished individual accounts***, meaning the loss of compounding earnings on what should have been but were not credited to their individual accounts.

25. As KRS Plan participants, the Tier 3 Plaintiffs have contributed to and continue to contribute ***thousands of dollars of their personal funds*** to help fund KRS's ongoing operations and the KRS pension and insurance trusts. They are ***required*** to contribute between 5–9% of their pay annually into KRS's common investment pool. ***They are involuntary participants***. These Tier 3 employee contributions are comingled with KRS's other monies. Over the work career of a 20–30-year work life, these mandatory "contributions" of their own monies amounts to many thousands of dollars. *See* KY. REV. STAT. §§ 61.560(1), 61.691(1). While the Tier 3 contributions are "matched" by their employer, the retirement benefits provided to the public workers of Kentucky are ***not gifts***.

KRS Member Personal Contributions To Pension/Insurance Trusts Via Mandatory Payroll Deductions		
Yearly Gross Salary	**Personal Contribution Percentage**	**30 Year Worker Total Personal Contribution**
$40,000	5% $2,000	$60,000
	7% $2,800	$84,000
	9% $3,600	$108,000
$80,000	5% $4,000	$120,000
	7% $5,600	$168,000
	9% $7,200	$216,000
$120,000	5% $6,000	$189,500
	7% $8,400	$252,000
	9% $10,800	$324,000

26. Tier 3 Plan participants participate in a Hybrid Cash Balance Plan, which has characteristics of both a defined benefit plan and a defined contribution plan. This plan resembles a defined contribution plan because it determines the value of benefits for each participant based on ***individual accounts***. However, the assets of the plan remain in the single, ***comingled investment pool*** like a traditional defined benefit plan. Their final individual account balance, and thus their pension, depends on the stewardship of KRS's trustees and KRS's investment returns (and expenses) over the years. Unlike Tier 1 and 2 members, KRS Tier 3 members in return for higher contributions and completely unprotected benefits — even vested benefits — receive a minimum 4% annual return, plus an annual "upside" of 75% of KRS's investment returns over 4% computed on a 5-year basis and credited to their accounts. ***The "upside" credits of Tier 3 plan participants have been diminished each year since 2015 as a result of the poor performance (losses) and excessive fees attributable to the "Black Box" and other hedge funds, i.e., the alleged***

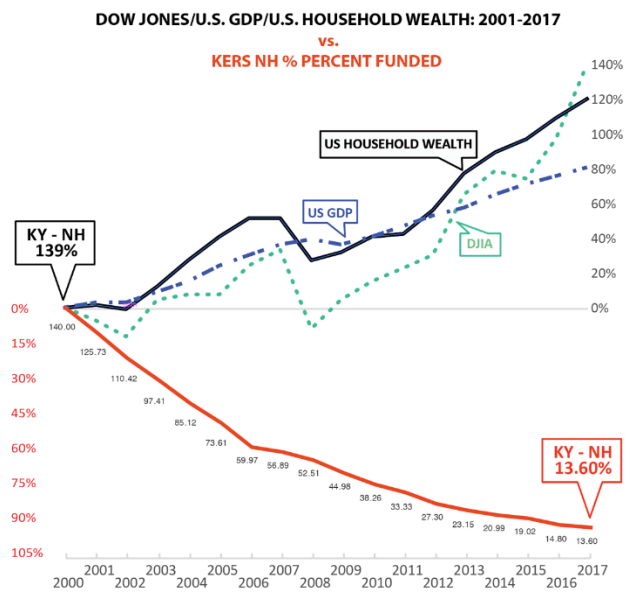
wrongdoing in this case. All Tier 3 members have ***already been injured due to the diminishment of their benefits as a result of the wrongdoing alleged***. ***They are entitled to recover those damages individually***.

27. KRS became badly underfunded in 2008–2009. The Hedge Fund Sellers were constantly watching for underfunded public pension plans which they targeted knowing their trustees were generally unsophisticated and that the plans are not subject to state regulation, and the trustees are or were often looking for high return vehicles to invest in to overcome funding shortfalls. The hedge fund sellers spotted this slow deer, targeted KRS and moved in. With the help of complicit and disloyal KRS insiders, the Hedge Fund Sellers became "trusted advisors" — even before being finally selected by the KRS Board — to help KRS find a way out of its predicament. Over the next several years, they plundered the KRS funds, sticking them with high-risk/low-return Black Box hedge funds and then later illegally taking control of KRS's entire hedge fund portfolio all while gorging on massive fees.

28. Now the Tier 3 Plaintiffs/Class Members are stuck in the worst-funded public retirement funds in the United States, and as active members are ***forced to continue to*** "***contribute***" ***their own earnings into the smoldering remains of what were once fully-funded plans***, which the Defendants helped destroy and where all of their benefits are completely unprotected.

KRS-NH PERFORMANCE vs. OTHER PUBLIC PENSION PLANS

VISUAL 1



Pension Fund	% Funded	Pension Fund	% Funded	Pension Fund	% Funded
Connecticut Municipal	86%	Missouri Local EES	95%	Sacramento Co. ERS	87%
Delaware State EES	89%	Missouri PEERS	86%	South Dakota EES	100%
TENN	93%	Missouri Teachers	86%	South Dakota EES	100%
Florida Retirement System	85%	Montana County EES	92%	Texas County	88%
Houston Fire Fighters	86%	Nebraska School EES	90%	Texas Court EES	88%
Iowa PERS	84%	New York State Teachers	87%	Texas Teachers	86%
Los Angeles Fire and Police	94%	North Carolina Local	95%	Washington School EES /Teachers	88-92%
Louisiana State Parochial	99%	North Carolina EES	91%	Washington, DC P&F	110%
Maine Local Govt. EES	86%	Oklahoma PERS	93%	Washington, DC Teachers	91%
Milwaukee City ERS	95%	Oklahoma Police	99%	Wisconsin EES	100%
Minnesota Police and Fire	88%	Pennsylvania Municipal	100%	KERS NH	13.6%

29. Disregarding a 2010 warning that KRS "***fac*[*ed*] *an appreciable risk of running out of assets in the next few years*" *and could not invest its way out of the crisis by taking more investment risk***, the T/Os and the Defendants took the very action they had been warned "***risked the fastest depletion of the plan's assets***" and "***substantially increas*[*ed*] *the chances of the catastrophic event of depleting all assets in the near future***." The T/Os and Defendants dramatically changed KRS's investment allocations to take on ***much more risk***, and in 2010–2011, bet $1.5 billion on highly risky, extremely expensive and unsuitable hedge fund vehicles which were effectively "Black Boxes." The T/Os and their advisors had also been explicitly warned in 2009 of the need to conduct "***thorough***" and "***extensive due diligence***" into these new, exotic, untested vehicles ***and*** into the backgrounds of the sellers, including using "***private investigators***." They ignored that warning as well.

30. Instead, the KRS T/Os bet big, putting 10% of KRS's assets — twice the 5% originally authorized — into what they told KRS members and Kentucky taxpayers were "***absolute return***" investments that would be "long-term driver[s] of Fund performance," with "***tremendous potential to exceed the Plan's actuarial return assumptions and historical returns***," expected net long-term returns of 7.5% or more, which could "***lower*** [***KRS's***] ***risks***" through "equity-like returns with bond-like volatility." These were highly risky Black Box hedge fund bets. And they lost big. They never achieved the expected returns for KRS over any 5-year period (but did deliver spectacular returns for the Hedge Fund Sellers). In just a few years, terrible Black Box returns (and losses exceeding $100 million in one year), plus "exorbitant fees," brought about the warned-against catastrophe, pushing KRS to the edge of insolvency. The T/Os had handed over $1.5 billion in trust funds to Wall Street hedge fund sellers with "***checkered pasts***" — ***littered with fraud and breach-of-duty lawsuits and a record of cheating their investors and partners***. This was directly contrary to the portentous 2009–10 warnings, and it was also a breach of the T/Os' duties to safeguard and prudently invest KRS's trust funds.

31. ***By 2011-2012***, ***the KRS funds were the worst funded in the United States***, with funding ***deficits nearing*** $***30 billion***, ***a situation caused by the course of misconduct complained of***. On February 6, 2013, *Lanereport.com* reported:

> **Kentucky Pension Shortfall A Potential Bankruptcy Bomb**
>
> Kentucky Retirement Systems (KRS) is underfunded by more than $30 billion ***and falling further behind***.
>
> ***

> According to the Institute for Truth in Accounting, the funding gap for the retirement systems has grown by roughly $3 billion in the past year alone, and the shortfall for the Kentucky Retirement Systems' six groups is over $30 billion .... A recent Pew Center on the States study describes the commonwealth's pension situation as "***unsustainable***" due to this liability and because KRS is paying out more than it is taking in.

32. The financial problems at, and the threat of failure of, KRS resulted in the creation of a new Hybrid Cash Balance Plan (Tier 3) with lower and ***entirely unprotected benefits***, ***but higher employee contributions of their own funds/earnings***.

33. As a result of the possible failure of the KRS funds, the legislature enacted major legislation impacting KRS, the KRS Funds, and the existing benefits all Plan members were entitled to. New state hires post-January 1, 2014 were involuntarily placed in a new Hybrid Cash Balance Plan ***required to pay increased personal contributions and denied inviolable contract protections for all of their benefits — pension and insurance — even vested benefits***.

34. KRS members ***including the new Tier 3 members*** were assured these legislative enactments changing the KRS benefit structure would fix the problems. After the 2013 Legislation was passed, then-Governor Steve Beshear referred to the new legislation as:

> ... a bipartisan agreement to solve the most pressing financial problem facing our state — ***our monstrous unfunded pension liability and the financial instability of our pension fund***.
>
> ***
>
> "As a result of this legislation, we fully honor the commitments made to state workers and retirees; address the financial uncertainty that threatened our state's credit rating.

35. However, due to Defendants' ongoing misconduct, KRS's funded status continued to decline. In late 2016, it came out that KRS's "absolute return" [Black Box] investments had ***lost over*** $***100 million in less than 12 months***. Independent eyes came on the KRS Board of Trustees and disrupted the conspiracy, curtailed the hedge fund misadventures, and exposed years of false statements, assurances and concealments as well as deliberate manipulation of KRS's financial and actuarial assumptions, which had long masked its true financial condition.[11]

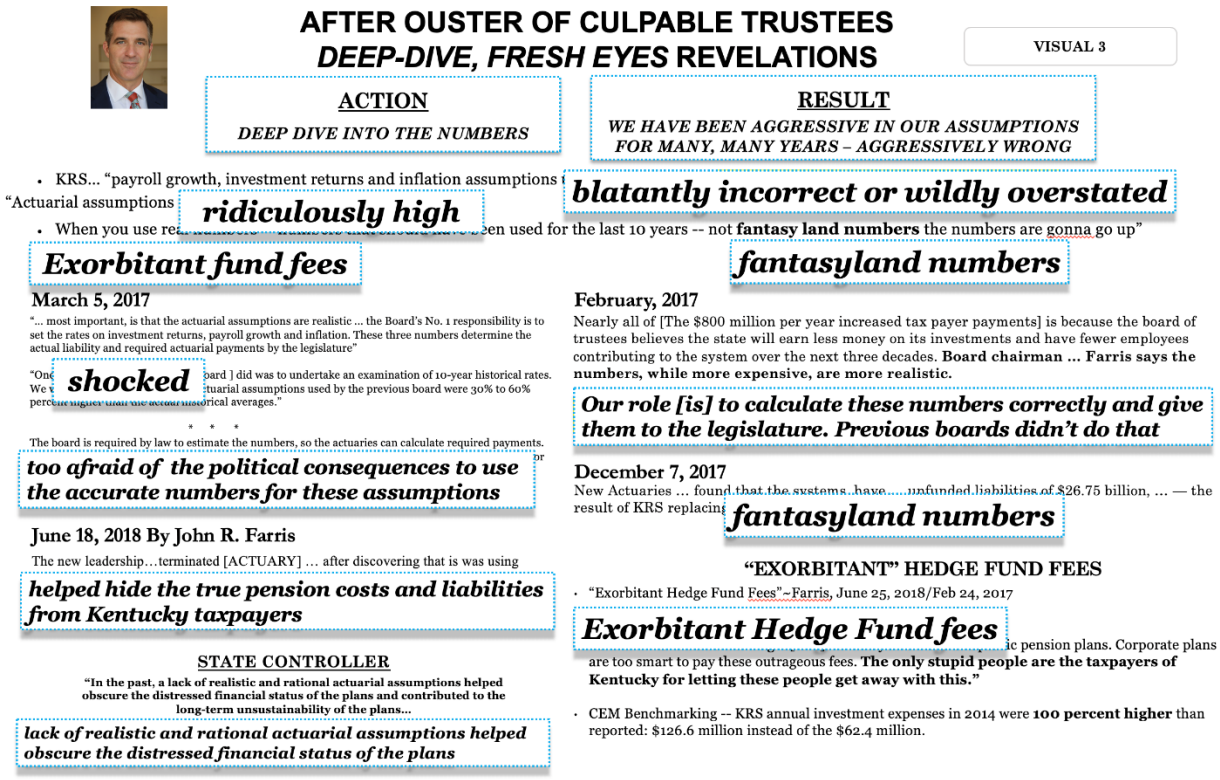
36. In 2016, certain new trustees conducted a "***deep dive***" into what had been going on inside KRS and were "***shocked***" by what they discovered. Based on their investigation, State officials and new trustees confirmed years of misconduct.

- that "***payroll growth, investment return and inflation assumptions***" were "***ridiculously high***, ***blatantly incorrect or wildly overstated***";
- that "***fantasyland numbers***" helped "***hide the true pension costs and liability from Kentucky taxpayers***" as the "lack of realistic and rational actuarial assumptions ***helped obscure the distressed financial status of the plans***";
- that "***past assumptions were often manipulated***" and "[t]he result was to provide a ***false sense of security*** and justify smaller than necessary contributions to the pension plan — ***a morally negligent and irresponsible thing to do***";
- that "[w]e have been aggressive in our assumptions for many, many years — ***aggressively wrong***," which "led to this, accumulation of billions in unfounded liability" because the prior Board "***was too afraid of the political consequences to use the accurate***

[11] As discussed in more detail below, even the 2016 "deep-dive" failed to discover or to publicize the continuing misconduct and significant wrongdoing by KKR Prisma and its associated Defendants — along with former Chief Investment Officer Peden, former Executive Director Thielen and current Executive Director David Eager — in connection with the secret and unlawful ASA and AASA, which allowed KKR Prisma and KKR to self-deal with KRS assets for their own profit, a key part of the scheme and conspiracy and discovery of which was required to be able to properly, ethically plead a RICO claim.

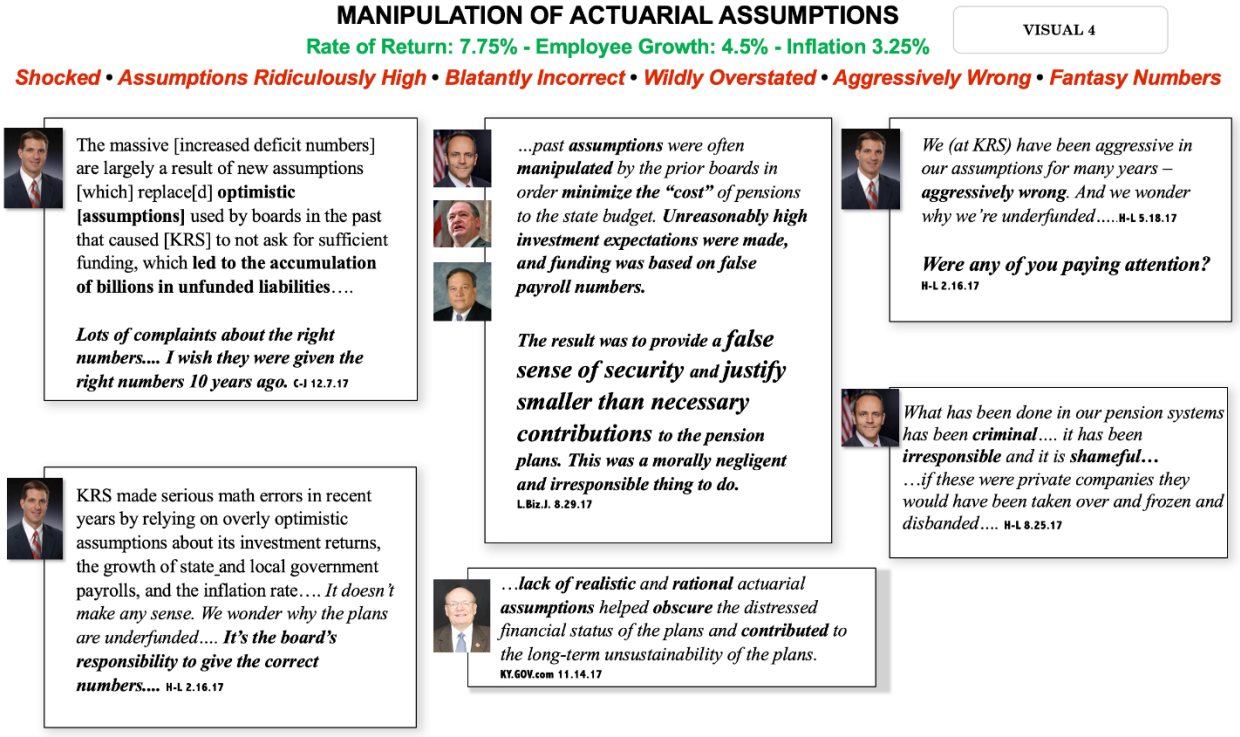
numbers for these assumptions"; and

- that "[***w***]***hat has been done in our pension system has been criminal … irresponsible and it is shameful***."



37. The Commonwealth's three highest elected officials laid bare the misconduct by the KRS Trustees:

> "The biggest cause of the shortfall was erroneous actuarial assumptions made by past members of the [B]oards..., which led to significant underfunding .... [P]ast assumptions were often ***manipulated*** by the prior pension [B]oards in order to minimize the "cost" of pensions to the state budget. Unreasonably high investment expectations were made and funding was based on ***false*** payroll numbers.
>
> The result was to provide a false sense of security .... ***This was a morally negligent and irresponsible thing to do***."



38. The KRS plans/trusts have never recovered. Today, they remain the worst funded plans in the United States — because of the course of misconduct and concerted action by Defendants beginning in or before 2009 that decimated KRS and its pension and insurance funds, almost destroying them until the conspiracy was disrupted in late 2016. Unfortunately, the damage inflicted on the Tier 3 class members continues — and will continue indefinitely.

B. The Defendants' Wrongful Course of Conduct and Conspiracy

1. Investment Losses and False Actuarial Assumptions Plunge KRS into a Crisis in 2009–2010

39. Between 2001 and 2009, the funded status of the KRS Funds declined due to large investment losses, which severely damaged KRS's investment portfolio and demonstrated that the 7.75% Assumed Annual Rate of Investment Return ("AARIR")

the Trustees had been using for years was unrealistic and would never be consistently achieved. By 2009–2010, the Trustees were facing accelerating retirements, requiring KRS to pay out increasing amounts to longer-living retirees while slowing government hiring — meaning fewer new hires, *i.e.*, less new money coming into the Plans. Billions in investment losses and deteriorating demographics had hurt the funds. The T/Os were trapped in a financial/demographic vise.

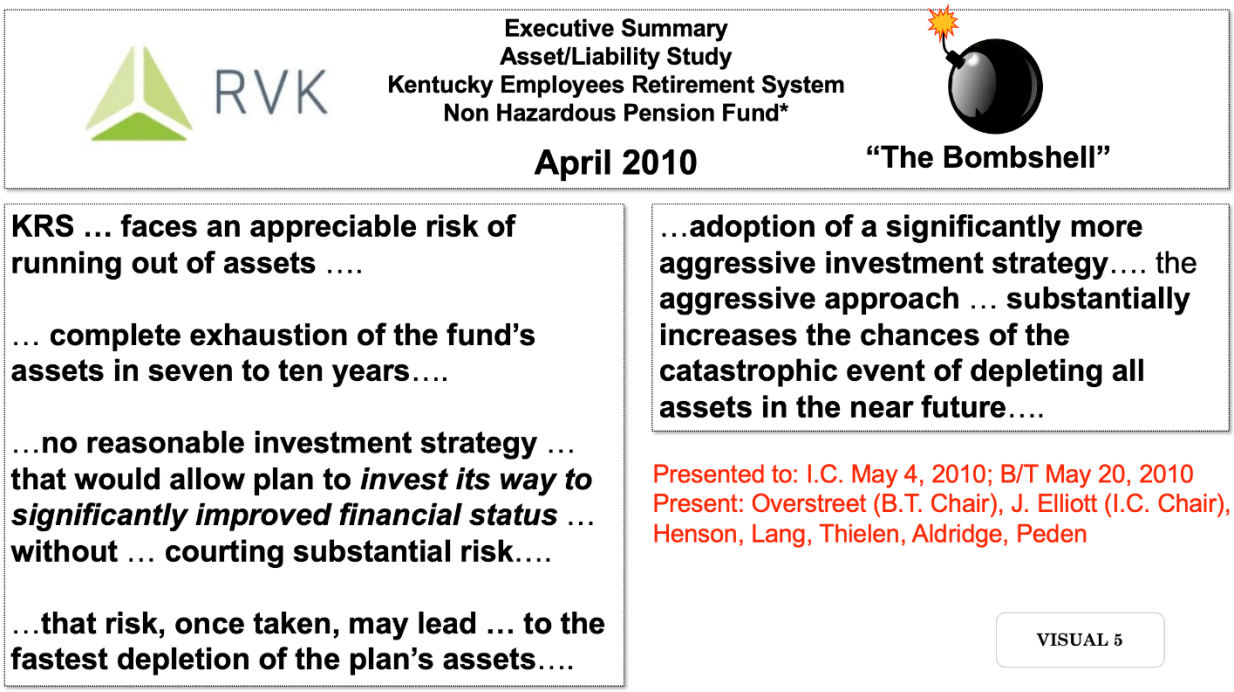
40. In the midst of the 2009–2010 crisis, the T/Os were also engulfed by the infamous placement agent kickback scandal,[12] which would result in firings and demotions of KRS insiders implicated in these dubious activities. Audits uncovered $13 million in "***suspicious payments***" to "placement agents" who had received kickbacks in return for getting KRS investment monies placed. Exposure of this unsavory practice at public funds erupted into a national scandal. Several pension fund figures and fixers went to jail. In Kentucky, Park Hill Group — controlled by Blackstone and/or some of its executives — received one of the largest "suspicious payments," over $2 million. As a result of this scandal, KRS's CIO and CEO/ED were both fired. Overstreet, longtime Board Chair, was demoted.

41. This scandal, and related firings, gutted KRS's staff and deprived the Trustees of the kind of staff support needed at this critical time. ***The sophisticated Hedge Fund Sellers were already stalking the KRS funds because their business plans focused on underfunded public pension plans and they knew the Trustees were dealing with internal turmoil and staff turnover***

[12] Crit Luallen, *Examination of Certain Policies, Procedures, Controls, and Financial Activities of Kentucky Retirement Systems*, June 28, 2011, *available at* https://kyret.ky.gov/About/Internal-Audit/Documents/2011%20State%20Audit.pdf (last visited July 6, 2021).

[***as well as***] ***new, inexperienced investment staff and would be unusually dependent upon their expertise and sophistication***.

42. Confronting KRS's threatened financial status in the midst of this "suspicious payments" scandal and personnel pandemonium, the T/Os received a liquidity study. That April 2010 "***Bombshell***" report warned that KRS "***faces an appreciable risk of running out of assets in the next few years***," and there was "***no prudent investment strategy that would allow KRS to invest its way to significantly improved status***." It warned that increasing the risk level of investments to try to invest KRS out of the hole "***substantially increases the chances of the catastrophic event of depleting all assets in the near future***." The Hedge Fund Sellers learned of the contents of the Bombshell report.



43. Notably, in evaluating investments a few years earlier, the KRS Board's Investment Committee ("I.C.") — then headed by Susan Horne (who left the Board) — had rejected hedge funds as an unsuitable investment for the life savings of the

Kentucky workers and taxpayer funds the Trustees were sworn to protect. The I.C. concluded KRS was "***not interested in hedge funds***" from a "***fiduciary standpoint***" due to "***red flags***" including "***higher risk***."

KRS REJECTS HEDGE FUNDS IN 2006

VISUAL 6

April 24, 2006
KRS INVESTMENT COMMITTEE MEETING

- *Need to be concerned about the **PERCEPTION** from members, legislators, or other public officials.*
- *Concern from **FIDUCIARY STANDPOINT** - hedge funds **UNCONSTRAINED**.*
- ***FUNDS WILL NOT TELL INVESTORS WHAT THEY DO*** [or] ***WHAT POSITIONS THEY HOLD***.
- **SELL ASSETS THEY DO NOT OWN**.
- **HAVE HIGHER RISK AND EXPOSURE.**

Present: Overstreet, Henson, Thielen, Aldridge

- ***ENOUGH RED FLAGS ABOUT HEDGE FUNDS – NO NEED TO GO ANY FURTHER.***
- **[KRS]** ***NOT INTERESTED IN HEDGE FUNDS***

44. The Defendants worked together to overcome — reverse — this prudent decision to not get involved in hedge funds so that they could exploit KRS's financial distress by selling their purportedly "high yield" "safe" hedge funds. Working together with others, the Defendants exploited the T/Os' disregard of both the Bombshell report's warnings and the prior decision to avoid hedge funds. The "***catastrophic event of depleting all assets in the near future***" came very close to occurring in due course, and that grave danger remains today.

2. The Forecasted Financial Catastrophe Followed the Trustees/Officers' 2011 Purchase of $1.5 Billion in High-Risk Black Box Hedge Funds

45. As the T/Os searched for a way out of that financial and actuarial vise, and while in the midst of internal scandal and disorganization, KRS presented a tempting

"honeypot" for the high-powered Hedge Fund Sellers. The Hedge Fund Sellers knew KRS T/Os were dealing with a much more serious situation than was known by the public. They targeted KRS to sell it risky and expensive "Black Boxes." They custom-designed "Black Box" fund-of-funds vehicles for KRS and named them the "Henry Clay Fund," the "Daniel Boone Fund" and the "Newport Colonels Fund."

46. Ignoring the Bombshell report's dire warnings, the Trustees turned to these Wall Street financial houses who targeted underfunded public funds as unsophisticated targets. They sell high-fee, high-risk hedge funds and pocket large annual management fees *regardless of investment performance*, in addition to large "incentive fees." These Hedge Fund Sellers targeted KRS as part of their business plans, which focused on public funds — especially underfunded funds.[13] They did this due to the combined factors of little government oversight of public funds, the relative lack of sophistication of public fund trustees and officers, and the huge amount of monies available for "investment," *i.e.*, the "honey pot."[14] A former KRS trustee said: "These funds can't get [high fees] from anywhere besides public pension plans. Corporate plans are too smart to pay these outrageous fees."

47. At the instigation and ***with the assistance of the Hedge Fund Sellers***, in August 2010, the T/Os and the Hedge Fund Sellers dramatically changed

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[13] *See* Gary Rivlin, *The Whistle Blower: How a Gang of Hedge Funds Strip-Mined Kentucky's Public Pensions*, THE INTERCEPT, Oct. 21, 2018, *available at* https://theintercept.com/2018/10/21/kentucky-pensions-crisis-hedge-funds/ (last visited July 6, 2021).

[14] *See* Gary Rivlin, *A Giant Pile of Money: How Wall Street Drove Public Pensions into Crisis and Pocketed Billions in Fees*, THE INTERCEPT, Oct. 20, 2018, *available at* https://theintercept.com/2018/10/20/public-pensions-crisis-wall-street-fees/ (last visited July 6, 2021).

KRS's investment allocations to allow them take on much more risk. The T/Os rejected a "more conservative" portfolio because it would not project out future investment returns at 7.75%, fearing that since KRS "***members do not understand sophisticated market strategies***," "***they won't understand a lower rate of return***" which "***will create anxiety***." So, the T/Os picked a "***more aggressive***" strategy "***with higher projected returns***" that projected out investment returns over 7.75% — even though they knew that was impossible to achieve — because it would "***look better***" — and (more to the point) because it would camouflage and thus forestall the need for increased taxpayer funding.

KRS Investment Allocations Changed to Accept Hedge Fund Sellers' High-Risk/High-Fee Blackbox Hedge Funds

AUGUST 12, 2010 - I.C. MEETING
AUGUST 19, 2010 - B.T. MEETING

VISUAL 7

INVESTMENT COMMITTEE BOARD OF TRUSTEES MEETINGS – TRUSTEES CHANGE KRS INVESTMENT ALLOCATIONS – GO AGGRESSIVE/ADD RISK

- **Present: Overstreet (B.T. Chair), Lang (I.C. Chair), J. Elliott, Longmeyer, Henson, Aldridge, Peden, Thielen**
- Portfolio 1 – "more conservative" but will earn **less** than 7.75%
- INVESTMENT ADVISOR recommends "more conservative" portfolio - Trustees reject.
  - **Trustee Lang: "KRS members do not understand sophisticated market strategies" – "Won't understand lower rate of return"**
  - **Trustee Lang: "Portfolio 1 has lower rate of return" – will create "ANXIETY" among members**
- **Trustees go aggressive – select Portfolio 2**
  - **Portfolio 2 – "more aggressive" "more aggressive" "more aggressive" – will earn over 7.75%**
  - **Trustee Overstreet: "go with Portfolio 2 because of the higher projected returns" – WILL LOOK "BETTER"**

NEW ALLOCATION OF KRS TRUST FUNDS

- **Absolute Return – Black Box Fund of Hedge Funds – 100% increase – 0% to 10% – $1.5 billion**

CREATES AN APPARENT ANNUAL RATE OF RETURN OF 7.93%

48. The T/Os then sold off much of KRS's solid income-producing investments to fund these highly risky, super-expensive "absolute return" hedge fund purchases. The T/Os sold off 34% of KRS's good stocks, 53% of its fixed-income investments and 100% of its U.S. Treasuries. This giant $1.5-billion bet — 10% of KRS's funds — resulted in, by

far, the largest single and riskiest investment KRS ever made and it turned out to be a disaster which helped cripple the KRS pension and insurance Plans/Trusts, ultimately damaging the Tier 3 class members.

49. The T/Os recklessly gambled, and chose to cover up the true extent of the KRS financial/actuarial shortfalls and take longshot imprudent risks … to try to catch up for the Funds' prior losses. In 2009, the Trustees had been warned that these new exotic "absolute return" products and their sellers required "***thorough***," "***extensive due diligence***."

THE 2009 WARNING REQUIRING EXTENSIVE THOROUGH DUE DILIGENCE INTO ABSOLUTE RETURN VEHICLES AND SELLERS

VISUAL 8

To: Investment Committee

From: KRS Investment Staff

Presented to Feb 3, 2009 I.C. Meeting
Present: Henson, Lang, Overstreet, Thielen, Aldridge

Date: February 3, 2009

Subject: KRS Absolute Return Strategy Allocation

Recommendation: It is the recommendation of the KRS Investment Staff and Consultant that the Investment Committee approve an initial allocation **of up to 5.0% of the Fund's assets to be invested in absolute return strategy fund-of-funds ("FOF").**

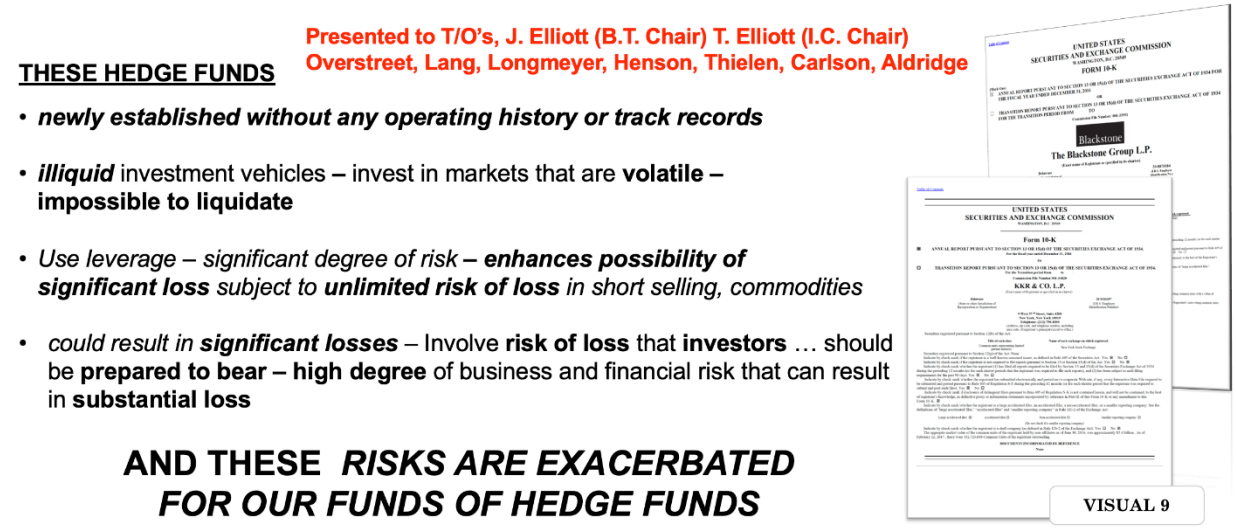
Risks: … structural risks are the primary concerns faced by absolute return fund–of–funds … Structural risks often entail risks to the organization or the operations of the absolute return strategies …they cannot be eliminated … structural risks can be monitored and controlled by ensuring that extensive due diligence of the manager is conducted. Thorough due diligence may entail the use of private investigator checks on manager …

50. In 2010, the T/Os had put over $100 million into the first "absolute return" vehicle Arrowhawk, a startup, which folded quickly under a cloud of controversy. A second speculative "investment" in Camelot collapsed when the owner was indicted. As these two speculative plunges blew up, a "tip" about payoffs in return

for investments led to the 2009–10 special audit that uncovered that millions of the "suspicious" payments were connected to these "investments."

51. In spite of this "absolute return" test run blowup, the "suspicious payments" scandal and the disruption of the KRS Board and staff, the T/Os and their assistors and co-conspirators acted in direct defiance of the April 2010 report's explicit warnings. In August-September 2011, they greatly increased the risk of KRS's investment portfolios by betting $1.5 billion in trust funds (10% of the Funds' assets) on "Black Boxes" — opaque vehicles that had *no prior investment performance*. The T/Os bet on the most exotic, risky, toxic and expensive type of hedge funds —***funds that invest in other hedge funds***. They are called "Black Boxes" because the investor does not know what downstream hedge funds invest the money in, or what the true fees are or how they are computed or shared among the various funds involved. The investor does not have any way to monitor the investing practices of the downstream funds or accurately value the holdings. "Black Boxes" are secretive because downstream funds claim their methods and strategies and fees are "proprietary" and will not share them. This was one reason KRS rejected hedge funds earlier and considered them unsuitable investments for trust funds.

52. The Hedge Fund Sellers have admitted in governmental filings ***that the Black Boxes were the riskiest products they had to sell***.



53. Due to the efforts of Buchan/PAAMCO – working with KRS's then Chief of Investment Officer Tosh during 2009–2010, and Cook's and Peden's efforts as well to become "***trusted advisors***" to KRS, the prior veto of hedge funds was overcome and Hedge Fund Sellers were successful in getting KRS to buy $1.5 billion of their Black Box Hedge Funds. The initial $1.5 billion in Black Box sales in 2011 were also polluted by serious conflicts of interest — illegal acts under Kentucky law. Cook (a hedge fund seller for Aegon/Prisma who would later in 2016 become a KRS Trustee as the course of misconduct and conspiracy progressed) was a key actor from the outset. Based in Louisville for Aegon for years, Cook became a partner in Wall Street-based Defendant Prisma (which later combined with KKR), and specialized in selling Black Boxes. Cook led the initial $1.5 billion hedge fund sales effort to KRS in 2010–11. KRS could not possibly have put an entire $1.5 billion in the hands of a single hedge fund seller. So, the Hedge Fund Sellers worked to get a shared "kill" — working together with Cook on the ground in Kentucky leading the effort to get KRS to commit $1.5 billion which the

Hedge Fund Sellers split equally between them. David Peden was Cook's friend who worked for years with Cook at Aegon and Prisma before going inside KRS in 2009 as a fixed-income investment officer. Nevertheless, Peden was quickly involved in selecting Prisma and handing over close to $500 million to Cook/Prisma for their single-investor "Daniel Boone Fund." At the time of the 2010–11 Black Box sales to KRS:

- Board Chair and I.C. member, Jennifer Elliott, was a partner at Louisville-based Stites and Harbison, lawyers for Aegon — which owned 68% of Prisma. Cook, who had been a senior executive at Aegon with long-time connections to Elliott and her firm — was in 2010–11 a top executive at Prisma based in Louisville and leading the Black Box sales effort; and

- Peden, a new KRS investment officer whose duties did not involve "alternative investments," but rather stodgy fixed income, was intimately involved in selecting Prisma and KRS's purchase of its risky/exotic "Daniel Boone Fund"; he had worked with Cook at Aegon and Prisma for years and was Cook's friend.

54. According to an August 2, 2011 KRS internal memo regarding the proposed sale of Prisma's Daniel Boone Black Box to KRS:

> Prior to joining Prisma, Cook was the head of the capital market strategies group at Aegon … focusing on alternative investments [hedge funds]. Also at AEGON USA, Cook was the head of the derivatives group ….
>
> * * *
>
> Conflicts of Interest — There are three known relationships between KRS Trustees/employees and Prisma Capital Partners; 1) KRS Board of Trustees Chair Jennifer Elliott's employer, Stites & Harbison, PLLC (but not Ms. Elliott), has provided legal work for Prisma co-owner Aegon Group; … and 3) KRS Fixed Income Director David Peden was previously employed by both Aegon Group and Prisma Capital Partners.

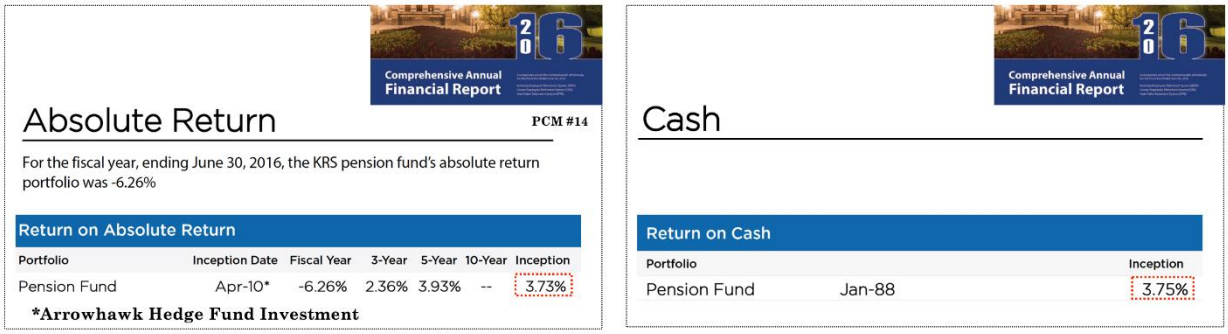
55. These relationships were flagged internally at KRS in September 2011 as "***conflicts of interest***." No further investigation took place. ***The conflict was never cleared***. It was concealed. The tainted Black Box hedge fund transactions

went forward — a key step in the course of misconduct that would go on for several years, enriching the Hedge Fund Sellers by hundreds of millions of dollars, ultimately injuring the Tier 3 Plaintiffs.

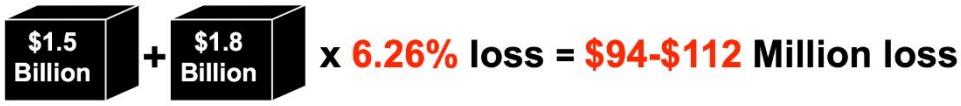
3. The $1.5-Billion Black Box Plunge Was a Financial Disaster, Helping Push KRS's Funds/Trusts to the Brink of Insolvency

HOW DID THE ORIGINAL BLACK BOXES DO?
WORSE THAN CASH

VISUAL 11



"Black Boxes"



56. The speculative Black Box plunge was a big loser. By 2016, despite the "exorbitant fees" paid to the Hedge Fund Sellers, these super expensive Black Boxes earned just 3.73% over their 5-6 year lives — ***less than the 3.75% KRS historically earned on its cash*** in the bank, and ***less than fixed income*** over comparable periods — ***during a time when the S&P 500 went up over 350%***. Then these funds lost over $100 million in less than 12 months in 2015–2016. Then they lost hundreds of millions more (–2.3%) in 2016–18 — ***as the S&P soared by another 30%***. The 2020 KRS Annual Report reflects that ***Absolute Return investments lost (0.13%) for the 5-year period ended June 30, 2020*** — a period during which these investments consisted primarily of Prisma's Daniel Boone Fund and direct hedge

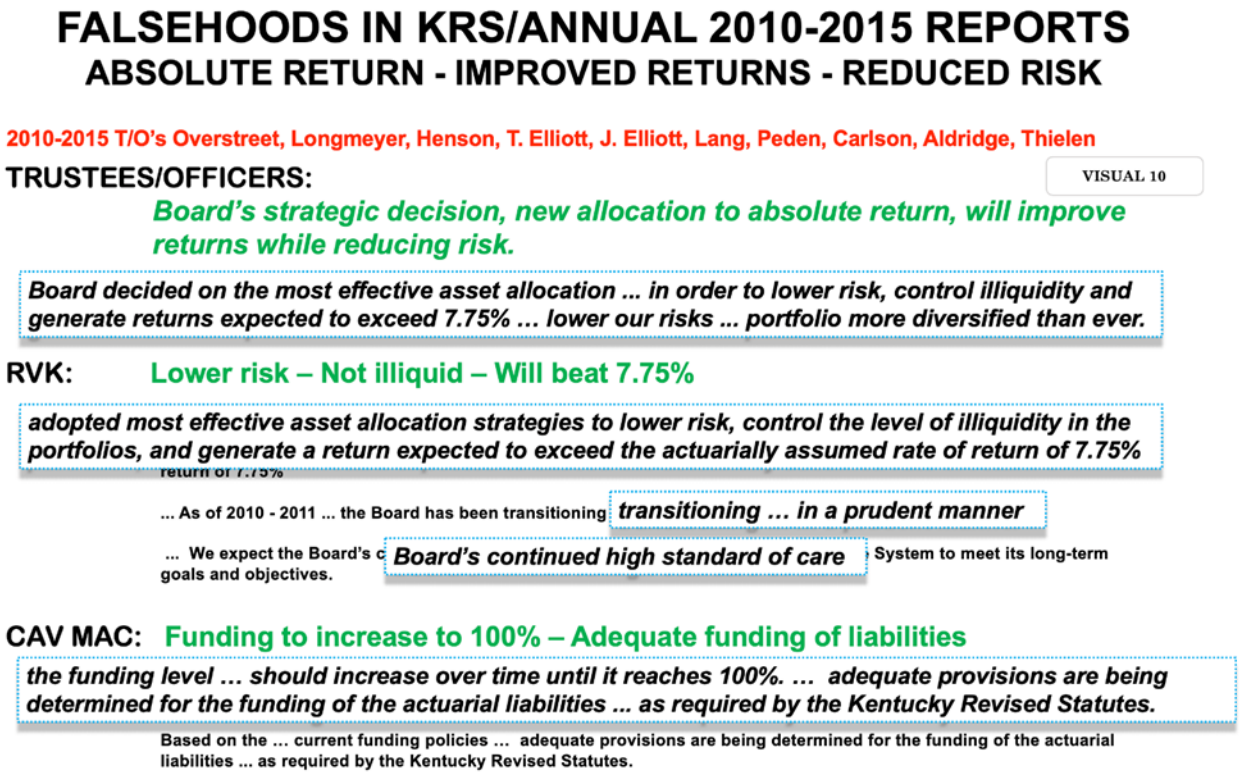
fund investments selected or approved by KKR Prisma – and underperformed even the Core Fixed Income investments over that period by almost 4%.[15] These were the exact sort of losses the "hedges," with their supposed "reduced volatility" and "safe diversification," were supposed to protect against. Along the way they consumed hundreds of millions of dollars in "exorbitant" fees. The investment opportunities missed because they were displaced by the hedge fund misadventure harmed KRS finances. All of this exacerbated KRS's underfunding, helped push it to the edge of insolvency, and damaged the Tier 3 Plaintiffs.

57. The Hedge Fund Sellers' predation on KRS continued into 2015–2016. The course of misconduct, aiding and abetting, common enterprise and conspiracy that came together in 2010–11, when William S. Cook (then a senior executive of Prisma) and David Peden (then a member of the KRS investment staff) worked together to help engineer the initial Black Box purchases, including the conflicted $400+ million Prisma Daniel Boone Fund, continued in 2015–2016 when KKR Prisma's Cook and Michael Rudzik worked in concert with Peden, by then KRS's Chief Investment Officer (CIO), to ***deliver control over KRS's entire $1.6 billion hedge fund portfolio to KKR — a Wall Street behemoth whose numerous interests conflicted with the interests of KRS and its members — and then allow KKR Prisma and its top executives to leverage that position for their own self-interested benefit, all to the damage of the Tier 3 Plaintiffs***.

[15] The 2020 Annual Report also reflects that ***Absolute Return trailed KRS's own U.S. Equities portfolio by almost 10% over the prior 10-year period*** (3.18% vs. 12.95%) — a huge difference and a huge difference-maker.

4. The Trustees/Officers, Their Advisors/Assistors and the Hedge Fund Sellers Lied to KRS's Members and Kentucky Officials

58. The T/Os reported the financial/actuarial status of KRS's funds via Annual Reports. KY. REV. STAT. 61.645(19)(m). During 2010–2015 the T/Os issued false and misleading Annual Reports and made other statements that were reviewed and approved by the Defendants. This created a "false sense of security" while covering up the course of misconduct and without which the scheme and conspiracy could not have gone on — and without which the Tier 3 Plaintiffs would not have been damaged.



59. Not only did these reports fail to disclose the truth, they deliberately misled KRS members, the public, and taxpayers about what the T/Os, the Hedge Fund Sellers and their assistors misleadingly described as new "absolute return" investments, suggesting they always provided positive returns — which they most certainly did not. False assurances were made that decisions had been taken "to diversify this portfolio to

improve returns while reducing risks," "adopted [the] most effective asset allocation strategies to lower risk," that the new "absolute return" investments would "lower [KRS's] risks," "reduce volatility," "control [the] level of illiquidity," thus making KRS's "portfolio … more diversified than ever," and were "expected to exceed the actuarial/assumed rate of return of 7.75%."

60. The trustees furthered the "false sense of security" by extolling their own "continued high standard of care," assuring KRS members, Kentucky taxpayers and the Legislature that "adequate provisions are being determined for the funding of actuarial liabilities" as required by law and "the funding level should increase over time until it reaches 100%." None of this was true. These false statements were part of the course of misconduct made to cover up Defendants' actions and false presentation of KRS finances and to permit the scheme and conspiracy of the Defendants to continue — allowing them to profit more.

5. The 2016–17 Disclosures and Near Collapse of the KRS Plans

61. The 2013 legislation, curtailment of certain benefits and creation of the new Tier 3 plan benefit levels did not halt the financial decline of the KRS funds. By 2016–17, the KRS Pension Plans were $28+ billion underfunded and facing collapse. After an internal "deep dive" in February 2017, the ***new Chair*** of the KRS Board, John Farris, was quoted as saying:

> KRS made serious math errors in recent years, relying on overly optimistic assumptions about its investment returns, the growth of state and local government payrolls. We have been aggressively wrong in our assumptions for many years ….
>
> It doesn't make any sense … We wonder why the plans are underfunded. It's not all the legislatures' fault. It's the board's responsibility to give the correct numbers. …

> Payroll growth was negative and you assumed 4% growth? Were any of you paying attention?

62. When the KRS year-end June 30, 2017 financial results were released, it was reported:

> "The massive dollar amounts came as no surprise and are largely a result of new assumptions ... lowering projections on how much the plans will earn on investments and on how much government payrolls are expected to grow."
>
> John Farris, [The New] Chairman of the Board, said the new assumptions replace optimistic ones used by boards in the past that caused Kentucky Retirement Systems to not ask for sufficient funding which led to the accumulation of billions in unfunded liabilities.
>
> "Now we're giving the right numbers. Lots of complaints about the right numbers. I understand it ... I wish it wasn't that way. I wish they were given the right numbers 10 years ago."

63. At the time these results were released, the State Budget Director stated:

> "In the past, a lack of realistic and rational actuarial assumptions helped obscure the distressed financial status of the plans and contributed to the long-term unsustainability of the plans ....

64. On February 16, 2017, the *Lexington Herald Leader* reported:

> **TROUBLED KENTUCKY PENSION SYSTEM MIGHT NEED BILLIONS MORE THAN ASSUMED**
>
> Kentucky Retirement Systems ... might be in far worse financial shape than previously thought.
>
> * * *
>
> KRS made serious math errors in recent years by relying on overly optimistic assumptions about its investment returns, the growth of state_and local government payrolls, and the inflation rates, KRS board chairman John Farris told his fellow trustees ....
>
> For example, KRS assumed that it would earn an average of 6.75 percent to 7.5 percent on money it invested, but it earned an average of 4.75 percent, Farris said. KRS assumed that

public payroll would grow by 4 percent a year through pay raises or more government hiring — a larger payroll means larger pension contributions by employees — but public payroll has dropped overall because of repeated budget cuts, he said.

"***It doesn't make any sense***," said Farris …. "***We wonder why the plans are underfunded***. ***It's not all the legislature's fault***. ***It's the board's responsibility to give the correct numbers***."

65. On May 18, 2017, the *Lexington Herald Leader* reported:

KENTUCKY'S PUBLIC PENSION DEBT JUST GOT BILLIONS BIGGER

Kentucky's public pension debt just got a few billion dollars bigger.

Under the new numbers presented to the board, KRS' official unfunded pension liability of $18.1 billion will increase by somewhere between $3.6 billion and $4.5 billion ….

* * *

Following Thursday's board vote, the primary state pension fund operated by KRS — known as the Kentucky Employees Retirement System (Non-Hazardous) — has only 13.81 percent of the money it is expected to need in coming years.

* * *

"***The most important function of our board is to give correct numbers to the legislature***," Farris said. "***If we don't do that***, ***if we continue to rely on aggressively optimistic assumptions***, ***then we will continue to fall behind***."

* * *

KRS had assumed that it would earn from 6.75 percent to 7.5 percent on money it invested; it assumed that public payroll would grow by 4 percent a year; and it assumed an inflation rate of 3.25 percent. All of those numbers look unrealistic.

* * *

"***We*** (***at KRS***) ***have been*** "***aggressive***" ***in our assumptions for many years — aggressively wrong***," Farris said. "***And we wonder why we're underfunded***."

66. During late 2016–2017, independent eyes got to look at what had gone on inside KRS for the past several years when the PFM investigation of KRS was commissioned by the Executive Branch. In September 2016, PFM issued the "PFM Report," which was described in media reports as follows:

> **KENTUCKY'S PENSIONS ARE WORST-FUNDED IN U.S., STUDY SHOWS**
>
> A new study shows that Kentucky has the worst funded pension system in the nation.
>
> And from another media report:
>
> The PFM Group today presented an alarming report to the Public Pension Oversight Board detailing the factors that made Kentucky's pension systems the worst funded systems in the United States. The report revealed that the systems have had a combined $6.9 billion negative cash flow since 2005 as benefits paid to retirees plus program expenses greatly exceeded appropriated funding. According to the report, if this negative cash flow is not corrected, the ability to make payments to current and future retirees is at risk … "PFM's analysis is the most comprehensive and detailed look at the many factors that contributed to the massive unfunded pension liabilities crippling our state," stated John Chilton, Kentucky's State Budget Director.

67. The Executive Branch of the Commonwealth has stated:

> ***The KRS and TRS plans have taken on significantly more investment risk over the last decade in order to chase unrealistically high investment returns***.
>
> When compared to other public plans, the KRS plans have had an allocation to riskier alternative investments that nearly double the peer average. Unfortunately, significant exposure to market risks still remains."
>
> * * *
>
> Billions in pension debt are growing in perpetuity … even if the plans earn their expected investment return ….

68. On August 24, 2017, the *Lexington Herald Leader* reported:

FORMER HEAD OF KENTUCKY RETIREMENT SYSTEMS 'SHOULD BE IN JAIL,' BEVIN SAYS

> Gov. Matt Bevin told a gathering of Kentucky's city and county leaders Thursday that the former executive director of the financially ailing Kentucky Retirement Systems ***deserves to be in jail***.
>
> * * *
>
> "***Bill Thielen should be in jail and that's a fact***. And I don't know who's here from the media but if this was a private company, if this was a private pension plan he would be."
>
> "It has been negligent, it has been irresponsible and it is shameful".
>
> "***What has been done in our pension systems has been criminal***," ***Bevin said*** … "***if these were private companies they would have been taken over and frozen and disbanded and the payouts of benefits would have been stopped by law***."[16]

69. In 2017, three of the highest elected officials of the Commonwealth, the Governor (Matt Bevin), the House Speaker (Jeff Hoover) and the Senate President (Robert Stivers) jointly wrote:

> "The biggest cause of the shortfall was erroneous actuarial assumptions made by past members of the boards of these systems, which led to significant underfunding …
>
> … [P]ast assumptions were often manipulated by the prior pension boards in order to minimize the "cost" of pensions to the state budget. Unreasonably high investment expectations were made and funding was based on false payroll numbers.

[16] Even then, there was no indication that Governor Bevin, Trustee Farris or PFM was aware of the secret terms of the ASA and the blatant self-dealing supposedly permitted thereunder. It remained a deep secret hidden well within KRS until plaintiffs' counsel discovered it during 2018 in the Kentucky litigation. To date, the extent and monetary value of the self-dealing in which KKR Prisma engaged through the ASA is unknown, as neither Prisma or KKR has made disclosures of the same. Nor is it known at this time whether any of the involved persons committed violations of KRS Ch. 521 in connection with the ASA.

> The result was to provide a false sense of security and justify smaller than necessary contributions to the pension plans. This was a morally negligent and irresponsible thing to do."

70. As their assets dwindled and funding levels fell and benefit costs soared, straining their liquidity, the ability of the funds to invest in rational long-term investments that hold the potential for higher returns — as well-funded, liquid pension plans can do — was lost. KERS and SPRS now had to hoard dwindling resources — being more conservative and cautious. Their investment strategy became preservationist.

71. In May 2017, *Pensions & Investments* reported:

> **Kentucky Retirement Systems Lowers Return Assumption to 5.25%**
>
> Along with the assumption changes, KRS' investment committee ***is recommending more conservative asset allocations*** ….

72. At the KRS Board of Trustees meeting in May 2017, the Board received a report that explained why these funds' investment options were so severely limited.

> **ILLUSTRATIONS ARE FOR KERS NON-HAZARDOUS PENSION**
>
> - June 30, 2016 market value of assets = $1.9 billion
> - 2015–2016 benefit payments = $0.9 billion
> - Assets represent two years' worth of benefit payments
> - High liquidity needs
> - High funding needs

73. In February 2018, it was publicly reported:

> **Kentucky Retirement System Earmarks $270 Million, Cuts Hedge Fund Managers**

> Kentucky Retirement Systems, … allocated up to $270 million total to three alternatives managers, said David Eager, interim executive director.
>
> ***
>
> ***The Kentucky Employees Retirement System non-hazardous pension plan and the State Police Retirement System were the only plans that did not participate in the new investments because they have low funding ratios and cannot afford to lock up capital*** ….

6. The 2015–2016 "Strategic Partnership" and Secret Advisory Services Agreement Yields More Self-Dealing and Losses

74. The predation on KRS continued into 2015–2016. The course of misconduct, aiding and abetting, joint enterprise and conspiracy that came together in 2010–11, when William S. Cook (then a senior executive of Prisma) and David Peden (then a member of the KRS investment staff) worked together to help engineer the initial Black Box purchases, including the conflicted $400+ million Prisma Daniel Boone Fund, continued in 2015–2016 when KKR Prisma's Cook and Michael Rudzik worked in concert with Peden, by then KRS's Chief Investment Officer (CIO), to ***deliver control over KRS's entire $1.6 billion hedge fund portfolio to KKR — a Wall Street behemoth whose interests conflicted with the interests of KRS and its members — and then allow KKR Prisma and its top executives to leverage that position for their own self-interested benefit, to the damage of the Tier 3 Plaintiffs***.

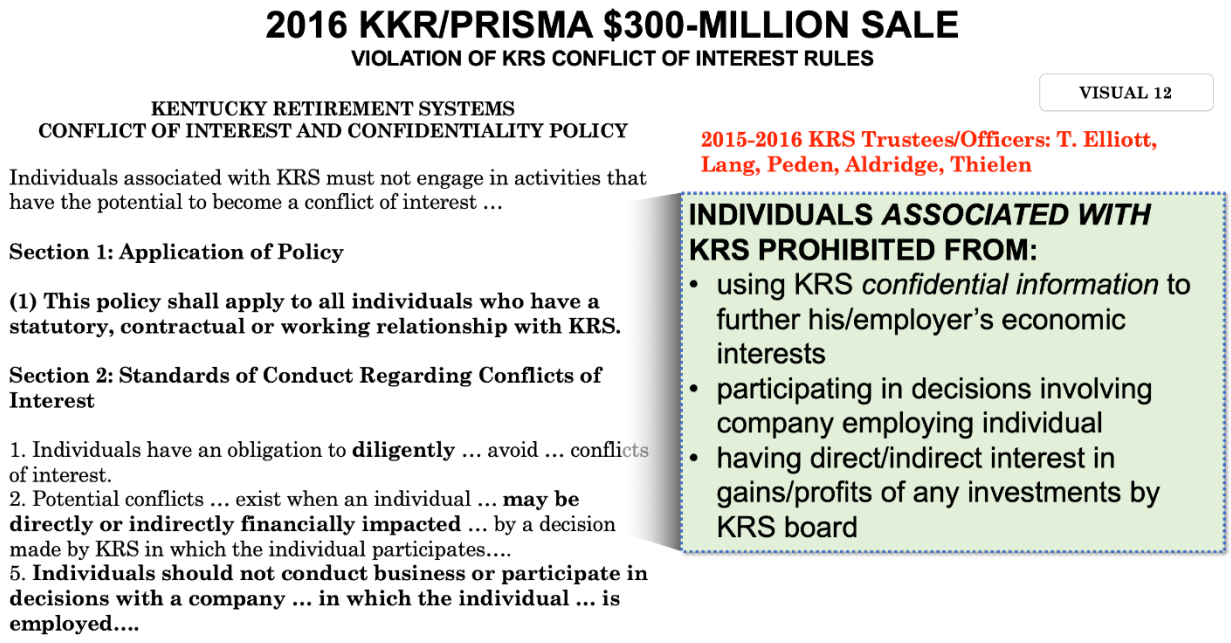
75. Cook and Peden convinced the Trustees to have KRS enter into a "Strategic Partnership" with KKR Prisma, through which another KKR Prisma executive (Michael Rudzik) and his team were "seconded" to KRS — inserted into — inside — KRS ***while still on KKR's payroll*** to "help" KRS with its investments. This KKR Prisma

team took over management and oversight of KRS's entire $1.6 billion hedge fund portfolio, answering only to the conflicted coconspirator Peden. And, under the secret (*i.e.*, confidential and non-public) ASA, KKR Prisma was allowed to use its fiduciary position and KRS assets for its own self-dealing profit, in violation of Kentucky law and KRS's Conflict of Interest Policy.[17]

76. With this KKR Prisma executive team ***illegally inside*** KRS and while other public pension funds were fleeing Black Boxes, KRS put $300 million more into the KKR Prisma Black Box (the biggest loser), and allowed the KKR Prisma team to manage KRS's other hedge fund investments and illegally profit from those activities. This was nothing less than a conflicted, insider-assisted takeover of KRS's absolute return investment portfolio, resulting in at least $***585 million*** in self-interested investments benefiting KKR Prisma.

77. By gaining the additional $300 million in its own losing Daniel Boone Fund, KKR Prisma helped itself at the expense of KRS at a time when the hedge fund industry was badly stressed and KKR Prisma needed more assets under management. Additionally, the transactions also benefitted Cook and Rudzik ***personally***, as they stood to receive millions of dollars from contingent KKR performance-based payments because of KKR's prior acquisition of Prisma. This was fraud and self-dealing of the first order in blatant violation of the KRS conflict of interest policies.

[17] KRS policies are administrative regulations with the force of law.



78. All of this was also in violation of the KPL, including the "sole interest" fiduciary standard required by KY. REV. STAT. § 61.650(1)(c). The investments were not made "solely" in the interests of the members and the beneficiaries of KRS, as required by the KPL, but to benefit KKR Prisma, Reddy, Cook, Rudzik, Kravis and Roberts. The additional $300 million Daniel Boone investment — just like the original purchase in 2010–11 — ***was a disaster, losing some 2.3% over the next 2+ years versus a 30% gain for the S&P Total Return Index***. Moreover, because it had handed control over the entire $1.6 billion hedge fund portfolio over to conflicted hedge fund sellers, KRS stayed fully invested in hedge funds when other pension funds were rapidly divesting the asset class, to the detriment of KRS and its members and beneficiaries. The hedge funds continued to underperform while charging large fees. The damage to the Tier 3 class members' individual retirement accounts by Defendants' and the T/Os' misconduct was serious, lasting and continued well into 2018 and beyond.

7. The 2019–2020 "Independent" Investigation and Report

79. After allegations of the 2015–2016 wrongdoing and Eager's participation in that wrongdoing surfaced, in 2020 KRS commissioned a purported "independent" investigation of prior investment wrongdoing at KRS including the allegations that had been made by the original plaintiffs in the Kentucky derivative suit for KRS and the taxpayers. After expending $1.6 million on the report (overrunning its initial $1.2 million budget), KRS management allegedly "delivered" the "report" to the Attorney General then, after a series of non-public Board meetings decided to do nothing in connection with the *Mayberry* Action — other than opposing the Tier 3 group's motion to intervene therein — and clamped a tight lid on the contents of the report, refusing for various "reasons" to make it public or produce it in response to open records requests. KRS management's apparent support for the Attorney General's continued prosecution (as intervenor) of the *Mayberry* Action — with an amended pleading that still "mirrors" the *Mayberry* Plaintiffs' amended complaint, with virtually nothing changed, suggests that the now-secret report did not exculpate the Defendants or the T/Os — including Eager.

IV. SUBJECT-MATTER AND PERSONAL JURISDICTION

80. This Court has subject matter jurisdiction of the claims stated herein, including the RICO claim.

81. The Court has personal jurisdiction over each Defendant. Each Defendant has purposefully availed itself or themselves of the privilege of doing business in Kentucky on a regular, systematic and persistent basis, directly and through its or their agents, obtaining large amounts of fees, commissions and personal economic benefits over a period of several years. The Court has personal jurisdiction over those

Defendants not residing in Kentucky pursuant to KY. REV. STAT. § 454.210, as each meets the statutory definition of a "person," and these claims arise from the actions of each "directly or by an agent" in that each Defendant regularly transacted and/or solicited business in the Commonwealth and/or derived substantial revenue from goods used or consumed or services rendered in the Commonwealth and/or contracted to supply goods or services in the Commonwealth and/or caused injury by an act or omission in the Commonwealth and/or caused injury in the Commonwealth by an act or omission outside the Commonwealth. In addition, the exercise of specific personal jurisdiction over any defendant resident outside Kentucky is consistent with the U.S. Constitution's "due process" clause.

82. The Kentucky jurisdictional contacts of the corporate Hedge Fund Seller Defendants are also attributable to the individual controlling persons/top executives of those Hedge Fund Sellers due to their direct personal control and domination of those entities — which are actually and de facto their personal instrumentalities as detailed herein.

83. The Hedge Fund Sellers and their top executives purposely availed themselves of the privilege of seeking and doing business in Kentucky, specifically with the two largest pension funds — indeed the two largest economic entities in Kentucky, over a period of several years collecting hundreds of millions in fees for their entities, a meaningful portion of the profits from which flowed to the top executives personally.

84. Any Hedge Fund Seller employee who traveled to Kentucky on behalf of a Hedge Fund Seller was the agent of both the Hedge Fund Seller and the top executives of that Hedge Fund Seller and reported to them directly or through a committee they controlled. Upon information and belief, Schwarzman, Kravis, Roberts, Hill, Reddy

and/or Buchan all signed contracts and other legal documents with both KRS and The Kentucky Teachers Retirement System ("KTRS") relating to investments, including in the case of KRS the hedge fund investments involved in this case, which were structured as limited partnerships using detailed contracts, signed in Kentucky and to be performed in part in Kentucky.

85. As part of the Hedge Fund Sellers' persistent seeking of and then doing business in Kentucky, in addition to the sale of the Black Box funds of hedge funds involved in this case, they have been selling other similarly risky and expensive "alternative investments" to both KRS and KTRS, and then continuing to do business in Kentucky to oversee and service these investments on an ongoing basis collecting millions of fees each year.

86. As of June 30, 2016, KTRS was holding the following investments previously sold to them by KKR Prisma and Blackstone and serviced and overseen by them on an ongoing basis, for the previous several years:

- Blackstone Partners VII, LP $50 Million
- Blackstone Partners VIII, LP $19 Million
- KKR & Co., European Fund III $49 Million
- KKR & Co., European Fund IV $16 Million
- KKR & Co. Fund 2006 $14 Million

87. Blackstone also sold to KRS and then serviced Blackstone Capital Partners V and VI Funds, in amounts ranging from $13 Million to $64 Million.

88. Privately owned jet planes of Kravis and Roberts in the case of KKR Prisma and Schwarzman in the case of Blackstone were used by their respective companies to fly their agents to Kentucky, for which the companies were charged and

for which Kravis, Roberts and Schwarzman were reimbursed, in amounts, on information and belief, often in excess of $5 million per year. Thus, each of Kravis, Roberts and Schwarzman personally profited from Kentucky business.

89. Given the foregoing, the Hedge Fund Seller Defendants should have had reason to anticipate being "haled" into court here. And there is no undue-burden in requiring the Hedge Fund Sellers and their executives to defend a suit in Kentucky. Kravis, Roberts, and Schwarzman each have the power to require their companies to pay any expense in connection with litigation, and they each have the ability to appear anywhere in the United States at no personal expense to themselves. They each have indemnity agreements with their respective companies to pay for their travel, their expenses and their legal fees, they have each previously retained counsel in Kentucky and defended suits in Kentucky and other states. They each are also indemnified by their respective companies for any verdict or judgment against them.

90. KRS and its members were directly targeted victims of the Hedge Fund Sellers' alleged misconduct specifically directed at Kentucky individuals and causing injury in Kentucky. The Kentucky Pension and Trust law is applicable. Ninety percent of the class members live in Kentucky. There is a compelling Kentucky interest in asserting jurisdiction over all Defendants and having this case adjudicated in Kentucky.

91. KKR Prisma (Kravis and Roberts) and Blackstone (Schwarzman) have made, or arranged to have made, political contributions to politicians in Kentucky for both state and federal offices, for the purpose of improving their prospects of obtaining business from KRS and KTRS. Blackstone and KKR have employed lobbyists as their agents in Kentucky to assist them in obtaining KRS and KTRS business. These acts were intended to help influence KRS to plunge into the high-risk high-fee and unsuitable

investments they were selling. Blackstone paid $2.35 million to a controlled entity, Park Hill Group, to help get the KRS business. Park Hill Group is a firm that is a "placement agent" of the kind implicated in KRS's earlier "suspicious payments" scandal.

92. Any out-of-state Defendant participated in a years-long conspiracy, scheme, and common course of concerted conduct and enterprise with in-state residents and actors, involving travel into Kentucky by themselves or their agents for business purposes, thus subjecting themselves to the personal jurisdiction of this court.

V. THE NAMED PLAINTIFFS

93. Plaintiffs are:

(a) Ashley Hall-Nagy became a member of KRS in November 2016 and is a member of the KERS plans, entitled to Tier 3 benefits. She is in the Tier 3 KRS Hybrid Cash Balance Plan which is not a defined benefit plan. She has an individual retirement account within the KRS plans. She contributed her own funds to KRS. Her pension and insurance benefits are not protected by any inviolable statute and her pension benefit depends upon KRS's stewardship and investment performance, as that impacts the end value of her individual pension account. Nagy's "upside sharing" pension benefits have been diminished due to the decreased returns and increased expenses to KRS post January 1, 2014 as a result of the misconduct complained of, and will continue to be diminished going forward. Her final pension benefit has been reduced. This has and will damage her by thousands of dollars.

(b) Tia Taylor became a member of KRS in March 2019 and is a member of the KERS-NH plan, entitled to Tier 3 benefits. She is in the Tier

3 KRS Hybrid Cash Balance Plan which is not a defined benefit plan. She has an individual retirement account within the KRS plans. She contributed her own funds to KRS. Her pension and insurance benefits are not protected by any inviolable statute, and her pension benefit depends upon KRS's stewardship and investment performance, which impact the end value of her individual pension account. Taylor's "upside sharing" pension benefits have been diminished due to the decreased returns and increased expenses to KRS post January 1, 2014 as a result of the misconduct complained of, and will continue to be diminished going forward. This has and will damage her by thousands of dollars.

(c) Bobby Estes became a member of KRS in August 2015 and is a member of the CERS-H plan, entitled to Tier 3 benefits. He is in the Tier 3 KRS Hybrid Cash Balance Plan which is not a defined benefit plan. He has an individual retirement account within the KRS plans. He contributed his own funds to KRS. His pension and insurance benefits are not protected by any inviolable statute and his pension benefit depends upon KRS's investment performance, as that impacts the end value of his individual pension account. Estes's "upside sharing" pension benefits have been diminished due to the decreased returns and increased expenses to KRS post January 1, 2014, as a result of the misconduct complained of, and will continue to be diminished going forward. This has and will damage him by thousands of dollars.

94. All of the named Plaintiffs are residents and citizens of Kentucky.

VI. THE DEFENDANTS AND OTHER IMPORTANT ACTORS

A. KRS

95. KRS is not named as a defendant. KRS holds Trust Funds held for several pension and health insurance plans for Kentucky workers:

> **KERS (Kentucky Employee Retirement System**): this system consists of two plans — **Non-hazardous and Hazardous**. Each plan is a cost-sharing multiple-employer benefit pension plan that covers all regular full-time members employed in positions of any state department, board, or agency directed by Executive Order to participate in KRS.
>
> **CERS** (**County Employee Retirement System**): This consists of two plans — **Non-hazardous and Hazardous**. Each plan is cost sharing multiple-employer benefit pensions plan that covers all regular full-time members employed in non-hazardous positions of each participating county, city and school board, and any additional eligible local agencies electing to participate in CERS.
>
> **SRS** (**State Police Retirement System**): This system is a single-employer pension plan that covers all full-time state troopers employed in positions by the Kentucky State Police.

B. Hedge Fund Sellers

1. KKR, Kravis, Roberts, Prisma, Reddy, Cook, and Rudzik

96. Defendant KKR & Co., Inc. (formerly known as KKR & Co., L.P.) ("KKR") is a large publicly-owned Wall Street financial enterprise which sells "investment" products and provides investment counseling, advice and management services.[18] KKR makes billions of dollars a year in profits selling extremely complex high-risk investment products charging exceptionally high fees. According to KKR, "our hedge fund business [was] comprised of customized hedge fund portfolios, hedge fund-of-fund

[18] Effective on July 1, 2018, KKR converted its entity structure from a public limited partnership to a public corporation.

solutions … managed by KKR PRISMA." KKR is worth over $50 billion with yearly net income over $5 billion.

97. Defendant Henry R. Kravis co-founded KKR in 1976 and is Co-Chairman and Co-Chief Executive Officer and its Managing Partner. According to KKR's Annual Report, Kravis is "actively involved in managing the firm and … has more than four decades of experience financing, analyzing and investing in public and private companies …. As Co-Chief Executive Officer, Mr. Kravis has an intimate knowledge of KKR's business."

98. Defendant George R. Roberts co-founded KKR in 1976 and is Co-Chairman and Co-Chief Officer and its Managing Partner. According to KKR's Annual Report, Roberts is "actively involved in managing the firm … has more than four decades of experience, financing, analyzing, and investing in public and private companies …. As our Co-Chief Executive Officer, Mr. Roberts has an intimate knowledge of KKR's business."

99. Because of Kravis's and Roberts' status as co-founders, Board Co-Chairs and Co-CEOs of KKR, as well as serving Co-Chairs of its Management Committee, Kravis and Roberts were both in a position to control and did control the day-to-day operations of KKR during the relevant time periods. While they are legally distinct from the "publicly owned" corporate entity through a complex web of private partnerships, Kravis and Roberts personally controlled "the management of [KKR's] business and affairs … rather than through a board of directors … and [were] authorized to appoint other officers" at all relevant times prior to 7/1/2018. After the conversion to the corporate entity, Kravis and Roberts effectively control 100% of the voting stock of KKR. Kravis and Roberts could elect all of the Directors of KKR, appoint all officers and

control all aspects of KKR's corporate structure and operation, and they did so. They also jointly held the power to remove any such officers, directors or employees. Kravis and Roberts were the responsible corporate officers for the selection, oversight, supervision and training of the top officers and personnel of KKR who were involved in the day-to-day dealings with KRS during the relevant time period.

100. Kravis and Roberts are two of the most financially sophisticated and wealthiest people on Wall Street. In addition to the vast wealth they have accumulated, they were each paid over $100 million per year for running KKR in 2017 and similar amounts going forward. KKR and its controlling shareholders state in governmental filings that:

> "We depend on the efforts, skills, reputations and business contacts of … our founders Henry Kravis and George Roberts … the information and deal flow they and others generate during the normal course of their activities …. Accordingly, our success depends on the continued service of these individuals."

101. Defendant Girish Reddy co-founded Defendant Prisma Capital Partners LP in 2004 with Cook and some Goldman Sachs bankers who agreed "it was time for a fund of funds that could tap into pension funds [because] they knew they wanted hedge fund exposure." Prisma was formed to specialize in selling custom-designed Black Box hedge funds to public pension funds targeting underfunded public pension plans. Before founding Prisma in 2004, Reddy was a partner in the Wall Street firm Goldman Sachs. He made millions of dollars a year — for a number of years — running Prisma before he retired in 2018. He was actively involved in creating the Daniel Boone Fund and selling it to KRS for its Funds. Cook worked closely with Reddy at Prisma. They were "friends." Peden worked with them at Prisma before moving to KRS.

102. Defendant William S. Cook is sued in his individual capacity and role at Prisma, KKR and KKR Prisma, not in his role as a KRS Trustee. He is a resident of Kentucky, a substantial participant in the alleged wrongdoing and a substantial source *i.e.*, primary defendant from whom recovery of the damages is sought. Cook was a financial operator and executive for over seventeen years with Aegon USA, a Louisville Kentucky-based company owned by Aegon International, where he specialized in selling hedge funds. In 2004, Cook and fellow Aegon executive, Michael Rudzik, along with three former Goldman Sachs partners including Defendant Girish Reddy, helped form Prisma Capital Partners, L.P. ("Prisma") in New York City with Aegon as its biggest investor and biggest client. Throughout the relevant period Cook and Rudzik on behalf of the firms they represented, co-owned, were partners in, or executives of, were assigned the role of gaining access to and capturing KRS's pension funds' huge pool of assets — the "honey pot" — and getting KRS as a customer for their investment products. Cook was a managing director — top executive — of Prisma, had a large equity interest in Prisma, and was a member of the Prisma Investment Committee, which included the other four top officers of Prisma. Prisma was acquired by KKR in 2012. Cook, Rudzik and Reddy were among the small group of those who sold their Prisma equity to KKR in a multi-hundred million-dollar "earn out" transaction. Cook became a managing director of KKR, and participated in the multi-million-dollar long-term "earn out" payments, with large contingent payments in 2014–17 based on Prisma's continued growth in assets under management and profits. Cook retired from KKR in March 2015, but retained his interests both in KKR and in the contingent multi-million-dollar performance payment due in 2017.

103. Cook was at Prisma when it marketed and sold the $400+ million "Daniel Boone Fund" to KRS in 2010–11 and was a major participant in and driver of that transaction using his contacts — inside KRS and elsewhere — to help arrange the transaction in violation of KRS's own, as well as generally applicable conflict of interest policies and standards. His friend and protégé, and former Aegon and Prisma employee, David Peden, was on the KRS investment staff and personally inserted himself into the sales process even though his job in Fixed Income had little if anything to do with Alternative Investments in general, or hedge funds in particular. Prisma was a very small hedge fund seller and likely would not have qualified to sell the initial $400+ million Black Box to KRS — especially in view of the fact that the total Management Fees to be paid to Prisma and its sub-managers were the highest of the three selected — without undue and improper influences behind the scenes. Cook used his influence improperly and behind the scenes to further KKR's and Prisma's interests over those of KRS, including helping to arrange the $585 million in self-dealing Daniel Boone and other conflicted, KKR Prisma-recommended hedge fund transactions with the behind-the-scenes assistance of Peden. Cook was appointed to the KRS Board of Trustees on June 17, 2016, and remained on the Board until his term expired in the summer of 2019.[19]

104. Defendant Michael Rudzik was at Aegon and Prisma with Cook and Peden, subsequently was a managing director/partner at KKR Prisma, and continues as a

[19] Cook was vetted for his appointment as KRS trustee by, among others, Steve Pitt, then general counsel to Gov. Bevin. That Cook still retained a contingent earn-out right from KKR which could have been materially affected by decisions of the KRS Board or Investment Committee was not apparently noted in his appointment paperwork.

managing director of PAAMCO Prisma (the company formed upon the combination of Prisma and PAAMCO). Cook, Peden, Reddy, and others arranged for Rudzik to go inside KRS to promote and protect the interests of KKR and Prisma, while he remained on the KKR Prisma payroll. By undertaking this role — which Peden described as "effectively … [an] extension of KRS staff" — Rudzik individually took on a fiduciary role. Rudzik's conduct violated KRS's conflict of interest policy and Kentucky law. He attended both the May 3, 2016 Investment Committee Meeting where the $300 million self-dealing Daniel Boone Fund conflicted upsizing transaction was approved, as well as other KRS Board, Investment Committee and staff meetings where the additional $285 million in KKR Prisma-recommended investments were made. Rudzik, Reddy and Cook all had performance-based payouts from KKR based on the sale of Prisma to KKR that could potentially pay them millions of dollars in 2017. The gross amount of the contingent payment — owed to 15 people including Cook, Rudzik and Reddy — was estimated by KKR at nearly $50 million as reflected in December 15, 2015 SEC reports. Rudzik lives in Kentucky.

105. KKR entered the hedge fund business in 2008–2009, but during 2010–2011, two KKR hedge fund operations suffered large losses, a serious setback for KKR at the time it was attempting to expand its business to target underfunded public pension funds as customers for high-fee hedge fund products. After those losses, KKR intensified its efforts to get into the fund of hedge fund business because of its very high profit potential, *i.e.,* the opportunity to sell these Black Box vehicles to unsophisticated underfunded public pension funds. Beginning in early 2010, Kravis and Roberts began to try to acquire Prisma, which was already successfully targeting pension funds with its custom-designed fund of hedge fund products and producing very rapid growth in

assets under management, and consequent profits. Securing the $400+ million Daniel Boone Fund sale to KRS was a major step in "dressing up" Prisma for sale to KKR — thus further enriching Cook and Reddy by boosting not only Prisma's assets under management and its profits, but also Cook's stature and position in the KKR Prisma structure. It may fairly be inferred that Peden was aware of the personal stakes for his friend Cook. In 2012, KKR acquired Prisma (combined company referred to as KKR Prisma) by purchasing (with a three-tier earn-out structure) the equity ownership of Reddy, Cook, Aegon and the other Prisma owners.

106. In 2017, KKR engineered the combination of Prisma and PAAMCO to create a new firm PAAMCO Prisma Holdings, LLC. KKR retained 39.9% of the equity of the new entity and receives fixed payments in addition. Prisma Capital Partners LP continues to exist within PAAMCO Prisma Holdings LLC. KKR continues to bear legal responsibility for the liabilities of Prisma for its acts and omissions prior to the closing of this combination. KKR's liability in whole or in part for PAAMCO Prisma will be a subject for discovery herein.

107. KKR Prisma held itself out as having great sophistication, experience and expertise in financial matters, stating: (i) "Our business offers a broad range of investment management services to our fund investors"; (ii) "We are a leading global investment firm that manages investments … including … hedge funds. We aim to generate attractive investment returns by following a patient and disciplined investment approach"; (iii) "Our investment professionals screen the [potential investment] opportunity and [then] … proceed with further diligence …. This review considers many factors including … expected returns … historical and projected financial data … the quality and track record of the issuer's management team … specific investment

committees monitor all due diligence practices"; and (iv) "We monitor our portfolios of investments using as applicable, daily, quarterly and annual analyses."

108. Because of the importance of the acquisition of Prisma to KKR, the effort was personally overseen by Roberts and Kravis. "One of the things that was extremely important was whether the team at Prisma would fit into our culture," Kravis says. "We spent a lot of time discussing this …. We got to know Girish and his team by spending time with them [and spoke] to our management committee at length about this." The acquisition was completed in 2012. After the acquisition, KKR Prisma intensified its targeting of public pension plans.

109. KKR Prisma's business plan, created, approved, and implemented under Kravis and Roberts, targeted public pension plans and they specifically targeted Kentucky where they knew there were two large, underfunded public pension plans — KRS and the KTRS. Prisma had targeted troubled, underfunded public pension funds as customers for the exotic investment vehicles it sold. Prisma realized that KRS trustees and officers were dealing with a much more serious financial and actuarial situation than was publicly appreciated. Prisma custom-designed a "Black Box" fund of hedge funds vehicle. It told KRS's Trustees and Officers that this Black Box would produce the kind of high investment returns, with downside protection and safe diversification, that Trustees and Officers were seeking to cover up their own malfeasance, and would make up for past losses, while providing safe diversification. Prisma named this fund the "***Daniel Boone Fund,"*** because it targeted and was designed for the workers of Kentucky who were members and beneficiaries of KRS.

110. During their efforts to acquire Prisma and their intimate involvement in its business as the Co-CEO's of KKR Prisma thereafter, Roberts and Kravis acquired

knowledge about Prisma, the strategy by which Reddy, Cook and Prisma were producing rapid and profitable growth by targeting troubled pension funds, including the very large $400-to-$500 million Daniel Boone Fund that Prisma had recently sold to KRS. After the acquisition by KKR of Prisma, KKR Prisma knew that this custom-designed Daniel Boone Fund was an extraordinarily risky fund of hedge funds vehicle, and that it was illiquid, opaque, and unsuitable for continued holding by a pension fund in the particular situation of KRS, which was badly underfunded and facing accelerating retirements, increasing liquidity needs and fewer and fewer new members. KKR, Kravis and Roberts joined and continued the conspiracy and common enterprise to get their share of the shared kill.

111. By 2015–2016 many institutional investors in funds of hedge funds had grown angry over excessive and hidden fees, illiquidity, lack of transparency with regard to investment strategies and pricing estimates, poor investment returns and/or large losses. As lock up periods expired and the toxic reputation of these exotic, opaque, secretive, high-fee/high-risk vehicles spread, the fund of hedge funds industry contracted. Assets under management, the industry's life blood, declined, and the business of the industry underwent a severe contraction.

112. As the Daniel Boone Fund began to lose millions in 2015–2016, KKR Prisma, Peden and Cook, with knowledge and active assistance from Roberts, Kravis and Reddy, worked to arrange for a KKR Prisma Executive (Rudzik) to work inside KRS, ***while still being paid by KKR Prisma***. Peden, Cook, Reddy and KKR Prisma referred to this arrangement as a "Strategic Partnership." Subsequently, while Cook and Peden and the KKR Prisma executive were working inside KRS, KKR Prisma sold $300 million more in Black Box vehicles to KRS, despite the KKR Prisma Black Box being the

worst performing of the three black box hedge funds. This very large sale to KRS was a significant benefit to KKR Prisma, which was then suffering outflows due to customer dissatisfaction over poor results and excessive fees, as well as to Reddy, Cook and Rudzik personally.

113. In acting and failing to act as alleged herein, these Defendants breached their own duties to KRS and its plan/trust members and beneficiaries, and knowingly induced and aided and abetted the breach of duties by the Trustee (acting through its T/Os, who also breached their own duties), while participating by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise acting in concert with the Trustee (acting through its T/Os, who also breached their own duties) and/or each other to commit unlawful acts, including the violation of the mandatory duties imposed on each of them by Kentucky law, all to further their own economic interests.

2. Blackstone, Schwarzman and Hill

114. Defendant Blackstone Group, Inc. (formerly known as Blackstone Group L.P.) ("Blackstone") is a large Wall Street financial enterprise that provides asset management and advisory services and sells hedge fund products targeting pension funds as potential customers. Blackstone makes billions of dollars a year in profits selling extremely complex high-risk investment products charging exceptionally high fees. Blackstone has yearly revenues over $6 billion. It has over $2 billion in annual net income. It is an extraordinarily profitable business and receives large fees on its hedge fund vehicles regardless of investment performance. In 2018, Blackstone converted its entity structure from a public limited partnership to a public corporation.

115. Defendant Blackstone Alternative Asset Management, L.P. ("BAAM") is a subsidiary and operating unit of Blackstone ("Blackstone" and "BAAM" are collectively referred to as "Blackstone"), and is the world's largest "allocator" to hedge funds, and is a leading manager of institutional funds of hedge funds. It stated that its "Hedge Fund Solutions" investment philosophy "is to protect and grow investors' assets through both commingled and custom-designed investment strategies designed to deliver compelling risk-adjusted returns and mitigate risk. Diversification, risk management, due diligence and a focus on downside protection are key tenets of our approach."

116. Blackstone claims to be a sophisticated and experienced expert in financial matters. It has said that before deciding to invest in a new hedge fund or with a new hedge fund manager, it "conducts extensive due diligence" including a "review of the fund's manager's performance … [and] risk management …. Once initial due diligence procedures are completed and the investment and other professionals are satisfied … the team will present the potential investment to the relevant Hedge Fund Solutions Investment Committee … [of] senior managing directors … and other senior investment personnel…. Existing hedge fund investments are reviewed and monitored on a regular and continuous basis … Blackstone Vice Chairman and BAAM CEO, J. Tomilson Hill, … and other senior members of our Hedge Fund Solutions team meet bi-weekly with Mr. Schwarzman … to review the group's business and affairs."

117. Defendant Stephen A. Schwarzman is the Chairman and Chief Executive Officer of Blackstone and leads the firm's Management Committee. Schwarzman founded Blackstone and has been involved in all phases of the firm's development since its founding. Schwarzman rose to prominence at Lehman Brothers, where he was a top executive — a Managing Director. Lehman later collapsed amidst widespread financial

fraud and misconduct at the firm. According to Blackstone, it "depends on the efforts, skills, reputations and business contacts of Schwarzman, and other key senior managing directors, the information and deal flow they generate during the normal course of their activities …."

118. Because of Schwarzman's status as a Founder, Board Chair and CEO of Blackstone, as well as serving as Chair of its Management Committee, Schwarzman was in a position to control and did control the day-to-day operations of Blackstone during the relevant time periods. Through a complex web of private partnerships and trusts, Schwarzman can elect all of Blackstone's Board of Directors and control all aspects of Blackstone's corporate structure and operation and has done so — control so absolute that he has "no duty or obligation (fiduciary or otherwise) to give any consideration to any interest of [Blackstone's unit holders] and will not be subject to any different standards imposed by … law, rule, or regulation or in equity." Schwarzman was the responsible corporate officer for the selection, oversight, supervision and training of the top officers and personnel of Blackstone other than himself who were involved in the day-to-day dealings with KRS during the relevant time period.

119. Defendant J. Tomilson Hill is President and Chief Executive Officer of the Hedge Fund Solutions group, Vice Chairman of Blackstone and Chief Executive Officer of BAAM and a resident and citizen of NY. Hill is responsible for overseeing the day-to-day activities of the group, including investment management, client relationships, product development, marketing operations and administration. Before joining Blackstone, Hill served as Co-Chief Executive Officer of Lehman Brothers, which later collapsed amidst widespread financial fraud and misconduct.

120. The Blackstone business plan, created, approved, and implemented under the personal supervision of Schwarzman and Hill, targeted troubled public plans and specifically targeted KRS.

121. Blackstone targeted KRS as a troubled public pension fund making it a potential customer for the exotic investment vehicles it created and sold. It spotted KRS's underfunded Funds and, because of its sophistication, Blackstone realized its trustees and officers were dealing with a much more serious internal financial and demographic situation than was publicly known. Blackstone custom-designed "Black Box" fund of fund vehicles and indicated to the T/Os that it would produce the kind of high investment returns, with downside protection and safe diversification, that Trustees and Officers were seeking to make up for past losses and cover up their malfeasance. Blackstone named this vehicle the "Henry Clay Fund."

122. Blackstone, Schwarzman and Hill knew that this custom-designed Henry Clay Fund was an extraordinarily risky fund of hedge funds vehicle, and that it was illiquid, opaque, and unsuitable for a pension fund like KRS. KRS was badly underfunded and facing accelerating numbers of member retirements, resulting in increasing liquidity needs and fewer new members.

123. The Henry Clay Fund provided exceptionally large fees for Blackstone. The amount of the fees could not be calculated by KRS and were not disclosed to KRS, many hidden in an impenetrable spider web of fees, spun together by Blackstone for its benefit.

124. In acting and failing to act as alleged herein, these Defendants breached their own duties to KRS and its plan/trust members and beneficiaries, and knowingly induced and aided and abetted the breach of duties by the Trustee (acting through its

T/Os, who also breached their own duties), while participating by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise acting in concert with the Trustee (acting through its T/Os, who also breached their own duties) and/or each other to commit unlawful acts, including the violation of the mandatory duties imposed on each of them and Trustees by Kentucky law, all to further their own economic interests.

3. Pacific Alternative Asset Management Company LLC and Buchan

125. Defendant Pacific Alternative Asset Management Company, LLC ("PAAMCO") is located in Irvine, California and operates world-wide. PAAMCO (now part of PAAMCO Prisma Holdings) sells investment products including hedge funds and funds of hedge funds and describes itself as:

> "… a leading institutional investment firm dedicated to offering alternative investment solutions to the world's preeminent investors. Since its founding in 2000, PAAMCO has focused on investing on behalf of its clients while striving to raise the standard for industry-wide best practices. With a global footprint that extends across North America, South America, Europe and Asia, PAAMCO's clients include large public and private pension funds, sovereign wealth funds, foundations, endowments, insurance companies and financial institutions. The firm is known for its complete Alpha approach to hedge fund investing which focuses on … controlling costs and protecting client assets."

126. During 2009–11 PAAMCO was one of the largest, fastest growing and most profitable hedge fund sellers in the United States with several billion dollars of assets under management. PAAMCO claimed special expertise in designing and managing funds of hedge funds designed for public pension plans. PAAMCO's business plan, created, approved, and implemented under the personal supervision of Buchan,

targeted troubled public pension plans and specifically targeted Kentucky where there was a large underfunded public pension plan — KRS.

127. Defendant Jane Buchan was a co-founder and CEO of PAAMCO. Materials approved by Buchan and PAAMCO describe her as the Chief Executive Officer of PAAMCO, and "[a]s CEO, Jane is responsible for overall business strategy and firm direction." Buchan was the dominant Executive and personality at PAAMCO, a closely held private company, and was hands-on involved in all aspects of its funds of hedge fund business which specifically targeted public pension plans. She personally oversaw and directed the sale of the PAAMCO Black Box fund of hedge funds to KRS.

128. Because of Buchan's status as a co-founder, Board member, and CEO of PAAMCO, as well as serving Chair of its Management Committee, Buchan was in a position to control and did control the day-to-day operations of PAAMCO during the relevant time periods. Buchan could, with a few co-founders, elect all of the Directors of PAAMCO, appoint all officers and control all aspects of PAAMCO's corporate structure and operation, and she did so. Buchan was the responsible corporate officer for the selection, oversight, supervision and training of the top officers and personnel of PAAMCO other than herself who were involved in the day-to-day dealings with KRS during the relevant time period.

129. PAAMCO targeted KRS as a troubled public pension fund as a potential customer for the exotic investment vehicles it created and sold, knowing the trustees and officers were dealing with a much more serious financial and actuarial situation than was publicly known. PAAMCO custom-designed a "Black Box" fund of hedge funds vehicle and indicated to Trustees and Officers that it would produce the kind of high investment returns, with downside protection and safe diversification, that Trustees and

Officers were seeking to make up for past losses and cover up their malfeasance. PAAMCO nicknamed this vehicle the "Newport Colonels Fund."

130. Buchan developed and exploited an improper relationship with Adam Tosh, the KERS Chief Investment Officer to become a "trusted advisor" with access to KRS financial information to use to get KRS to make the $1.5 billion hedge fund bet. Buchan worked secretly with Tosh and his assistant and successor Aldridge behind the scenes, and Tosh assured her before the selection process was complete that PAAMCO would be one of the 2 or 3 firms picked for the black box hedge fund sale — a fixed insider deal at KRS.

131. PAAMCO and Buchan knew that the custom-designed Colonels Fund was an extraordinarily risky fund of hedge funds vehicle, and that it was illiquid, opaque, and unsuitable for a pension fund like KRS, which was badly underfunded and facing accelerating numbers of member retirements, resulting in increasing liquidity needs and fewer and fewer new members.

132. In acting and failing to act as alleged herein, these Defendants breached their own duties to KRS and its plan/trust members and beneficiaries, and knowingly induced and aided and abetted the breach of duties by the Trustee (acting through its T/Os, who also breached their own duties), while participating by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise acting in concert with the Trustee (acting through its T/Os, who also breached their own duties) and/or each other to commit unlawful acts, including the violation of the mandatory duties imposed on each of them by Kentucky law, all to further their own economic interests.

133. For years, PAAMCO and Buchan have held themselves out to be paragons of virtue in the hedge fund industry, a leading example of adherence to the highest possible standards of honesty, transparency and ethical behavior in its business practices. In a glowing profile of Buchan in 2014 in the Orange County Register, that Buchan reviewed and approved, it was reported:

> Buchan, CEO and co-founder of Pacific Alternative Asset Management Co. (PAAMCO), is one of the most powerful women in global finance, a luminary in the complex, opaque hedge fund universe.
>
> With satellite offices in Singapore and London, Buchan's fund-of-funds is a manager and adviser for some of the world's biggest pension plans, endowments and sovereign wealth funds, helping them to invest some $15.7 billion into hedge funds.
>
> WORKING FOR RETIREES
> ...
> From the outset, PAAMCO focused on institutions. Unlike many funds-of-funds, Buchan said, "we don't do high-net worth individuals. There's nothing wrong with making rich people richer, but that is not the ethos of this company."
>
> Plus, there's the intellectual challenge: a single wealthy investor might have as much as a billion or so dollars to invest in hedge funds. Pension plans juggle many billions.
>
> "We build big portfolios for very sophisticated clients," Buchan said. "We like working with very large pools of capital and very compelling problems."
>
> While a few institutions set aside "affirmative investment" money targeting, in part, female or minority managers, Buchan said PAAMCO has never sought business through diversity mandates.
>
> "This firm has succeeded by going toe to toe with the top firms," she said. "I compete against both men and women. I'm not interested in being the tallest dwarf. I don't care to get extra points for being green, purple, short, thin or fat."

134. According to Buchan, she is asked to speak all over the world because "[w]e are known throughout the world for promoting fiduciary standards in hedge fund investing." Buchan and PAAMCO helped found, and Buchan is a director of, the International Hedge Fund Standards Board,[20] the standard-setting organization for the hedge fund industry, which claims to promote "transparency, integrity and good governance" in the way the hedge fund industry operates.

135. Buchan, in addition to her own personal involvement in the PAAMCO business, in law and in fact controlled all operations of PAAMCO at relevant times. As the responsible corporate officer, she had a duty to properly train all officers and employees who acted as its agents and servants in the duties of good faith, care, loyalty, absence of self-dealing, compliance with applicable external codes of conduct and care (such as the CFA) and internal codes of conduct and care, and fiduciary duties owed by PAAMCO officers, agents and employees, when selling or continuing to hold products and services. Further, Buchan had a duty to supervise all officers, agents and employees and in the exercise of their fiduciary duties to KRS, and their duties of good faith, care, loyalty, code compliance, and the absence of self-dealing. This she failed to do when dealing with KRS, to the damage of the Tier 3 class members.

136. PAAMCO was founded by Buchan and a few others with secret financial support from ultra-wealthy hedge fund mogul S. Donald Sussman of Greenwich, Connecticut. Sussman had a background Buchan wanted to conceal from potential investors, customers and regulators, as he had been convicted of dishonest behavior in

[20] In light of recent events disgracing the fund of hedge fund industry, Buchan's Board is now called "Standards Board for Alternative Investments."

connection with the investment of fiduciary monies. Buchan and Sussman created fake documents to disguise Sussman's large ownership stake in PAAMCO as a loan, because Buchan and the other founders believed they could hide Mr. Sussman's background from investors and regulators. "A Hedge Fund Controlled by Women, So It Claimed," published by *The New York Times* on October 18, 2010, reported that the "loan" terms were extraordinary. The real deal was a $2 million investment by Sussman for 40% ownership of PAAMCO, with Buchan and the parties putting up only $40,000 total under the fake documents. Sussman was paid the greater of either 10% annual interest or 40% of the profit of PAAMCO. From 2003 to 2007, Sussman secretly collected his share of the profits, $55 million. As PAAMCO continued to make these huge profits, Buchan decided to evade and dishonor the secret commitment to Sussman. As a result, Sussman sued Buchan and her co-founders of PAAMCO for fraud and breaches of fiduciary duty, exposed their dishonesty and won the case on summary judgment. Buchan and her PAAMCO co-founders did not appeal. To further conceal Sussman's ownership of PAAMCO, Sussman and Defendant Buchan used offshore shell companies called Paloma Partners/Franklin Realty Co. to hold his PAAMCO interest.

137. In sworn testimony, one PAAMCO co-founder admitted there were "two important factors" why Sussman's ownership and control of PAAMCO was hidden: "The first was the potential impact of disclosing Mr. Sussman's involvement" in a governmental filing and "the second was our potential to have status as a majority female-owned entity," which could lead to "engagement as an investor and manager to an extent that otherwise wouldn't be the case."

138. Buchan not only concealed Sussman's ownership of PAAMCO to deceive customers and regulators but also to falsely present the picture of a female-controlled

enterprise, which gave PAAMCO an edge in competing for public pension fund business. Buchan used PAAMCO's purported "female majority owned" to improperly gain a competitive advantage, and to attract pension funds.

139. The Judge in Sussman's case noted that the disguised ownership arrangements with Sussman "may have been designed to mislead a number of observers, from the tax authorities to the SEC to entities wishing to invest in women-owned businesses." As a result of these findings of fiduciary dishonesty by the PAAMCO founders, public pension funds withdrew millions of dollars of their trust fund assets from the PAAMCO managed or created hedge funds. These events occurred shortly before PAAMCO sold the Colonels Fund to KRS. Other pension funds took steps to review or curtail dealings with PAAMCO. But not KRS. This prior dishonest conduct was not disclosed. It was concealed by Buchan, PAAMCO and Aldridge.

4. The Peculiar Entity Structures of KKR and Blackstone

140. Due to its carefully crafted and unusual corporate structures, while KKR and Blackstone appear to be companies with publicly traded shares/units and share/unit holders, they are in fact the personal instrumentalities of Kravis, Roberts and Schwarzman, controlled vehicles used by them to conduct their businesses such that they have a complete unity of interest and purpose with them and are as a result the "jurisdictional alter egos" of those entities. This was true both before and after KKR and Blackstone converted from limited partnership form to corporate form. However, the corporate entities they control are distinct and separate from them as individuals.

141. As "public" companies, KKR and Blackstone are required to make filings with the SEC. These filings must be truthful. According to SEC filings, Schwarzman "is the Chairman and Chief Executive Officer of Blackstone and the Chairman of the board

of directors of our general partner…. Blackstone Group Management L.L.C. is wholly owned by our senior managing directors and controlled by our founder, Mr. Schwarzman."

> Our general partner Blackstone Group Management L.L.C., Schwarzman manages all of our operations and activities. Our general partner is authorized in general to perform all acts that it determines to be necessary or appropriate to carry out our purpose and to conduct our business. Our partnership agreement provides that our general partner in managing our operations and activities is entitled to consider only such interests and factors as it desires, including its own interests, and will have no duty or obligation (fiduciary or otherwise) to give any consideration to any interest of or factors affecting us or any limited partners, and will not be subject to any different standards imposed by the partnership agreement, the Delaware Limited Partnership Act or under any other law, rule or regulation or in equity.
>
> The limited liability company agreement of Blackstone Group Management L.L.C. establishes a board of directors that is responsible for the oversight of our business and operations. Our general partner's board of directors is elected in accordance with its limited liability company agreement, where our senior managing directors have agreed that our founder, Mr. Schwarzman will have the power to appoint and remove the directors of our general partner.

142. Schwarzman is Blackstone's general partner and it "manages all of our operations and activities," "as it desires" in "its own interests" and is not subject to "any law rule, regulation or equity." Now that's 100% control.

143. The KKR structure is almost a duplicate of that of Blackstone – just with Kravis and Roberts on top. Kravis and Roberts are Co-Chairman and Co-Chief Executive Officers of KKR and they are the only two members of its Executive Committee. The managing general partner of KKR is KKR Management LLC, which is owned and controlled by Kravis and Roberts.

> … [O]ur limited partnership agreement provides for the management of our business and affairs by a general partner rather than a board of directors. Our Managing Partner [Kravis/Roberts] serves as our sole general partner. Our Managing Partner has a board of directors that is co-chaired by our founders Henry Kravis and George Roberts who also serve as our Co-Chief Executive Officers and are authorized to appoint our other officers.

144. The fact that these entities are made to look like "public" companies cannot conceal that they operate as the personal and business and wealth-creation vehicles of Kravis, Roberts and Schwarzman personally and that the control, legal, operational and managerial power of Kravis, Roberts, and Schwarzman is such that these separate legal entities are in effect their personal instrumentalities, of which they are controlling, responsible corporate officers.

145. In addition to the control agreements cited above, Kravis, Roberts and Schwarzman each in fact constantly and actually exercise their control of their instrumentalities. According to Blackstone, Schwarzman "has been involved in all phases of the firm's development since its founding in 1985" and it "depends on the efforts, skills, reputations and business contacts of Schwarzman, and other key senior managing directors, the information and deal flow they generate during the normal course of their activities …." As to the part of Blackstone's business that is at the center of this case, *i.e.*, hedge funds:

> Before deciding to invest in our new hedge fund or with a new hedge fund manager, our Hedge Fund Solutions team, conducts extensive due diligence …. Once initial due diligence procedures are completed and the investment and other professionals are satisfied with the results of the review, the team will present the potential investment to the relevant Hedge Fund Solutions investment committee.

> The investment committee is comprised of Tomlinson Hill, C.E.O. of the Hedge Fund Solutions group and Vice Chairman of Blackstone, and other senior members of our Hedge Fund Solutions team meet regularly with Mr. Schwarzman to review the group's business and affairs.

146. As to Kravis and Roberts as Co-Chairmen and Co-Chief Executive Officers of KKR, they are "actively involved in managing the firm and [have] an intimate knowledge of KKR's business."

> "We depend on the efforts, skills, reputations and business contacts of … our founders Henry Kravis and George Roberts …. the information and deal flow they and others generate during the normal course of their activities…. According, our success depends on the continued service of these individuals."

147. The Blackstone and KKR controlling executives/shareholders continued their domination and control after their recent reorganization into corporations for tax purposes.

148. Hedge Fund Sellers knew that the "absolute return assets" or "absolute return strategies," *i.e.,* fund of hedge funds they sold KRS were discussed in KRS's Annual Reports, each of the Hedge Fund Sellers reviewed and was aware of the contents of the KRS Annual Reports and a press release and statements by KRS officials. They knew that the information therein regarding the KRS "Absolute Return" assets/strategies, *i.e.,* the Black Boxes, was incomplete, inaccurate, false, and misleading. Hedge Fund Sellers also knew if the true nature and risks of these high-risk/high-fee vehicles were disclosed in the KRS Annual Reports, an uproar would have resulted and the unsuitable "investments" could have been terminated, costing the Hedge Fund Sellers millions and millions of dollars a year in fees. Hedge Fund Sellers

let the deception continue because it served their selfish economic purposes and prolonged the profitable conspiracy and common enterprise.

C. Investment/Fiduciary and Actuarial Advisors

1. Investment Advisor RVK

149. Defendant R.V. Kuhns & Associates, Inc., a/k/a/ RVK, Inc. ("RVK") became KRS's investment advisor following the termination of the previous advisor as a result of KRS's $4.4 billion in investment losses in 2008–09. RVK holds itself out as having great experience and expertise in investments. It describes itself as: "One of the largest fully independent … consulting firms in the US, [which] provides world-class investment advice to institutional investors, including defined benefit and defined contribution pension plans …. RVK also states it provides 'unbiased general investing consulting services … a team of dedicated consultants with significant experience in the financial field, including investment advising, investment management and actuarial advisory services.'"

150. Jim Voytko was the President and Principal of RVK until 2012. Voytko and his successor, Rebecca A. Gratsinger, were each personally involved in the KRS account and each signed one or more of the false and misleading letters and reports contained in KRS Annual Reports detailed herein. KRS was an important source of fees for RVK and an account that was crucial to Voytko and Gratsinger's personal success, compensation and position in the firm. RVK, Voytko, and Gratsinger very much wanted to keep KRS as a client. RVK's business model depended on representing a large number of public pension funds, charging each, including KRS, over $500,000 each year. The pension funds were, in effect, an "annuity client." RVK's business model depended on keeping clients. RVK chose to go along, participate and approve, and then

pocket their large fees each year. Gratsinger became the CEO of RVK in 2012, and she took over the KRS account.

151. RVK, Voytko and Gratsinger were intimately involved in the affairs of KRS and its Funds. They had unlimited access to all KRS internal data and investments detail, and were aware of KRS's true financial and actuarial condition. RVK prepared the analysis ("the RVK Report") in 2010 which revealed the closing vise that KRS faced between the demographics of its members and beneficiaries and its actuarial situation. RVK advised the Trustees and Officers to quickly put $1.2/1.5 billion in the Black Boxes, even though they were unsuitable investments for KRS. They have also repeatedly made false statements regarding KRS's investing principles, practices, procedures, skills and results in KRS Annual Reports, falsely reassuring members and taxpayers as to the state of the Trustees' stewardship.

152. RVK, Voytko, and Gratsinger reviewed and were aware of the contents of the KRS Annual Reports and knew that the information therein was incomplete, false, and misleading, and that they had a duty to correct these statements. They also knew if the true nature of these high-risk, high-fee vehicles or the over-stated AARIR assumptions and estimates were disclosed in the KRS Annual Reports, an uproar would have resulted, an independent investigation could have ensued and RVK could have been terminated, costing them an important client and threatening their high-volume public pension fund client driven business model. RVK, Voytko and Gratsinger let the deception continue because it served their selfish economic purposes to do so.

153. In acting and failing to act as alleged herein, RVK breached its own duties to KRS, and knowingly induced and aided and abetted the breach of duties by the Trustee (acting through its T/Os, who also breached their own duties), while

participating by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise acting in concert with the Trustee and/or other Defendants or T/Os to commit unlawful acts, all to further its own economic interests.

2. Fiduciary Advisor Ice Miller

154. Defendant Ice Miller, LLP ("Ice Miller"), is a limited liability partnership law firm that has served as Fiduciary Advisor to KRS for many years. Ice Miller has had unrestricted access to KRS records and data and constant participation in and intimate knowledge of KRS's true finances, demographics and actuarial situation.

155. Ice Miller states that it has extensive expertise and experience in fiduciary matters for pension plan trustees including advising on the purchase of fiduciary insurance, conflicts of interest and investments in fund of hedge fund investments:

> We represent … public retirement systems … [as] a talent mosaic with the ability to bring the exact legal skills needed for specific projects; [its] Alternative Investments Group offers a broad range of legal advice and services … in connection with [public funds'] alternative investment programs; [and] … since the late 1980s, we have advised these clients in the collective investment of billions of dollars …. Our attorneys have significant experience evaluating, structuring and negotiating alternative investments across the full range of strategies …. Our attorneys are experienced with alternative investments of all sizes … to the largest multi-billion-dollar fund of funds. We also regularly advise our institutional investor clients regarding the protection of their alternative investments.

156. KRS was an important client and source of fees for Ice Miller. Ice Miller's business model depended on representing many public pension funds, charging many, including KRS, over $500,000 each year. These funds were essentially "annuity clients." It was important in this business model not to lose clients, particularly by

matters within its own control. Ice Miller wanted to keep KRS as a client, and was willing to overlook uncomfortable and inconvenient realities to do so.

157. Ice Miller also had a duty to advise KRS in connection with the black box hedge fund purchase, and "Strategic Partnership" with KKR Prisma and the ASA/AASA and the conflicts of interest that tainted these transactions, making them illegal.

158. Ice Miller has also breached its duties by failing to adequately implement, update and oversee the training and education program for trustees and officers as mandated by Kentucky Pension Law. Trustees who were sold the Black Boxes were inadequately trained in fund of hedge fund vehicles and in how to properly and legally deal with the financial/actuarial vise they were in during 2010–11. Ice Miller has continued to violate its duties to KRS by permitting Cook to serve on the Investment Committee (and at one time to be the Investment Committee Chair) and as a trustee during the time KRS invested hundreds of millions of dollars in Prisma to help KKR Prisma while a Prisma executive, still paid by Prisma, worked inside KRS, with access to confidential information and the ability to wield influence. Ice Miller was aware of the events of 2015–2016 including the secret ASA/AASA and the "license to self-deal" embedded therein, as well as violation of KRS's conflict of interest policies with Rudzik coming inside KRS, and approved that misconduct by permitting it to continue.

159. Ice Miller reviewed and was aware of the contents of the KRS Annual Reports and knew that the information therein was false and misleading as detailed elsewhere. Ice Miller reviewed and approved those Annual Reports which identified it as KRS's "fiduciary advisor" and knew that, if the true nature of these high-risk, high-fee Black Box vehicles were known and the false and unrealistic actuarial assumptions and estimates were disclosed in the KRS Annual Reports, KRS's publicly reported funding

deficits would have skyrocketed, an uproar would follow, and an independent investigation could have occurred. Ice Miller could have been terminated and could have lost an important client, thereby threatening its high-volume public pension fund client-driven business model. Ice Miller chose inaction to benefit its own economic self-interest.

160. In acting and failing to act as alleged herein, Ice Miller knowingly aided and abetted the breach of duties by the Trustee (acting through its T/Os), while participating by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise acting in concert with the Trustee and/or other Defendants or T/Os to commit unlawful acts, including the violation of the mandatory duties imposed on each of them and Trustees by Kentucky law, all to further its own economic interests.

3. Actuarial Advisor — Cavanaugh Macdonald

161. Defendant Cavanaugh Macdonald Consulting, LLC ("Cavanaugh Macdonald"), a Georgia limited liability company, represented that it had superior skill, experience and expertise in public pension fund actuarial matters and had the capability to independently and accurately determine the assumptions and estimates necessary to properly oversee and operate a public pension fund.

162. "We are innovative and independent, seasoned …. That's the Cavanaugh Macdonald promise: providing you the advice to help your benefit plans thrive. We are leaders in the public sector consulting community, providing thoughtful and innovative solutions that enable public sector benefit plans to thrive. We provide impartial advice and maintain our independence from political and other outside influences, and these strengths … and make us the leading public sector actuarial consultants in the country."

163. Cavanaugh Macdonald provided expert actuarial services to KRS for many years. It supplied a certification each year for KRS's actuarial estimates and assumptions as contained in the KRS Annual Reports. This included KRS's AARIR and the underlying actuarial assumptions and estimates that went into calculating the actuarial liabilities owed by KRS.

164. Thomas J. Cavanaugh (CEO), Todd B. Green and Alisa Bennett were executives and principals at Cavanaugh Macdonald and were in charge of the KRS account. They signed one or more of the false Cavanaugh Macdonald certifications, opinions and reports that were contained in KRS Annual Reports.

165. KRS was an important client and source of fees for Cavanaugh Macdonald. Cavanaugh Macdonald's business model depended on representing many public pension funds, charging each, including KRS, over $500,000 each year. These funds were essentially "annuity clients." It was important in this business model not to lose clients, particularly by matters within its own control. Cavanaugh Macdonald wanted to keep KRS as a client, and was willing to overlook uncomfortable and inconvenient realities to do so.

166. The KRS account was of considerable personal and financial importance to Cavanaugh, Green and Bennett and their status, compensation and position in the firm depended upon it.

167. Cavanaugh Macdonald reviewed and was aware of the contents of the KRS Annual Reports and knew that the information therein was incomplete, false and misleading. They also knew if the true nature and risks of the false actuarial assumptions and estimates were disclosed in the KRS Annual Reports, KRS's publicly reported funding deficit would have skyrocketed, an uproar would follow, investigations

could have ensued, and they could have been terminated. Cavanaugh Macdonald would lose an important client and its high-volume public pension fund client-driven business model would be threatened. Allowing the deception to continue served the economic interest of Cavanaugh Macdonald — it chose inaction to benefit its own economic self-interest.

168. In acting and failing to act as alleged herein, this Defendant knowingly aided and abetted the breach of duties by the Trustee (acting through T/Os, breaching their own duties), by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise, acting in concert with the Trustee and/or other Defendants or T/Os to commit unlawful acts, including the violation of the mandatory duties imposed on each of them and Trustees by Kentucky law, all to further its own economic interests.

VII. THE KRS PENSION AND INSURANCE PLANS AND THE TIER 1, TIER 2 AND TIER 3 BENEFITS

169. KRS provides three Tiers of Pensions and Insurance Plans for each of the funds it administers. During the 2013 legislative session, Senate Bill 2 was enacted, creating Tier 3 benefits for members with a participation date on or after January 1, 2014. The only benefits promised by KRS to its member that are protected by so-called "inviolable contracts" are the core "monthly pension benefit" of members entitled to Tier 1 and Tier 2 benefits. All other benefits of all plan participants are specifically, explicitly denied any such protection by statute and are subject to diminishment or elimination by KRS and/or the Legislature as they see fit.

170. According to KRS's publications — from which the following graphics are taken — this is how KRS's pension and insurance plans/trusts work. Below is how Tier 3 plans are described by KRS:

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Hybrid Cash Balance Plan Guide

for members who began participating January 1, 2014 and after

Tier 3

KRS currently administers three different pension benefit tiers within our defined benefit plans. The Hybrid Cash Balance plan was established as part of Senate Bill 2, which was enacted by the Kentucky General Assembly during its 2013 Regular Session. We refer to this as Tier 3 Benefits.

What is the Hybrid Cash Balance Plan?

The Hybrid Cash Balance Plan is for members who began participation on or after January 1, 2014. A Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. A Cash Balance Plan resembles a defined contribution plan because it determines the value of benefits for each participant based on individual accounts. However, the assets of the plan remain in a single investment pool like a traditional defined benefit plan. A Cash Balance Plan resembles a defined benefit plan since it uses a specific formula to determine benefits.

Who is eligible?
All regular full-time employees who began participation with KRS on or after January 1, 2014 contribute to the Cash Balance Plan. Your participation in the plan is mandatory unless you are a non-participating employee. Employment classifications that are non-participating include part-time, seasonal, temporary, probationary (CERS only), interim, emergency, and independent contractors.

How does it work?
Members and employers contribute a specified amount into the member's account. The account earns a guaranteed amount of interest at the end of each fiscal year. If the member has participated in the plan during the fiscal year, there may be an additional interest credit added to the member's account depending on KRS' investment returns. All interest is paid on the preceding year's balance so there is no interest paid in the member's first year.

When a member is eligible to retire, the benefit is calculated based on the member's accumulated account balance.

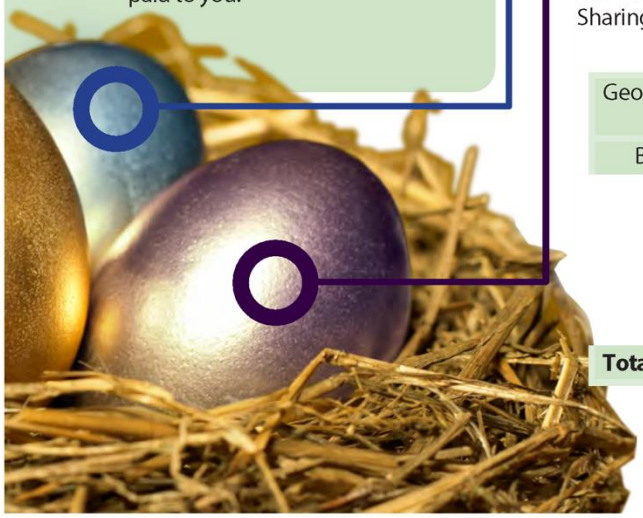
BASE INTEREST

Your account earns a base of 4% interest annually on both the member contributions and the Employer Pay Credit balance. Interest is credited to your account each June 30, based on your account balance from the preceding June 30. New members do not see interest credited in their first year since there is no prior year balance.

Over time, the value of your account can increase a great deal. Visit myretirement.ky.gov for more information. For more information about how to register for your online account, see page 18.

What is Creditable Compensation?

Creditable compensation is used to calculate retirement benefits and includes all salary, wages, tips, and fees as a result of services performed for the employer, including time when you are on paid leave. It does not include payments for compensatory time paid to you.



UPSIDE SHARING

Upside Sharing Interest is the additional interest credit that may be applied to a Tier 3 account.

Upside Sharing Interest is not guaranteed. The following conditions must be met before Upside Sharing Interest is credited to a member's account:

» The system's geometric average net investment return for the last five years must exceed 4%.

» The member must have been active and contributing in the fiscal year.

If a system's geometric average net investment return for the previous five years exceeds 4%, then the member's account will be credited with 75% of the amount of the return over 4%. The credit will be applied to the account balance as of June 30 of the previous year.

The following example illustrates how Upside Sharing Interest works. Remember, Upside Sharing Interest is an additional interest credit. Member accounts automatically earn 4% interest annually. In this example, the additional 2.63% Upside Sharing Interest credit means the total interest paid would be 6.63%.

The geometric average net investment return is calculated on an individual system basis (i.e. KERS, CERS and SPRS). It is possible that the Upside Sharing Interest percentage will differ from system to system. It is also possible that one system may get an Upside Sharing percentage, and another system would not.

Geometric average net return	**7.5%**	
Base interest	- 4%	
	3.5%	
	X 75%	
	2.63%	Upside Sharing Interest Credit
	+ 4%	Base Interest
Total Interest Paid	**6.63%**	

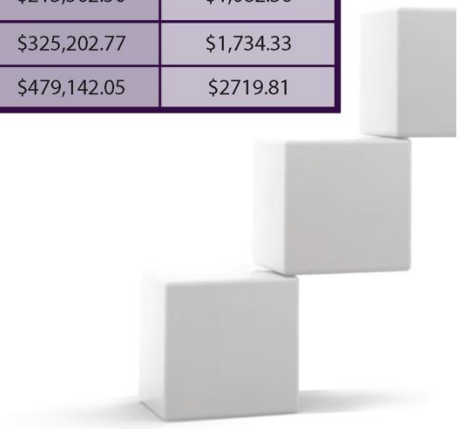
UPSIDE SHARING EXAMPLES

The examples below illustrate the range of return a Tier 3 member may expect to see in their accumulated account balance and final monthly benefit. Over the course of a career, members are likely to have a mixed return. These examples are intended only to demonstrate the possible range.

	BASE INTEREST 4% *without Upside Sharing Interest* This demonstrates an account where no Upside Sharing Interest was applied, this is the minimum.		VS	**BASE INTEREST 4% + *2.63% Upside Sharing Interest*** This demonstrates the account balance growth possible with a continuously healthy market return.	
Service at Retirement	**Accumulated Account Balance**	**Monthly Life Annuity Amount**		**Accumulated Account Balance**	**Monthly Life Annuity Amount**
NONHAZARDOUS: *This example is a nonhazardous member retiring at* **age 65**. *You can see how the monthly benefit increases when the member works longer.*					
20 yrs	$93,800.95	$610.04		$123,696.19	$804.46
25 years	$131,184.61	$853.16		$188,827.41	$1228.04
30 years	$176,667.55	$1148.96		$278,211.51	$1809.35
HAZARDOUS: *This example is a hazardous member who began participation at* **age 25.** *You can see how the monthly benefit increases when the member works longer.*					
20 yrs	$161,546.08	$818.97		$213,502.50	$1,082.36
25 years	$225,929.05	$1,204.90		$325,202.77	$1,734.33
30 years	$304,260.79	$1,727.11		$479,142.05	$2719.81

GOOD TO KNOW

Are my benefits protected?
Accrued benefits are protected but the General Assembly could change future benefits if required by fiscal circumstances.



KRS Benefit Tier Comparison

		Tier 1 *Participation before 9/1/2008* *Defined Benefit*	Tier 2 9/1/2008 through 12/31/2013 *Defined Benefit*	Tier 3 *Participation on or after 1/1/2014* *Cash Balance Plan*
Employee Contribution	Non-Haz	**5% total member contribution**	**6% total member contribution:** 5% to defined benefit pension 1% Health Insurance Contribution (HIC)	**6% total member contribution:** 5% to defined benefit pension 1% Health Insurance Contribution (HIC)
	Haz	**8% total member contribution**	**9% total member contribution:** 8% to defined benefit pension 1% Health Insurance Contribution (HIC)	**9% total member contribution:** 8% to defined benefit pension 1% Health Insurance Contribution (HIC)
Retirement Formula	Haz/Non-Haz	**Final Compensation x Benefit Factor x Years of service**** **Early Retirement Factors are applicable if requirements for an Unreduced Benefit are not met.	**Final Compensation x Benefit Factor x Years of service**** **Early Retirement Factors are applicable if requirements for an Unreduced Benefit are not met.	**Accumulated Account Balance / Actuarial Factor** Accumulated Account Balance= Employee Contributions + Employer Pay Credits + Base Interest + Upside Sharing (If applicable)

		Tier 1 *Participation before 9/1/2008* *Defined Benefit*	Tier 2 9/1/2008 through 12/31/2013 *Defined Benefit*	Tier 3 *Participation on or after 1/1/2014* *Cash Balance Plan*
Cost of Living Adjustment (COLA)	Haz/Non-Haz	No COLA unless authorized by the Legislature with specific criteria. This impacts all retirees regardless of Tier.	No COLA unless authorized by the Legislature with specific criteria. This impacts all retirees regardless of Tier.	No COLA unless authorized by the Legislature with specific criteria. This impacts all retirees regardless of Tier.
Inviolable Contract	Haz/Non-Haz	"Inviolable Contract" language covers all benefits except COLA and retiree health benefits after 7/2003	"Inviolable Contract" language covers all benefits except COLA and retiree health benefits after 7/2003	Accrued benefits would remain protected but the Legislature could change prospective benefits if fiscal circumstances call for it.

Revised: 2/2019

171. Even though the KRS plans are funded in part from the Tier 3 members' personal "contributions" (mandatory deductions from their paychecks), the "inviolable contract" protection exists for none of the other benefits provided by the Plans/Funds, including all Tier 3 benefits.

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Kentucky Retirement Systems

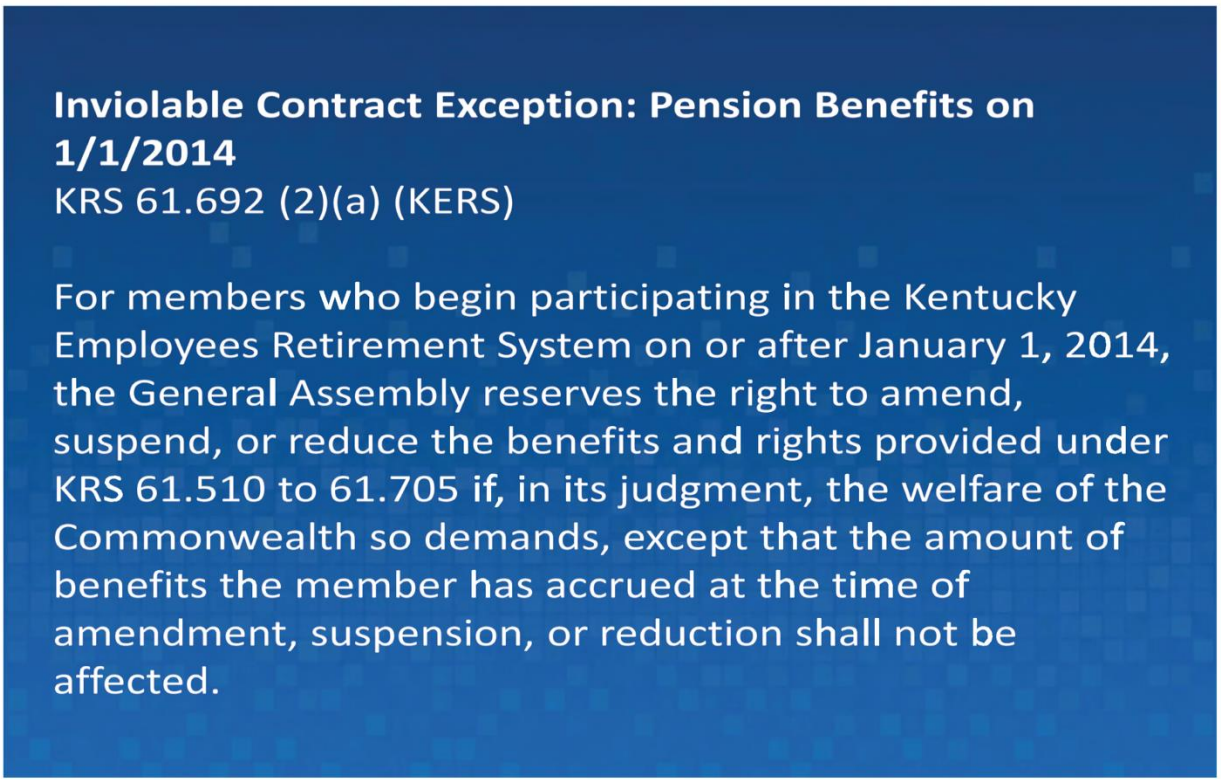
Inviolable Contract Overview

NOT COVERED BY INVIOLABLE CONTRACT:

- Pension benefits on or after January 1, 2014
- Health benefits on or after July 1, 2003
- Cost of Living Adjustments (COLAs)
- Employer contribution rates

Inviolable Contract Exception: Health Insurance Benefits
KRS 61.702(8)(e)

The benefits of this subsection provided to a member whose participation begins on or after July 1, 2003, shall not be considered as benefits protected by the inviolable contract provisions of KRS 61.692, 16.652, and 78.852. The General Assembly reserves the right to suspend or reduce the benefits conferred in this subsection if in its judgment the welfare of the Commonwealth so demands. (Made applicable to SPRS by virtue of KRS 16.645(22) and to CERS by virtue of KRS 78.545(35).)



172. According to KRS this is the current composition of the KRS pension and insurance plans membership and the average pensions being received:

SYSTEMS AND BENEFIT TIERS

BENEFIT TIERS

Each plan provides pension and insurance benefits based on the member's participation date.

Tier 1 Participation Date Prior to 9/1/2008

Tier 2 Participation Date 9/1/2008 - 12/31/2013

Tier 3 Participation Date of 1/1/14 and after

COUNTY EMPLOYEES RETIREMENT SYSTEM

CERS participating agencies include local governments (county and city), school boards, and eligible local agencies. The Non-Hazardous and Hazardous plans combined cover 248,969 members.

CERS Non-Hazardous

	Active	Inactive	Retired	Total
Tier 1	34,428	51,356	58,497	144,281
Tier 2	15,352	17,123	435	32,910
Tier 3	34,852	16,821	1	51,674
Total	**84,632**	**85,300**	**58,933**	**228,865**

CERS Hazardous

	Active	Inactive	Retired	Total
Tier 1	4,441	1,471	7,985	13,897
Tier 2	1,967	548	12	2,527
Tier 3	2,994	683	3	3,680
Total	**9,402**	**2,702**	**8,000**	**20,104**

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

KERS participating agencies include state departments, boards, and employers directed by Executive Order of the Governor to participate in KERS, which covers 135,046 members.

KERS Non-Hazardous

	Active	Inactive	Retired	Total
Tier 1	17,086	32,034	42,736	91,856
Tier 2	6,207	8,527	137	14,871
Tier 3	10,139	6,160	1	16,300
Total	**33,432**	**46,721**	**42,874**	**123,027**

KERS Hazardous

	Active	Inactive	Retired	Total
Tier 1	1,264	1,833	3,121	6,218
Tier 2	752	1,267	25	2,044
Tier 3	1,763	1,994	0	3,757
Total	**3,779**	**5,094**	**3,146**	**12,019**

STATE POLICE RETIREMENT SYSTEM

SPRS covers all full-time Kentucky State Police troopers.

SPRS

	Active	Inactive	Retired	Total
Tier 1	460	173	1,483	2,116
Tier 2	197	64	1	262
Tier 3	242	76	0	318
Total	899	313	1,484	2,696

KRS TOTALS

The KRS totals below reflect all systems combined.

KRS TOTALS - ALL SYSTEMS

	Active	Inactive	Retired	Total
Tier 1	57,679	86,867	113,822	258,368
Tier 2	24,475	27,529	610	52,614
Tier 3	49,990	25,734	5	75,729
Total	**132,144**	**140,130**	**114,437**	**386,711**

Average Monthly Benefit by Length of Service in KERS As of June 30, 2019 (in Whole $)				
	KERS Non-Hazardous		KERS Hazardous	
Service Credit Range	Number of Accounts	Average Monthly Benefit	Number of Accounts	Average Monthly Benefit
Under 5 years	6,211	$173.91	841	$202.44
5 or more but less than 10	6,084	433.48	853	574.94
10 or more but less than 15	5,594	719.91	782	1,030.75
15 or more but less than 20	4,779	1,060.91	698	1,539.20
20 or more but less than 25	5,102	1,407.91	1,117	2,025.22
25 or more but less than 30	12,854	2,296.57	207	2,859.94
30 or more but less than 35	6,712	3,241.38	59	3,688.32
35 or more	2,550	4,565.84	6	4,230.57
Total	**49,886**	**$1,662.13**	**4,563**	**$1,235.65**

Average Monthly Benefit by Length of Service in CERS As of June 30, 2019 (in Whole $)				
	CERS Non-Hazardous		CERS Hazardous	
Service Credit Range	Number of Accounts	Average Monthly Benefit	Number of Accounts	Average Monthly Benefit
Under 5 years	9,221	$163.47	1,156	$392.85
5 or more but less than 10	11,313	339.67	1,117	701.83
10 or more but less than 15	11,327	541.91	1,029	1,253.77
15 or more but less than 20	9,392	806.55	1,021	1,796.36
20 or more but less than 25	10,776	1,008.31	3,844	2,554.80
25 or more but less than 30	12,344	1,917.41	1,458	3,550.65
30 or more but less than 35	2,981	2,692.07	420	4,277.51
35 or more	792	3,730.67	88	5,290.93
Total	**68,146**	**$947.63**	**10,133**	**$2,133.82**

Average Monthly Benefit by Length of Service in SPRS As of June 30, 2019 (in Whole $)		
Service Credit Range	Number of Accounts	Average Monthly Benefit
Under 5 years	137	$547.95
5 or more but less than 10	57	937.32
10 or more but less than 15	63	1,410.22
15 or more but less than 20	114	2,081.51
20 or more but less than 25	506	2,691.85
25 or more but less than 30	491	3,670.44
30 or more but less than 35	238	4,753.84
35 or more	60	6,167.45
Total	**1,666**	**$3,073.44**

173. The following presentation of the current Actuarial and Investment situation at the KRS Plans is taken from KRS's 2019 Annual Report.

ACTUARIAL REPORT

This is an overview of the Pension and Insurance Funds' actuarial status for the fiscal year ended June 30, 2019. For more detailed information, refer to the Actuarial Section of the 2019 CAFR published on the KRS website.

2019 ACTUARIAL VALUATION RESULTS

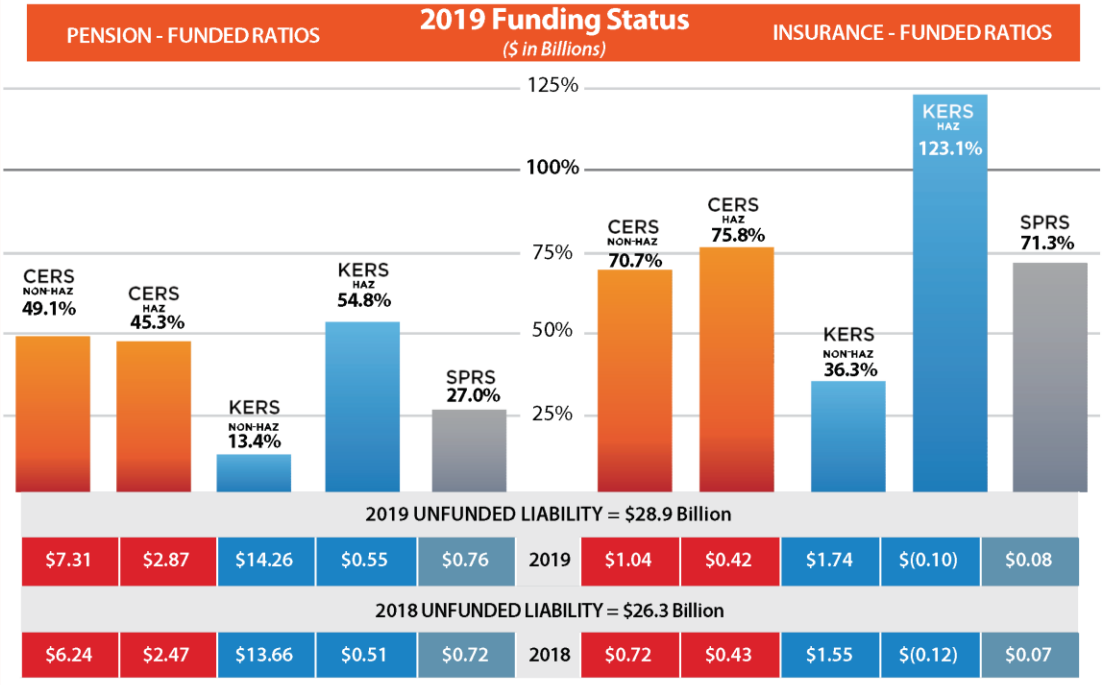
Each year the funding levels of the KRS Pension and Insurance plans are determined by the annual actuarial valuation based on assumptions set by the KRS Board for the fiscal year ending June 30. The fiscal year 2019 valuation results include new assumptions that were adopted by the Board in April 2019. In summary, total pension unfunded liabilities increased by $2.15 billion which was caused by lower payroll, changes in actuarial assumptions, and investment returns that fell short of the assumed rate of return. Total insurance unfunded liabilities also increased by $0.53 billion due to higher than expected Medicare insurance premiums and actuarial assumption changes. Total KRS unfunded liabilities increased by $2.68 billion. KRS is in year 24 of a 30 year amortization period.

PENSION PLANS

The actuarial unfunded liability for the Pension plans was $25.75 billion, an increase over fiscal year 2018. The funded ratio for all plans, except KERS Non-Hazardous, decreased since the prior year. These decreases are mainly due to the updated actuarial assumptions adopted by the Board. Additionally, the full actuarially determined contribution rates for both CERS funds were not paid in fiscal year 2019 due to the contribution phase-in provisions from HB 362 passed during the 2018 legislative session, which further decreased the funded ratio for these funds.

INSURANCE PLANS

The Insurance Plans' unfunded actuarial liability as of June 30, 2019, was $3.18 billion compared to $2.65 billion in the last fiscal year. The decreases for KERS Hazardous and CERS Non-Hazardous funds are mainly due to the updated actuarial assumptions adopted by the Board. The updated actuarial assumptions decreased the funded ratio for the other funds as well; however, other demographic experience offset this decrease so that the funded ratio stayed relatively stable for the KERS Non-Hazardous, CERS Hazardous, and SPRS funds. Total KRS Insurance funded ratio was 63.5%.



Fair Values By Plan - Pension as of June 30, 2019 *($ in Millions)*

	CERS Non-Hazardous		CERS Hazardous		KERS Non-Hazardous		KERS Hazardous		SPRS		TOTAL KRS	
Assets	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV
U.S. Equity	$1,359	18.90%	$454	18.79%	$341	15.65%	$128	18.72%	$44	15.68%	$2,326	18.25%
Non-U.S. Equity	1,502	20.90%	502	20.80%	367	16.83%	138	20.13%	48	17.32%	2,557	20.06%
Core Fixed Income	1,222	17.00%	402	16.65%	483	22.18%	114	16.59%	66	23.56%	2,287	17.94%
Specialty Credit	1,169	16.26%	387	16.02%	300	13.77%	110	16.08%	43	15.56%	2,009	15.76%
Opportunistic	67	0.94%	22	0.92%	20	0.90%	6	0.89%	3	0.87%	118	0.92%
Real Return	639	8.89%	218	9.02%	168	7.71%	58	8.44%	23	8.22%	1,106	8.68%
Private Equity	670	9.32%	229	9.49%	201	9.24%	62	9.00%	19	6.86%	1,181	9.27%
Real Estate	271	3.76%	87	3.59%	78	3.62%	25	3.74%	11	3.80%	472	3.71%
Absolute Return	125	1.73%	39	1.63%	40	1.84%	11	1.52%	4	1.51%	219	1.71%
Cash	165	2.30%	74	3.09%	180	8.26%	33	4.89%	19	6.62%	471	3.70%
TOTAL PORTFOLIO	**$7,189**		**$2,414**		**$2,178**		**$685**		**$280**		**$12,746**	

Fair Values By Plan - Insurance as of June 30, 2019 *($ in Millions)*

	CERS Non-Hazardous		CERS Hazardous		KERS Non-Hazardous		KERS Hazardous		SPRS		TOTAL KRS	
Assets	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV	Fair Value (FV)	% of Total FV
U.S. Equity	$466	18.84%	$249	18.88%	$185	19.93%	$99	18.82%	$37	18.74%	$1,036	19.02%
Non-U.S. Equity	498	20.17%	269	20.36%	199	21.57%	111	21.04%	40	19.80%	1,117	20.53%
Core Fixed Income	384	15.54%	206	15.59%	138	14.86%	86	16.27%	30	15.41%	844	15.50%
Specialty Credit	366	14.79%	194	14.71%	155	16.77%	84	15.94%	30	14.96%	829	15.22%
Opportunistic	27	1.10%	15	1.12%	10	1.05%	6	1.15%	2	1.12%	60	1.10%
Real Return	216	8.75%	112	8.52%	76	8.19%	45	8.54%	16	7.85%	465	8.55%
Private Equity	284	11.46%	160	12.10%	48	5.16%	52	10.02%	24	12.13%	568	10.43%
Real Estate	90	3.66%	50	3.75%	28	3.07%	21	3.95%	8	4.00%	197	3.62%
Absolute Return	40	1.62%	22	1.70%	14	1.53%	9	1.78%	4	1.77%	89	1.65%
Cash	101	4.07%	43	3.27%	73	7.87%	13	2.49%	8	4.22%	238	4.38%
TOTAL PORTFOLIO	**$2,472**		**$1,320**		**$926**		**$526**		**$199**		**$5,443**	

VIII. THE NAMED TIER 3 PLAINTIFFS WHO ARE MEMBERS OF KRS'S PENSION AND INSURANCE TRUSTS/PLANS HAVE BEEN DAMAGED

174. Each of the named Plaintiffs has suffered harm — injury in fact — and damages caused by, the Defendants' misconduct, which is redressable in this lawsuit via the relief sought for the Tier 3 Plaintiffs and the class. Moreover, the alleged misconduct impaired the financial condition of the KRS pension and insurance plans/trusts, greatly increasing the likelihood that those pension and insurance plans will fail, resulting in the loss of all benefits and causing the amount of the Upside Sharing Interest credited to the accounts of Tier 3 members to be materially diminished.

175. Each of the Named Tier 3 Plaintiffs is or was required to contribute varying percentages (5–9%) of their own money in the form of payroll deductions to help fund the respective pension and insurance plans in which they are participants, plus an additional non-refundable 1% into the pension plan. These personal contributions are involuntary extractions because participation in the plans is mandatory for all Tier 3 members.

176. For the individual Named Plaintiffs, these mandatory personal contributions have amounted to thousands of dollars. These Tier 3 KRS members' personal contributions are comingled with employer payments to the KRS funds and are invested with them according to KRS's investment strategy and decisions made by the trustees, the KRS investment staff, the advisors and investment/product vendors they work with. Over the years, the KRS plan ***members' personal funds contributions have been ill-invested***, ***diminished***, ***lost and/or*** wasted including in unsuitable, reckless investments such as Black Box Hedge Funds and the excessive fees those Black Boxes carry. For example, in fiscal 2014, 2015, 2016 and 2018, the KERS-NH plan was

cash flow negative — deductions (primarily benefit payments to retirees and administrative expenses) were greater than the sum of all incomes (including member and employer contributions, general funding and investment income). Thus, current employees who are contributing to the KERS-NH plan were paying for current retirees, and none of the current employees' contributions was put away for their own retirement. But the monies contributed by the Tier 3 Plaintiffs and plan members belonged to Plaintiffs and other class members. It was entrusted by them to the KRS trustees and their advisors/assistors' fellow actors who mis-invested, lost or wasted those funds, causing damage to the named Plaintiffs and other Tier 3 KRS plan members.

177. The Tier 3 members are not in a defined benefit plan with a fixed and guaranteed future pension benefit like Tier 1 and Tier 2 members. The Tier 3 Plan is a Hybrid Cash Balance Plan where a member's actual pension benefit depends on the ***value*** of the member's ***individual account*** when he/she retires. Tier 3 members have ***individual accounts and their retirement benefits are based on the value of their individual accounts*** at the time they retire. That value depends significantly on the investment performance and expense levels of KRS. Because the Tier 3 members are entitled to Upside Sharing based on a backward-looking 5-year geometric average of plan-wide returns, the Tier 3 members' accounts have been significantly affected by poor investment performance and high expense levels that pre-dated their entry into KRS as new public employees. The individual accounts exist as accounting entries; the actual assets are part of the comingled whole of the KRS plans. Thus, if a plan (such as the KERS-NH pension plan) were to be depleted, the assets backing the Tier 3 individual accounts would be gone.

178. The investment funds of all KRS Plan Members are comingled by each Fund, and investment decisions are made by the KRS trustees and investment staff, the same as other Plans. Tier 3 Members are entitled to a fixed annual interest rate on their account balances, plus "Upside Sharing," *i.e.*, they get 75% of KRS's 5-year investment returns over 4%, an amount calculated and credited to the Tier 3 members' individual accounts each year. Because they are in a Hybrid Cash Balance Plan, the Tier 3 retiree's pension benefit is ultimately based on the value of his/her individual account at retirement, which is in turn affected by the stewardship and KRS retirement investment returns over the years the worker is employed.

179. While the amount of the upside sharing returns to Tier 3 members have been modestly positive since 2014, Tier 3 benefit recipients have nevertheless been injured in fact and damaged by the defendants' alleged misconduct. ***Simply put, the Tier 3 Upside Sharing amounts would have been materially higher each year, but for the misconduct alleged herein.*** The alleged wrongdoing *i.e.*, the course of conduct was still raging on inside KRS well into 2017, and the adverse economic impact of that misconduct, the bad hedge fund investments, and their excessive fees ***continued well into 2020 and beyond***. KRS's hedge fund investments returned a negative (-0.13%) for the five-year period ended 6/30/2020. In other words, these hedge fund investments have acted as a huge drag holding down plan-wide investment returns.

180. The poor hedge fund returns, resulting from the wrongful conduct complained of and caused in part by the excessive and wasteful Black Box and other hedge fund fees, were a drag on KRS returns for each 5-year period ended from 6/30/2015 through 6/30/2020, and thus diminished the amount of "upside sharing

interest" the Tier 3 beneficiaries received. Moreover, the investment constraints under which the KERS-NH and SPRS pension funds labored, caused by the wrongful conduct complained of, further diminished the upside sharing interest for the Tier 3 participants in those plans. Were it not for the Defendants' misconduct and waste of plan assets, which have been ongoing well through 2018–20, the investment returns of KRS would have been higher, and the upside sharing of these Tier 3 beneficiaries would have been higher and their ultimate pension benefit greater. ***This injury-in-fact and damage has already occurred***. The *minimum* "drag" for each of the five-year periods mentioned is:

fye 6/30/15	fye 6/30/16	fye 6/30/17	fye 6/30/18	fye 6/30/19
3.56%	3.89%	3.54%	2.97%	1.05%

For the year ended June 30, 2020, KRS earned only 1.15% on its investments — a miserable return – especially compared to the 5.3% return pensions invested in a global 60/40 strategy enjoyed. These poor returns were due in part to the continuing impact of the damages caused by Defendants' alleged wrongdoing, including the preservationist investment steps required by prior plan losses and the excessive fees charged by Defendants.

IX. DUTIES OF THE KRS TRUSTEES/OFFICERS AND DEFENDANTS TO KRS, ITS FUNDS AND ITS MEMBERS IN OVERSEEING, OPERATING AND DEALING WITH KRS

A. Kentucky Pension, Trust and Other Laws

181. Each Defendant had a duty to comply with Kentucky law, including the Kentucky Pension Law, Kentucky Trust Law, as well as the common law duties to act with loyalty and due care and in good faith with respect to, and in the "sole interest" of KRS plan / trust members – including the Tier 3 members – and to not induce, aid, abet

or assist or conspire or collude with any breach of trust by the Trustee, or any KRS trustee or officer to facilitate or advance the breach of duties such persons owed with respect to KRS, its members/beneficiaries or its pension and insurance funds and trusts.

182. ***All duties owed by each of the Defendants were owed directly to KRS's members and beneficiaries, including members of the Tier 3 class, as well as to KRS and its funds/plans.*** All three systems contained pension and insurance plans/trusts that were governed by the same Board, and managed by staff retained by that Board operating under uniform policies as a united overall economic entity under KERS.

> **61.645 Board of Trustees – Powers – Members – Other Duties – Annual financial report – Trustees education program – Information made available to public**
>
> (1) The County Employees Retirements System, Kentucky Employees Retirement System and State Police Retirement System ***shall be administered by the board of Trustees of the Kentucky Retirement Systems*** ….
>
> * * *
>
> (2) The board is hereby granted the powers and privileges of a corporation, including but not limited to the following powers:
>
> (a) To sue and be sued in its corporate name**:**
> (f) To purchase fiduciary liability insurance**;**
>
> * * *
>
> (15)(a)A trustee shall discharge his duties as a trustee …
>
> 1. In good faith:
> 2. On an informed basis; and
> 3. In a manner he honestly believes to be in the best interest of the Kentucky Retirement Systems
>
> (b) A trustee discharges his duties on an informed basis if, when he makes an inquiry into the business and affairs of the Kentucky Retirement Systems or into a particular action to be taken or decision to be made, he exercises the care an ordinary

prudent person in a like position would exercise under similar circumstances.

* * *

(d) A trustee shall not be considered as acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by paragraph (c) of this subsection unwarranted.

(e) Any action taken as a trustee, or any failure to take any action as a trustee, shall not be the basis for monetary damages or injunctive relief unless:

1. The trustee has breached or failed to perform the duties of the trustee's office in compliance with this section; and
2. In the case of an action for monetary damages, the breach of failure to perform constitutes willful misconduct or wanton or reckless disregard for human rights, safety, or property.

f) A person bringing an action for monetary damages under this section shall have the burden of proving by clear and convincing evidence the provisions of paragraph (e)1 and 2, of this subsection, and the burden of proving that the breach of failure to perform was the legal cause of damages suffered by the Kentucky Retirement System.

* * *

(19) In order to improve public transparency regarding the administration of the systems, the board of trustees shall . . . make available…

* * *

(b) The Comprehensive Annual Financial Report …

* * *

(m) Information regarding the systems' financial and actuarial condition that is easily understood by the members, retired members, and the public.

183. The KRS Board is the trustee and guardian of the funds and assets of the overall retirement system.

61.650 Board trustee of funds – Investment Committee – Standards of conduct

* * *

(1)(c) A trustee, officer, employee, or other fiduciary shall discharge duties with respect to ***the retirement system***:

1. Solely in the interest of the members and beneficiaries;

2. For the exclusive purpose of providing benefits to members and beneficiaries and paying reasonable expenses of administering the system;

3. With the care, skill, and caution under the circumstances then prevailing that 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;

* * *

(d) In addition to the standards of conduct prescribed [above], all individuals associated with the investment and management of retirement system assets, whether contracted investment advisors, board members or staff employees, shall adhere to the Code of Ethics and Standards of Professional Conduct, the asset Manager Code of Professional Conduct if the individual is managing retirement system assets, and the Code of Conduct for Members of a Pension Scheme Governing Body if the individual is a board member...

* * *

61.655 Board of trustees — Conflict of interest

No trustee or employee of the Kentucky Retirement Systems Board shall:

(1) Have any interest, direct or indirect, in the gains or profits of any investment or transaction made by the board . . .

* * *

(5) Use his or her official position with the retirement system to obtain a financial gain or benefit or advantage for himself or herself or a family member;

(6) Use confidential information acquired during his or her tenure with the retirement system to further his or her own economic interests or that of another person; or

(7) Hold outside employment with or accept compensation from any person or business with which he or she has involvement as part of his or her official position with the retirement system....

B. Operation/Oversight of the KRS Pension Funds

184. Because a public pension plan like KRS involves large numbers of plan members and beneficiaries (over 390,000) entitled to benefits totaling billions of

dollars, with large amounts of assets ($15 billion) to be invested over very long periods of time, the "law of large numbers" applies. Even a very small change in any of the key estimates/assumptions — how many members will retire and how long will they live, how many new employees will enter the plan, how much will they be paid, what will their raises look like, what will be their plan contributions, what will the inflation rate be and how much will the plan earn on its investments — can have a very large dollar impact when spread over the plans and over time. This is also true of any individual damage of the Tier 3 plan members.

185. Of all actuarial assumptions, the annual investment return assumption (AARIR) has the greatest impact on the projected long-term financial health of a pension plan. This is because over time, the majority of revenues of a public pension fund come from investment earnings. Even a small change in a plan's investment return assumption — as little as ¼ of 1% — can result in a very large impact, often hundreds of millions of dollars, on a plan's publicly reported funding level. As one commentator has said:

> Of all actuarial assumptions, a public pension plan's investment return assumption has the greatest effect on the projected long-term cost of the plan. This is because over time, a majority of revenues of a typical public pension fund come from investment earnings. Even a small change in a plan's investment return assumption can impose a disproportionate impact on the plan's funding level and cost.

186. Because these actuarial estimates/assumptions are essential to accurately determine all the important metrics on which the pension plan depends, these estimates must be realistic and constantly revised as circumstances evolve. Using knowledge of these factors, the competent, trained and prudent trustee must make discerning judgments as to each of the pertinent variables, in good faith, on an informed basis, and

after making inquiries and undertaking skeptical evaluations. Only then can the fund, its governmental sponsor and its beneficiaries know how much money the plan will owe and how funded or underfunded it actually is and how much money the government must put into the fund each year (the annual required contribution) to keep the fund at a healthy funding level. In addition, trustees must accurately and realistically estimate the AARIR a fund will achieve. The amounts the sponsoring political entities are supposed to contribute to the pension funds to keep the pension safe, stable, and adequately funded depends directly on the accuracy of this assumption.

187. The T/Os consistently used, or allowed the use of, outdated, misleading or false estimates and assumptions of the actuarial value of the Trust Funds' actuarial assets and liabilities. Most glaring was the use of 7.75% of AARIR in all years from 2006 through 2015 when the cumulative moving average annual rate of return of the KRS Funds never even came close to that figure ***in any one year***. That is not a mistake or a bad estimate. It is deliberate, willful manipulation to conceal the true financial and actuarial condition and underfunded status of the KRS Plans – and the yawning gap between AARIR and actual performance created opportunity for the Hedge Fund Sellers to peddle their false marketing built around unrealistic expected returns.

188. The trustees and officers willfully or recklessly violated their duties to KRS and its Funds, and did not act in good faith or in what they honestly believed was in the best interests of KRS, and its Funds when they failed to: (i) adequately safeguard the trust funds under their control; (ii) procure adequate fiduciary insurance; (iii) invest the trust assets prudently; (iv) avoid excessive and/or unreasonable fees and expenses; (v) use realistic estimates and assumptions regarding the actuarial condition and future investment returns of the funds; (vi) adequately match the assets and liability of the

funds; (vii) protect and assure KRS's full legal rights, including the right to sue in Kentucky state court, in open proceedings, with a jury trial, if KRS's legal rights were violated by others — especially by sophisticated out-of-state sellers of investment products who might try to limit or eliminate KRS's legal remedies; or (viii) make truthful, complete, accurate disclosure of, or a fair presentation of, the true financial and actuarial condition of the KRS Funds and Plans as is detailed in this Complaint.

C. Duties of The Hedge Fund Sellers

189. Kentucky law specifies that persons associated with the investment and management of KRS assets, including investment advisors and mangers like the Hedge Fund Sellers and RVK, are fiduciaries subject to, among others, "sole interest" and "exclusive purpose" obligations.

190. The excerpts from Blackstone and KKR 10-Ks make clear how KKR, Blackstone, Prisma, KKR Prisma, PAAMCO, and PAAMCO Prisma admit they owe "fiduciary duties to clients." Blackstone goes so far as to describe "our" firm "as stewards of public funds" that "supports a better retirement for millions of pensioners." "Stewardship" is "the conducting, supervising, or managing of something; especially: the careful and responsible management of something entrusted to one's care."[21]

[21] Merriam-Webster further notes, under the heading *Good Stewardship*:

> When *stewardship* first appeared in English during the Middle Ages, it functioned as a job description, denoting the office of a *steward*, or manager of a large household. Over the centuries, its range of reference spread to the oversight of law courts, … In recent years, the long-established "management" sense of stewardship has evolved a positive meaning, "careful and responsible management." …

MERRIAM-WEBSTER ONLINE, *available at* https://www.merriam-webster.com/dictionary/stewardship (last visited July 6, 2021).

191. The Hedge Fund Sellers ***explicitly agreed*** – while being considered as a hedge fund seller long before the actual sales – to "***accept fiduciary responsibility***" as part of accepting complete responsibility for and discretion to "select, deselect, and monitor the entire investment fund." Moreover, each Hedge Fund Seller took on common law fiduciary duties before selection and contracting by virtue of the successful efforts they each made to become "trusted advisers" to KRS and its officers and trustees.

192. Each of the Hedge Fund Sellers was in a conflict of interest when acting as fiduciaries, investment advisors or managers in advising the KRS investment staff and trustees on hedge fund investments and acting to manage KRS's investments, while at the same time selling KRS, or continuing the placement of, their own custom-designed high-fee, Black Box fund of hedge funds products. The Hedge Fund Sellers, as sophisticated financial professionals recommending investment strategies to KRS while selling their own products, were required to adhere to the highest standards. They had complete discretion to pick the sub-funds in each Black Box, and were the only entities able to exercise any management over them. In addition, the KRS Funds were going to be "locked up" under the Hedge Fund Sellers' control for years. Hedge Fund Sellers had a duty to only recommend those specific investments or overall investment strategies that were ***suitable*** for KRS given its ***particular circumstances***, having an "adequate and reasonable basis" for any recommendation made, including an obligation to investigate and obtain adequate information about the Funds' financial and actuarial condition and the investment recommended. And because of their superior knowledge and expertise and their knowledge of the dependence of the understaffed KRS on them and because they had discretion to select the downstream Black Box Funds, and because

monies placed in the Black Boxes could not be withdrawn at will — they owed fiduciary duties as well. They violated all these duties as detailed in this Complaint.

193. As fiduciaries, the Hedge Fund Sellers were obligated to put the interests of KRS above their own — and in no way to take or gain advantage over KRS or its members. They were required to tell the complete truth to KRS and its members.

D. Duties of The Investment and Fiduciary Advisors

194. The Investment Advisors and Fiduciary Advisors each owed KRS and its plan members fiduciary duties, the "sole interest" and "exclusive benefit" obligations as well as duties of due care and diligence, and the duty to assure that KRS trustees and officers comply with the Kentucky Pension Law and the other statutes enacted to protect KRS, its members and beneficiaries. RVK, was also subject to the CFA Code of Ethics, Standards of Professional Conduct, and the CFA Asset Manager Code of Professional Conduct and thus owed the same duties as the Hedge Fund Sellers as alleged above, and also failed to comply with those duties, as detailed in this Complaint. In light of Ice Miller's professed expertise, its duties included overseeing and monitoring the compliance with fiduciary standards by the trustees and officers, and by all professionals rendering expert advice and/or services to KRS, and by the sellers of significant investment products to KRS and the Funds.

195. After the huge losses of 2001–02 and 2008–09, the internal asset/liability study revealed a dangerous mismatch and a looming liquidity threat. While concealing the true state of affairs, trustees searched for some kind of high-yield "home run" investment to rescue themselves from and to cover up their own failed stewardship.

196. Rather than face the public outcry, uproar, political firestorm and inquiries that would have resulted had they told the truth in 2010–11 as the law required

them to do — rather than honestly disclosing the true facts and seriousness of KRS's financial/actuarial situation, so that proper and prudent steps could be taken then to rescue the funds, secure increased state funding at that time and assure the KRS Pension funds were prudently invested going forward — KRS trustees and investment staff, with the material aid and assistance of Defendants, obfuscated, misled and falsely reassured KRS's Pension members and beneficiaries and bet billions on speculative "absolute return" and "real return" "investment" strategies that failed.

197. The Hedge Fund Sellers sold the high-fee, high-profit Black Box vehicles to KRS even though they and RVK knew the extremely high-risk, high-fee, illiquid, speculative vehicles were unsuitable investments for KRS given its particular financial/actuarial situation. Then, even though the Kentucky Pension Law required Defendants to tell the truth — the complete unvarnished truth — in "easily understood" language to KRS retirees and beneficiaries, the Defendants did not do so.

198. Each Defendant made or permitted to be made statements they knew were false and/or misleading assurances and obfuscations to KRS members and beneficiaries through the KRS Annual Reports, which created a false sense of security, a false sense of good stewardship and a false sense of legal compliance. These statements include:

- Trustees were "performing their fiduciary duties." "Investment decisions" were "the result of the conscious exercise of discretion;" "proper diversification of assets must be maintained" and Trustees' policies "provide significant returns over the long term while minimizing investment related expense."

- Trustees "follow a policy of preserving capital" by protecting against … undue losses in a particular investment area."

- KRS portfolios "are diversified through the use of multiple asset classes" … "which represent an effective allocation to achieve overall return and risk diversification."

- "The Board decid[ed] on the most effective asset allocation strategies … to lower risk, control the level of illiquidity in the portfolios, and generate a return expected to exceed the actuarially assumed rate of return of 7.75%."

- "The main reason (for the new absolute-return strategy) is to reduce volatility in the portfolio overall … [and] to get our expected rate of return of 7.75%. Absolute return helps us maintain our expectations but lowers our risks."

- "The Board follows a policy of thoughtfully growing our asset base while protecting against undue risk and losses in any particular investments;" (ii) the "portfolios are diversified on several levels … through multiple asset classes [that] represent an efficient allocation to achieve overall return and risk characteristics;" (iii) "portfolios within each of the asset classes are diversified through both investment strategies and the selection of individual securities."

- "[N]ew allocations to the … absolute return buckets [mean] going forward the portfolio is more diversified than ever and represent an efficient allocation to achieve overall return and risk characteristics."

- "We expect the Board's continued high standard of care for these assets and commitments to diversification to allow the System to meet its long-term goals and objectives."

- "Based on the continuation of current funding policies by the Board, adequate provisions are being determined for the funding of the actuarial liabilities of the Kentucky Employee Retirement System … as required by the Kentucky Revised Statutes. The funding rates established by the Board are appropriate for this purpose" ….

- "The relationship of actuarial assets of each fund to the actuarial accrued liabilities," *i.e.*, "the funding level" should increase over time until it reaches 100%."

- Because of Trustees' "outstanding stewardship," KRS had received an award — "Certificate of Achievement" from the Government Finance Office Association of the United States" for "Excellence in Preparation of its financial reports" and for publishing an "easily readable and efficiently organized document" which satisfies "applicable legal requirements."

199. The Hedge Fund Sellers reviewed and were aware of the contents of the KRS Annual Reports and knew that the information was false and/or misleading. They

also knew that if the true nature and risks of these high-risk, high-fee vehicles were disclosed in the KRS official Annual Reports, an uproar would have resulted, their predatory business model could have been exposed, and the unsuitable "Daniel Boone," "Henry Clay," and "Colonels" investments would have been terminated, costing them millions and millions of dollars a year in fees, and resulting in very harmful publicity. So, they let the deception continue because it served their selfish economic purposes to do so.

200. The Investment Advisor Defendant — R.V. Kuhn — reviewed and was aware of the contents of the KRS Annual Reports and knew that the information therein regarding the KRS investment policies, practices, AARIR, KRS's "Absolute Return" strategies, *i.e.,* the Black Boxes, was incomplete, false and misleading. They also knew if the true nature of KRS's investment policies and practices, the risk of the AARIR and risks of these high-risk, high-fee vehicles were disclosed in the KRS Annual Reports, an uproar would have resulted, independent investigators could have been called for and the Investor Advisor Defendants could have been fired, costing them an important client and needed fees and seriously threatening their high-volume public pension client business model. So, they let the deception continue because it served their selfish economic purposes to do so.

201. The Fiduciary Advisor Defendant — Ice Miller — reviewed and was aware of the contents of the KRS Annual Reports and knew that the information therein regarding the matters alleged in this Complaint was incomplete, false and misleading. Ice Miller also knew if the true nature and risks of these high-risk, high-fee vehicles and the false actuarial assumptions and estimates were disclosed in the KRS Annual Reports, an uproar would have resulted, an independent investigation could have

followed and the Fiduciary Advisor could have been terminated, costing them an important client and needed fees, and seriously threatening their high-volume, public pension fund client driven business model. Moreover, Ice Miller was aware of but did nothing to stop the unlawful take over by KKR Prisma of the hedge fund portfolio and the activities surrounding and emanating from the ASA/AASA. So, it let the deception continue because it served its selfish economic purposes to do so.

202. Because they intentionally misled rather than tell the truth, Defendants' actions and failures to act alleged in this Complaint are one or more of a civil conspiracy, course of common conduct, and/or a joint enterprise. The associated false statements created what top Kentucky officials termed a "false sense of security" leading to "smaller than necessary [government] contributions," because instead of complying with the law and telling the truth they "manipulated … actuarial assumptions" used "unreasonably high investment expectations … while using "false payroll numbers" — which was "morally negligent and irresponsible conduct."

X. DEFENDANTS' SCHEME, CONSPIRACY AND COURSE OF CONDUCT AND JOINT ENTERPRISE

A. The 2010–2011 Black Box Hedge Funds Debacle

1. The 2000s Bring Huge Losses, Horrible Investment Performance and Funding Deficits

203. In 2000–01, KRS lost $2.2 billion in investments (over 20% of the KRS Funds' assets). In 2008–09, KRS lost over $4.4 billion (over 30% of the KRS Funds' assets). After these losses, the trustees received studies which revealed that the financial condition and liquidity of the Funds were seriously threatened and far worse than was publicly known. The trustees had been utilizing outmoded, unrealistic and even false

actuarial estimates and assumptions about the Pension Plans' key demographics, *i.e.*, retiree rates, longevity, new hires, wage increases, and inflation. For example, the Trustees used an assumed 4.5% yearly governmental payroll growth when new hiring rates were near zero or negative and interest rates were too. Most importantly, KRS's assumed annual rate of investment return ("AARIR") of 7.75% was not realistic.[22] Nevertheless, the trustees — actively induced and encouraged by the Defendants — continued to use assumptions that were proven to be dead wrong by the actual figures established since 2000. From 2000 through to date, the Funds' cumulative moving average annual rate of return has never even come close to that "assumption." That is not a mistake or a bad estimate. It is deliberate concealment.

204. Between 2000 and 2016, the KRS Plans achieved the following ***actual*** annual rates of return on investments[23] (negative returns are shown in red):

YEAR	Excluding Interest/Dividends		Including Interest/Dividends
2000	+1.82%		+4.91%
2001	-3.58%		-0.36%
2002	-5.12%		-1.74%
2003	-3.60%		-0.35%
2004	-0.73%		+2.38%
2005	+ 0.41%		+ 3.45%
2006	+ 1.32%		+ 4.32%
2007	+ 2.63%		+ 5.61%
2008	+ 1.45%		+4.44%
2009	-1.04%		+ 1.91%
2010	+ 0.21%		+3.08%

[22] Over the relevant time period KERS used AARIRs of 8.25% (6/30/01–6/30/06), 7.75% (6/30/06–6/30/15) and 7.50% after 6/30/15; amid recent disclosures the AARIR has been cut even further to 5.75%. For simplicity, and because 7.75% was used throughout the bulk of the relevant time periods, we use 7.75% throughout, unless the difference matters.

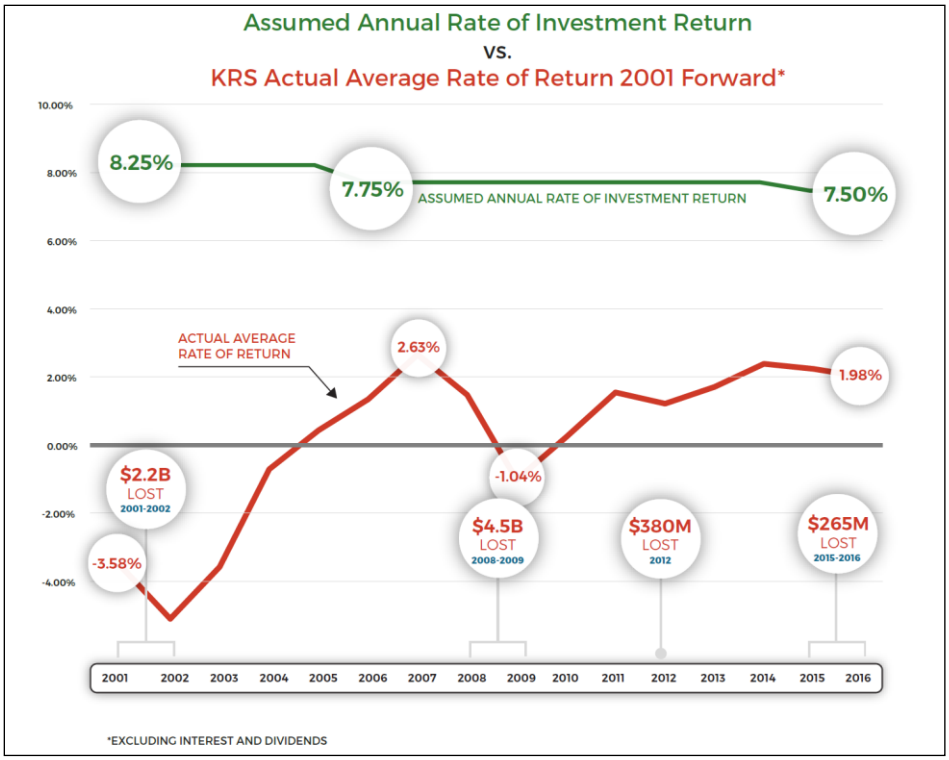
[23] The data in this chart, and in charts and throughout this Complaint, is the cumulative moving average of the actual returns from the year 2000 forward to each respective year end, unless the context clearly states to the contrary.

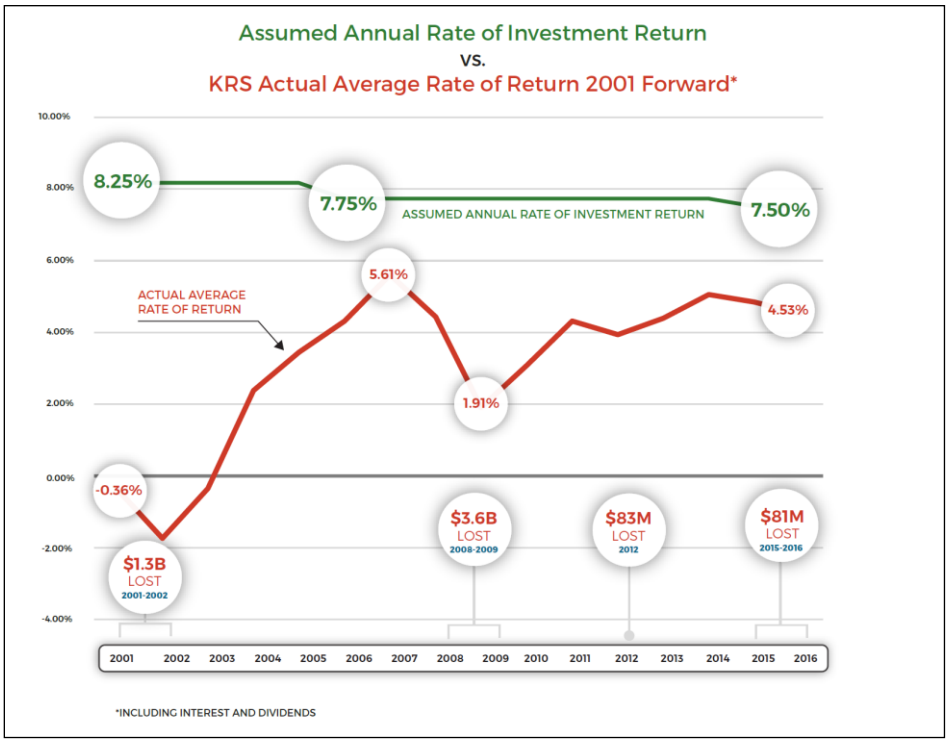
2011	+ 1.52%	+ 4.32%
2012	+ 1.19%	+ 3.94%
2013	+1.68%	+ 4.40%
2014	+ 2.36%	+ 5.06%
2015	+ 2.21%	+4.85%
2016	+ 1.98%	+4.53%

205. By 2009, the KRS Plans had achieved an average annual rate of investment return of negative -1.04% (excluding dividends/interest) and only positive +1.91% (including dividends and interest) since 2000 — a ten-year period. KRS's AARIR never recovered from the $6.6 billion in investment losses between 2000–2009.[24] The use of a 7.75% AARIR going forward was in disregard of the KRS Funds' own actual investment record and willfully reckless. The actual KRS's investment record and performance demonstrated to all Defendants that the 7.75% AARIR used by the KRS trustees, and upon which so much else depended, had been unrealistic and unachievable, and would continue to be going forward on an ongoing basis. The graphs below show how unrealistic it was to continue use of the AARIR of 7.75%:

[The remainder of this page is deliberately left blank.]

[24] If an investment is worth $50 and falls to $25, your loss is 50% or $25. Just to get back to even, your remaining $50 of investment money must go up 100%. Then to make up the AARIR for both years, you need the equivalent of two 7.75% returns on top of that. Losses of the magnitude suffered by the KRS Funds could not be made up with another AARIR of 7.75%.


Assumed Annual Rate of Investment Return
vs.
KRS Actual Average Rate of Return 2001 Forward*
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
8.25%
7.75%
ASSUMED ANNUAL RATE OF INVESTMENT RETURN
7.50%
ACTUAL AVERAGE RATE OF RETURN
-3.58%
2.63%
-1.04%
1.98%
$2.2B LOST 2001-2002
$4.5B LOST 2008-2009
$380M LOST 2012
$265M LOST 2015-2016
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016
*EXCLUDING INTEREST AND DIVIDENDS


Assumed Annual Rate of Investment Return
vs.
KRS Actual Average Rate of Return 2001 Forward*
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
8.25%
7.75%
ASSUMED ANNUAL RATE OF INVESTMENT RETURN
7.50%
ACTUAL AVERAGE RATE OF RETURN
-0.36%
5.61%
1.91%
4.53%
$1.3B LOST 2001-2002
$3.6B LOST 2008-2009
$83M LOST 2012
$81M LOST 2015-2016
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016
*INCLUDING INTEREST AND DIVIDENDS

2. The 2009–10 Financial/Actuarial Crisis and KRS's Board and Staff Personnel Crisis

206. While the trustees were attempting to deal with the largest investment losses KRS had ever suffered ($6.6 billion in just a few years), they were also facing (i) a significant increase in retirees, requiring the Plans to start paying out increasing amounts of benefits to retirees, who were living ever longer lives; and (ii) slowing growth in government hiring, *i.e.*, fewer new members (and fewer wage increases) to provide needed fresh money to the Plans.

207. In 2009–10, KRS was also suffering from serious Board turmoil and staff turnover. A special audit had uncovered $12–15 million in "suspicious payments" (now statutorily illegal payments) to mysterious placement agents, much of it in connection with KRS's first ever "investment" of over $100 million in two exotic hedge fund-like vehicles sold to KRS by financial firms in 2010 (in which KRS suffered large losses). The KRS Chief Investment Officer ("CIO") and Executive Director ("ED") were both fired. The Board Chair, a retired highway patrolman, was removed, but permitted to remain on KRS's Investment Committee. This left the trustees to face the financial/actuarial crisis with an interim ED who had no investment experience or expertise, plus a new Board Chair, new CIO, a new Director of Alternative Investments, and a compromised Investment Committee. None of these individuals had experience or expertise in "absolute return" funds of hedge funds, the Black Box[25] vehicles the Hedge Fund Sellers were about to sell to KRS.

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[25] "Black Box" hedge funds are vehicles where the "investor" knows little if anything about the contents of the vehicle or how the money is being "invested." This secrecy is usually based on a claim by the hedge fund seller/manager that the methods, strategies and fees of the fund are sophisticated, secret and successful and are thus proprietary and cannot be disclosed for fear of losing claimed competitive advantages.

208. In 2009–10, as KRS's trustees tried to deal with the huge investment losses with a disrupted Board and decimated staff, the KRS Plans' internal demographics continued to deteriorate: more retirees living longer, fewer new plan members, lower pay increases, and much lower investment returns than the published 7.75% AARIR. Trustees realized that, even if the KRS Funds could somehow earn 7.75% per year going forward forever, the Plans were going to face a serious liquidity squeeze.

209. By 2010, the KRS trustees and officers were caught in a tightening financial/actuarial vise. Having suffered over $6.6 billion in investment losses in seven years (which would penalize returns at least until 2014), they now had to find a way to pay ever increasing numbers of longer-living retirees, with fewer and fewer new plan members contributing wage assessments, all in a "zero" interest rate environment. They and their investment, actuarial and fiduciary advisors realized that the Plans would likely not have the money to pay the promised and legally-obligated pensions even assuming the Funds earned the published, but now known by them to be completely unrealistic, AARIR of 7.75% per year, every year, forever going forward. All defendants also realized that if they honestly and in good faith factored in and disclosed realistic actuarial assumptions and estimates and investment returns, the admittedly underfunded status of the Plans would skyrocket by billions of dollars overnight, that there would be a huge public outcry, that their stewardship and services to the Funds would be vigorously criticized, and that they would likely be investigated, ousted, and held to account.

3. The KRS Trustees and the Defendants Choose to Cover Up and Play Catch Up

210. Contrary to their obligations of truthful disclosure in "easily understood" language as mandated by the Kentucky pension statute, the KRS Board, with the knowing inducement and assistance of all the Defendants, chose to cover up the true extent of the KRS financial/actuarial shortfalls and take longshot imprudent risks with KRS Funds to try to catch up for the Funds' prior losses and deceptions. They misled, misrepresented and obfuscated the true state of affairs inside KRS from at least 2009 forward.

211. The KRS Board (again with the inducement, acquiescence and assistance of Defendants) made representations in KRS Annual Reports to members directly contrary to their actual actions, stating that: "(i) … the Board follows a policy of thoughtfully growing our asset base while protecting against undue risk and losses in any particular investment area. The Board recognizes its fiduciary duty … to invest the funds in compliance with the Prudent Person Rule; (ii) "its investment decisions … [are] the result of conscious exercise of discretion … and that proper diversification of assets must be maintained"; (iii) "through these policies" that KRS has been able to provide "significant returns" … while "holding down," [and] "minimizing investment expenses"; and (iv) that the KRS Annual Reports to members and taxpayers "would provide complete and reliable information as a means for determining compliance with statutory provisions and as a means of determining responsible stewardship of KRS funds."

4. KRS Is Targeted by the Hedge Fund Sellers

212. As the Board searched for a way out of the serious financial/actuarial crisis the trustees knew the Plans were in, they presented a tempting target for the Hedge Fund Sellers. "Hedge funds" is a term that encompasses private investment vehicles often structured as limited partnerships, employing what are called "alternative investment strategies." They are often referred to as "unconstrained" with few or no rules as to risk, investment strategies or asset classes.[26] But the products the Hedge Fund Sellers sold the KRS Trustees were even more exotic, risky, toxic and expensive than ordinary hedge funds. They were hedge funds that invested in *other hedge funds*.

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[26] Some marketing genius came up with the term "Absolute Return" to describe … well, actually, it's hard to say what exactly the term is meant to describe. Some hedge fund managers took to the term as an anodyne, non-scary marketing description for risky unconstrained investment vehicles. Financial economists Barton Waring and Lawrence Siegel once tried to capture the meaning of "Absolute Return" but basically gave up, writing:

> We asserted at the beginning that the notion of absolute-return investing has seduced many people into believing that superior returns can be achieved by those with strong views and little or no regard for benchmarks. But why do people think that absolute-return managers exist, and why do they think that such (imaginary) managers ought to earn supercharged returns?
>
> *Because they want to believe!* Beating the market is difficult, and in an environment in which responsible forecasters envision a 7–8 percent annual expected return on equity benchmarks, those who want or need a substantially higher return are looking for an easy solution, for more return and/or less risk. If they are hiring so-called absolute-return managers or setting up an absolute-return "asset class," they must either believe in the magic of the category or be convinced that skill levels are much higher for hedge fund managers than for the mere mortals who run ordinary long-only funds.

Waring and Siegel, *The Myth of the Absolute Return Investor*, FINANCIAL ANALYSTS JOURNAL, Vol. 62 Number 2, 2006, CFA Institute.

These funds are sometimes referred to as "funds of funds" or "funds of hedge funds" vehicles. More accurately they are called "Black Boxes" because the investor does not know what these downstream funds put the investors' money into, how they invest this money, what the true fees are or how they are shared among the various funds involved in the chain of funds. Further, the investor does not have any way to objectively and independently monitor the investing practices of the downstream funds or to determine or accurately measure the value of their holdings. "Black Boxes" are secretive and opaque because of the layers of secrecy placed between the investor and the investment, as downstream fund managers claim their methods, strategies and fees are "propriety," "secret" and cannot be shared.

213. Because KRS could not buy all $1.5 billion of Black Box Hedge Funds from one, the Hedge Fund Sellers — Blackstone, Prisma Capital and PAAMCO worked together to try to get a shared kill. In February 2009, CIO Tosh and RVK told KRS trustees that putting KRS trust assets into black box fund-of-funds hedge funds (euphemistically called "absolute return assets") could now be the "long-term driver of KRS Funds' performance," with "tremendous potential" to "exceed the [KRS] Funds' actuarial return assumptions" — "reducing risk" while producing "higher risk-adjusted and more consistent positive absolute returns," diminishing both risk and volatility — enhancing the ability of the KRS Funds to achieve its investment goals. These fund-of-funds hedge funds would supposedly achieve a "more predictable long-term return-added active return" (known by HFS as "Alpha") — but with "minimal additional risk." Feb. 3, 2009 Fund of Hedge Fund Memo to I.C.; Feb. 3, 2009 I.C. Mins. Tosh made these representations after talking with some or all of PAAMCO, Prisma and Blackstone.

214. KRS had never invested in anything this exotic, mysterious, risky and expensive. Because there were "structural risks" to the "organization or the operations" of hedge fund sellers that "cannot be eliminated," the Trustees were nevertheless assured in February 2009 that these risks could be "monitored and controlled by ensuring that extensive due diligence of the manager" including using "private investigator checks on the manager" and other checks to ensure that "sufficient … controls and procedures are in place." Aug. 19, 2010 B.T. Mins. With the promise of "tremendous potential" to exceed the KRS Funds' 7.75% AARIR with less risk and volatility, and downside protection, and armed with the assurances of rigorous due diligence to protect KRS's Trust Funds, in February 2009 the Trustees authorized investing 5% of KRS's Trust Funds in "absolute return assets." Feb. 3, 2009 I.C. Mins.

215. In September 2009, the Trustees agreed to KRS's first "absolute return" investment of $200 million in a hedge fund vehicle called "Arrowhawk Durable Alpha." Sept. 29, 2009 I.C. Mins.; Feb. 2, 2010 I.C. Mins. Arrowhawk, a "start-up" hedge fund with no prior track record of performance, was to be the "test" of the new absolute return strategy. By February 2010, the Trustees had put a total of $100 million of trust funds into Arrowhawk. Feb. 18, 2010 B.T. Mins. PAAMCO CEO Buchan — already a "trusted advisor" to the KRS pension funds the hedge fund sellers were eyeing as a target — called Tosh to congratulate him on getting the Trustees to take the Arrowhawk plunge: "I am sure it was no small feat."

216. As more aggressive "investments" (*e.g.*, Arrowhawk/Camelot) were being made in 2008-09, KRS was in the midst of suffering a second bout of huge investment losses – this time $4.4 billion or 30% of the KRS Funds' assets. Facing a second thousand-year flood in seven years, the Trustees requested an expedited asset-liability

study. In April-May 2010, they got an Asset-Liability Study. April 2010 RVK Asset-Liability Study.

217. The Study was a bombshell. It stated the KRS-NH Fund was likely in a death-spiral, facing "nine years of cash flow deficits," an "appreciable risk of running out of assets" – and there was no reasonable way for the Trustees to ever invest their way out of the financial and actuarial vise in which they were trapped. ("there was no prudent investment strategy that would allow KRS to invest its way to significantly improved status"). The Study also warned that any aggressive investment approach would "substantially increase[] the chances of the catastrophic event of depleting all assets in the near future."

218. When the Trustees were given the news, the warnings were even more graphic: "***there is no investment strategy that offers the probability of significantly improved returns without also assuming unacceptable risks to the asset base of the plan***." May 4, 2010 I.C. Mins.; May 20, 2010 B.T. Mins.

219. The Trustees received this alarming report in May 2010 as KRS was engulfed in the unfolding placement agent payments scandal. By then, state auditors had closed in on CIO Tosh, the Arrowhawk and Camelot Fund deals. When they tried to question Tosh, he left KRS and Kentucky and refused to speak to the auditors. Soon thereafter, Burnside (KRS's ED) was fired, and Board Chair Overstreet was demoted.

220. During much of 2010 and early 2011, the Trustees and KRS's advisers were consumed with attempting to control the fallout from the suspicious payments scandal and the resulting internal staff and Board dislocation at KRS.

221. This left KRS in 2010–2011 with: a new Board Chair (J. Elliott); an Interim Executive Director (Thielen); and an interim CIO (Aldridge) — none of whom knew anything about absolute return assets or fund-of-fund hedge fund investments.

222. Moreover, the Board itself was impaired. The Hedge Fund Sellers were already "trusted advisers" to KRS, knew this and exploited this knowledge. Despite this internal disruption and dislocation, KRS trustees continued down the path toward risky absolute return funds of hedge funds, guided and encouraged along that path by the Hedge Fund Sellers and KRS investment staff. KRS was in disarray. Having ignored the concerns that resulted in KRS's prior rejection of hedge fund investments, KRS suffered losses with Arrowhead and Camelot. These investment fiascos occurred despite the supposed existence of "extensive" due diligence checks of these types of investments – to prevent just this type of result: fund managers with checkered pasts and dubious backgrounds getting their hands on KRS's Trust funds.

223. The deteriorating status of the KRS Funds had caught the attention of the Hedge Fund Sellers long before the August/September 2011 sales of their hedge funds to the KRS Trustees. As indicated above, the documents show their hands-on inside involvement with Tosh (and subsequently, Aldridge) to shape KRS's policies to accommodate the risky, aggressive, super-expensive product they wanted to sell. Because they targeted underfunded pension plans and were financial experts, "they knew the KRS Trustees were dealing with a much more serious situation than was publicly known," and that internal staff and Board dislocation (due to the placement agent scandal), had deprived the Trustees of the necessary staff support and expertise. They targeted KRS to sell their extremely profitable (for the sellers) but very expensive (for the buyer), custom-designed "Black Box" funds of hedge funds of the kind they

knew Tosh and Aldridge had portrayed as capable of producing "tremendous" investment returns to "exceed the Funds' actuarial return assumptions" with safe diversification and down-side protection — just what the trapped KRS trustees were looking for. Feb. 3, 2009 I.C. Memo.

224. The Hedge Fund Sellers had been working with Tosh and Aldridge to get KRS to purchase the type of high-fee hedge funds they wanted to sell long before the actual August-September 2011 sale. They were already targeting KRS as early as 2009 as a buyer of their lucrative, high-fee funds, working with KRS staff to guide its trustees toward riskier investments – specifically the high profit Black Boxes they ultimately sold them. As early as 2009, PAAMCO's Buchan was already dealing with Tosh, congratulating him on his success in getting the KRS trustees to take their first absolute return plunge in Arrowhawk (which she described as "no small feat"), while discussing with Tosh how to restructure the KRS investment portfolio to take on more high-risk investments. Tosh/Buchan and Aldridge/Buchan continued to work together during 2010. Other memos of 2009 phone calls detail Buchan's early and ongoing involvement with KRS's Tosh and Aldridge in shaping KRS investment policy — to facilitate the sale of PAAMCO's hedge fund vehicles to KRS. Buchan was working with Tosh (who "is really interested in FOHFs") early on, assumed her firm's "trusted adviser" role to the KRS CIO, and was assured by Tosh — before the search process even began — that "***we are one of only two or three firms that should get this mandate***." She discussed how PAAMCO should "***use him***" (Tosh) and "***make FOHFs one of*** [***his next employer's***] ***solutions***," and then advised the new CIO Aldridge on how to conduct the hedge fund manager search that PAAMCO was to be part of — because PAAMCO "***should get … this mandate***."

225. The Hedge Fund Sellers were constantly involved with KRS insiders in 2010–11 — long before they sold the Black Boxes to KRS in August 2011 — meeting with them and talking to them about how the trustees could reshape KRS's investment policies and portfolios, to ignore the earlier warnings about and ban of hedge funds, and take on the increased aggressiveness and risk of their Black Box products. This was done even though this was the very course of action the trustees had been warned would "substantially increase the chances of a catastrophic depletion of the Funds' assets" — *i.e.*, to try to invest their way out of the hole they were told could not be prudently done.

226. Buchan/PAAMCO's early involvement in KRS's absolute return plunge was part of the Hedge Fund Sellers acting as investment advisers (the "trusted advisor role") – helping KRS shape its portfolio ("lots of overall help") months before they sold the Trustees the Black Boxes. This conduct brought with it fiduciary duties – express or imposed by law – regardless of whatever text they tried to insert later (when they were fiduciaries) into their complex and self-serving investment documents. The involvement of the Hedge Fund Sellers getting KRS to disregard the earlier ban on hedge funds — even after the Arrowhawk/Camelot fiascos – was a concerted effort, assisted by disloyal KRS insiders. Below is a partial list of "sales" meetings of the Hedge Fund Sellers with KRS:

SELLER	**LOCATION**	**DATE**	**KRS STAFF**
Blackstone	Fund on-site	March 1, 2010	David
Blackstone	KRS on-site	June 9, 2010	Investment Team
Blackstone	KRS on-site	April 6, 2010	Investment Team
Blackstone	Phone call	May 12, 2011	Investment Team
Blackstone	Fund on-site	June 15, 2011	Tom, TJ, David and RVK
Prisma	KRS on-site	April 9, 2009	Investment Team
Prisma	Phone call	April 14, 2009	David
Prisma	Fund on-site	June 17, 2010	Investment Team

Prisma	Phone call	August 25, 2010	Investment Team
Prisma	Phone call	May 19, 2011	Investment Team
Prisma	Fund on-site	June 16, 2011	Tom, TJ, David and RVK
PAAMCO	Fund on-site	January 26, 2010	Adam
PAAMCO	Fund on-site	March 22, 2010	David
PAAMCO	Phone call	July 23, 2010	David
PAAMCO	Phone call	August 24, 2010	Investment Team
PAAMCO	KRS on-site	September 28, 2010	Investment Team
PAAMCO	Phone call	May 18, 2011	Investment Team
PAAMCO	Fund on-site	June 29, 2011	Tom, TJ, David and RVK

227. In addition to these extensive dealings with KRS staff, specifically dealing with the Black Box hedge funds, Blackstone was already deeply involved with KRS. An August 2, 2011 memo regarding the Blackstone Black Box investment stated "KRS is currently invested in Blackstone Capital Partners V (2005 vintage, $60 million commitment) and Blackstone Capital Partners VI (2011 vintage, $100 million commitment), Blackstone's two most recent private equity fund vintages." Aug. 2, 2011 RVK Memo to I.C., at 1357. Blackstone was already acting as an investment adviser/manager for KRS — and therefore had fiduciary duties to KRS from as far back as 2005-06. This prior fiduciary relationship enabled Blackstone to gain unique access to the trustees to make the "educational presentation" to them in November 2008 which helped persuade the trustees to modify KRS investment policies to accept a higher degree of risk so it could accommodate the high-risk Black Boxes. Nov. 5, 2008 B.T. Mins.

228. Between June-August 2010, the trustees (having just been warned in May about the "substantial[] increase" in the likelihood of a "catastrophic event" that an "aggressive approach" to investing would create) — incredibly — did just that. The trustees increased the risk of all KRS investment portfolios by adopting the riskiest

investment option presented to them. June 22, 2010 I.C. Mins.; Aug. 12, 2010 I.C. Mins.

229. The trustees' motivation in adopting the "aggressive risk" posture is revealed by the documents; they: (1) believed it would "look better" to outsiders because using the more aggressive investment approach "projected a higher investment rate of return" which would give the "impression" that KRS was going to reach the 7.75% AARIR; (2) feared KRS members would "not understand" why KRS would trail the market if it adopted a more conservative portfolio (*i.e.*, they did not want anyone to ask why and thus perhaps begin to learn the truth); and (3) recognized that telling the truth and acknowledging the true position they were in would entail significant political pain they and their political patrons were unwilling to invite. Thus, they adopted an even more aggressive investment approach – the most aggressive option that was made available to them. Aug. 12, 2010 I.C. Mins.; Aug. 19, 2010 B.T. Mins.

230. These Black Box vehicles were secretive, opaque, illiquid, impossible to properly monitor or accurately value, high-fee, high-risk gambles with no historical record of performance, in which KRS's funds were "locked up" and the Hedge Fund Sellers had 100% discretion to pick the investments. They were unsuitable investments for the KRS Funds, given their particular financial/actuarial situation where the Trustees had just been warned there was no prudent way to invest the funds back to safely funded status and making aggressive investments like these "substantially increased the chance of the catastrophic event" of running out of assets.

231. Knowing all of this, the Hedge Fund Sellers knew the trustees would be virtually 100% dependent on them when making the single-largest investment decision

in the history of KRS Funds. That knowledge did not promote caution – instead was fuel for the fire, and they preyed on KRS for their own economic purposes.

232. In rapid fashion, in August/September 2011, the KRS Board put $1.2-$1.5 billion of KRS's Trust Funds (in three $400/$500 million pieces) into the black box fund-of-hedge-funds – by far the largest one-time investments KRS had ever made. They did this in spite of recent experiences and current reality: the Arrowhawk and Camelot disasters; the lack of staff support with experience/expertise in absolute return assets; or even that it was the now- discredited Tosh who had led them down this path – the only prior test of which (Arrowhawk) had failed. In spite of all of this, the Board bet big – "double or nothing" – putting not 5%, as previously decided, but 10% of the Funds' assets into "Absolute Return" vehicles. They would not – and could not – have made this bet without the direct inducement and aiding and abetting by the Hedge Fund Sellers and their other advisors.

5. The KRS Board Buys the Black Box Fund of Hedge Funds

233. In August 2011, the Trustee agreed to buy $1.2–$1.5 billion (in three extremely large commitments, each between $400 and $500 million) in Black Box fund of hedge funds vehicles. KRS's then-Chief Investment Officer ("CIO") — who, with no prior involvement or expertise of his own in hedge funds, was repeating the pitch and talking points of the Hedge Fund Sellers — publicly stated that these investments were "Absolute Return" assets, an "***absolute return strategy***" ***which would*** "***reduce volatility***" … [***get KRS to***] ***an expected rate of return of 7.75%*** … [***and which***] ***lowers our risk***." ***According to KRS's investment advisor RVK, Trustees had decided on the*** "***most effective asset allocation strategies for each pension and insurance plan … in order to lower risk, control the level of***

illiquidity in the portfolios and generate a return expected to exceed the actuarial assumed rate of return 7.75% [***and***] "***with new allocations to the … absolute return buckets … going forward the portfolio is more diversified than ever***."

234. The Black Box hedge funds were placed in each of the KRS Pension and Insurance Plans — spread across the available universe of funds. At least $240 million in Black Box investments were initially placed in the insurance trusts. Later hedge fund purchasers were similarly allocated in both the pension and insurance trusts.

235. These unsuitable "investments" did not lower risk, reduce illiquidity, or generate sufficient returns to enable KRS to even approach, let alone exceed, the assumed rate of 7.75% on an ongoing basis. They did generate excessive fees for those Hedge Fund Sellers, poor returns and ultimately losses for the Funds, in the end damaging the Tier 3 Plaintiffs. The Hedge Fund Sellers and their top executives benefited personally for a period of several years collecting hundreds of millions in fees for their entities, a meaningful portion of the profits from which flowed to the top executives personally.

236. These funds of hedge funds Black Boxes were sold to KRS by sophisticated, high-powered financial firms, headquartered in Wall Street and Los Angeles and operating all over the world: Prisma (later KKR Prisma), Blackstone and PAAMCO. Each of these firms targeted underfunded public pension funds like KRS. To them, KRS was a potential buyer of the exotic, high-fee and high profit hedge fund vehicles they sold. The Hedge Fund Sellers nicknamed these vehicles the "Daniel Boone Fund," "Henry Clay Fund," and "Newport Colonels Fund" ("Colonels Fund") because they were specially designed and created for Kentucky.

237. These funds of hedge funds were extremely high-risk, secretive, opaque, high-fee and illiquid vehicles. They were the largest, single one time "investments" (individually or collectively of one asset class) ever made by KRS. The Board took this gamble even though these "Black Boxes" had no prior history of investment performance, and, because of their secrecy, were impossible for the trustees to properly monitor, accurately value or even calculate the total fee burden.

238. Recent events should have alerted the trustees to the great danger of being sold "high yield/high return" exotic "investment" vehicles by Hedge Fund Sellers with "checkered pasts." In 2009, KRS put trust monies into its first hedge fund type investments. Connecticut-based Arrowhawk Capital Partners was a hedge fund seller — a startup with no investment record. The trustees entrusted it with $100 million. Arrowhawk was a flop. Under a cloud of controversy over its fees and lack of experience, it quickly folded. In 2009, the trustees made a multi-million dollar "investment" in The Camelot Group. Its owner was indicted for siphoning $9.3 million to pay for personal extravagances. That fund also collapsed. Other contemporaneous events were front page news that should have been red flags about exotic, opaque investment strategies poorly understood by the investors (the infamous Madoff scandal involving another New York-based investment manager who lost billions of investors' money in "***secret***" Black Box investment strategies, to name one). The fund of hedge funds that Hedge Fund Sellers were creating and selling themselves had a "checkered past" of questionable legitimacy as investments whose existence arose from the infamous "Fund of Funds" scandals involving Bernie Cornfeld and Robert Vesco, where investors lost billions. Notorious hedge fund blowups included Long Term Capital, Galleon and others.

239. In an echo of the earlier Arrowhead and Camelot disasters, shortly after the Board had been persuaded to hand over a $1.2 billion to three of the Hedge Fund Seller Defendants (KKR Prisma, Blackstone and PAAMCO) to put into Black Boxes, one of the top personnel of one Black Box was implicated in criminal conduct. Hedge Fund Seller Blackstone had placed KRS trust monies (Henry Clay Fund) in a hedge fund run by SAC Capital, a business controlled by Steve Cohen, a Wall Street colleague well known to Schwarzman and Hill, even though Cohen and SAC Capital were being investigated for financial misconduct at the time Blackstone gave some of its share of the KRS Trust Funds to Cohen. Top SAC Capital traders were later criminally convicted and Cohen and SAC Capital were severely punished. Having again recklessly put KRS Trust monies in exotic vehicles sold to them by sophisticated Hedge Fund Sellers and again been burned, trustees did not — as they should have — entirely remove their investments in the Black Boxes and put this money in safer, lower cost, more prudent investments handled by more reputable dealers. Nor did any of the Defendants insist that they do that.

240. KKR, Kravis and Roberts are regularly involved in complex financial transactions involving entities and/or individuals who owe fiduciary duties to others. The same is true of Blackstone and Schwarzman. Blackstone and KKR have stated in government filings that because of the way they conduct their business activities, they face "substantial litigation risk." Blackstone stated that the volume of such litigation has "been increasing." Because of the aggressive tactics they use in financial transactions to gain unfair advantage for themselves, they or entities they control or operate have been sued on multiple occasions for misconduct — including breach of fiduciary duty — in

transactions involving pension funds, trusts and other investors, to whom they owed fiduciary duties.

241. Schwarzman and Hill were also both top executives at Lehman Brothers, which was later implicated as having a significant role in one of the largest Wall Street frauds of all time, and directly causing the 2008–09 financial meltdown with consequent loss of billions in individual and institutional equity and a torrent of litigation alleging fraud. Both KKR and Blackstone have been fined by a government regulator for dishonesty and misconduct in their fiduciary capacity in connection with their fees charged to buyers of alternative investments like hedge funds. Buchan and the other founders of PAAMCO had been sued for financial deception and dishonesty and found liable upon summary judgment as detailed earlier — acts of deception and dishonesty that when exposed got PAAMCO fired by other public pension funds due to the risk of continuing to do business with them. These individuals and the exotic and secretive vehicles they were selling had "checkered pasts" that should have been red flags to trustees, and should have resulted in investigation with no investment, rather than investment without investigation.

242. Had KRS trustees been properly skeptical and careful and properly counseled by their advisors and staff, the consideration of making an extraordinarily huge onetime, first of its kind, blind bet on what these Hedge Fund Sellers were trying to sell them on, in light of these facts, should have involved exercising appropriate caution and prudence and they should have declined to deal with Hedge Fund Sellers and not buy what the Hedge Fund Sellers were selling, and to instead deal with other more reputable entities, offering more conventional, less high-risk, less high-fee, more transparent investments with a track record of performance. If the $1.5 billion had been

placed in a no/low-fee stock index fund like the S&P or DJIA, the $1.5 billion would have turned into at least $4 billion over the next several years. If Trustees had simply stayed with the existing 2009 asset allocations, the Funds would have enjoyed investment results that would have left it far better funded than they are now, an opportunity for gains and income that is now lost due to imprudent investments.

243. Dealing with and relying on (i) the Hedge Fund Sellers, with "checkered pasts" of their own or of the entities through which they operated, and who had been sued for breaches of duty and fraud in other complex financial and investment transactions and who even had to warn investors in other government filings of the "substantial litigation risk" their way of doing business exposed them to, and (ii) the advisors who led Trustees to believe that these "Black Boxes" could make up for past investment losses and help overcome the underfunding of the KRS Pension Plans and help restore them to financial health — and with the approval of its Fiduciary Advisor and Investment Advisors, the Board recklessly gambled, but it was KRS members, including Tier 3 members, who were injured, and are paying the costs.

244. The Black Boxes did not provide the investment returns KRS needed to return to or exceed its AARIR of 7.75%, did not provide safe diversification, provided very weak (or negative) absolute and very bad relative investment returns and ultimately lost millions of dollars in 2015–2016 — the very losses the "hedges" with their supposed "reduced volatility" and "safe diversification" would supposedly protect against. According to the investigative report issued by consulting group PFM ("PFM") in 2017, "a roughly 10% allocation to hedge funds in the KRS Retirement System Plans had a negative impact on overall plan returns." Further, the ongoing selloff of these hedge funds "is likely to result in improved performance and lower fees going forward."

PFM reported that "asset allocation," including this 10% allocation to the "hedge funds" (and an 8–10% allocation to Real Return assets) "***has been the primary detractor of relative KRS performance***."

6. The Hidden/Excessive Fees

245. In addition to being unsuitable investments, the purchase and holding of Black Box vehicles violated the Trustees' duties to administer the Pension/Trust Funds in the retirement system in an "efficient and cost-effective manner" incurring only "reasonable expenses." These speculative hedge fund vehicles contained double fees, many of which were hidden and impossible to measure accurately. The Hedge Fund Sellers were already charging very high and excessive fees to oversee and manage the funds of hedge funds they sold to KRS, on top of similarly high/excessive fees being charged by each of the hedge funds in which the Daniel Boone, Henry Clay and Colonels fund monies were placed.

246. Prisma, Blackstone, PAAMCO and later KKR Prisma charged annual "management fees" based on assets under management, plus "incentive fees" based on returns over very modest "hurdle rates." The underlying hedge fund managers also charged even more substantial management and incentive fees, some part of which found its way back into the pockets of Prisma, Blackstone, PAAMCO and later KKR Prisma. A former KRS trustee who was on the Board during the relevant period calculated that in one two-year period, KRS paid Blackstone's sub-managers about $40.5 million in fees; based on then similar fee structures, KKR Prisma got about $38.9 million in fees and PAAMCO received $33 million in fees in just two years. KRS paid over $150 million in fees in connection with the Henry Clay, Daniel Boone and Colonels funds during one 27-month span.

247. No one yet knows the true or total amount of these fees. According to the PFM report, the KRS internal records on fees paid to investment managers are contradictory and in disagreement, and the KRS records "do not include any performance-based fees or other hidden costs." Thielen (former Executive Director of KRS) has admitted he did not know how much money was paid out in fees to the underlying funds. That information, he said was "proprietary" and even kept from him. In fact, and despite the Kentucky Pension Law's mandate to the contrary, Peden, the then-CIO, said "the agency only cares about the net return on investment — after fees are subtracted," *i.e.,* they did not care about the costs and expenses of the $1.2–1.5 billion plunge they took into Black Boxes. KRS members have paid for the Board's willful neglect of its clear duty to avoid unreasonable expenses and to manage the Funds in a cost-efficient manner.

248. As to these fees, a former KRS trustee has stated: "These funds can't get them from anywhere besides public pension plans. Corporate plans are too smart to pay these outrageous fees. The only stupid people are the taxpayers of Kentucky for letting these people get away with this."

249. A report by CEM Benchmarking, Inc. ("CEM") (a global benchmarking firm specializing in cost and performance of investment and administration) found the Kentucky Retirement Systems annual investment expenses in 2014 were actually more than 100 percent higher than what the system reported: $126.6 million instead of the $62.4 million Trustees reported. This number will be much higher when the true level of fees paid in connection with Black Box funds of hedge funds is known. According to a former KRS trustee:

> ***KRS has squandered pension holders' money by paying high fees for riskier investments with lower returns than unmanaged stock market index funds. He said his reading of the CEM report is that KRS' investment underperformance of the last five years comes to about $1.5 billion, a third of which stems from hidden fees.***

7. The True Risks and Nature of the Black Boxes

250. Although no such disclosures were ever made to KRS members/ beneficiaries, in different contexts and where they were legally required to tell the truth about the nature of the "fund of funds" hedge fund vehicles they sold and the true nature of the risks associated with them, the Hedge Fund Sellers laid it bare. The Hedge Fund Sellers are required to make filings with government agencies that disclose the true nature and risks of the products they sell. They are subject to civil, even criminal liability, if these filings are false or misleading.

251. The quotes below from KKR are taken from filings signed by Kravis and Roberts. KKR warned:

> Hedge funds, including those in which our fund of funds are invested and the hedge funds we offer to fund investors may make investments or hold trading positions in markets that are volatile and which may become illiquid. Timely divestiture ... can be impaired by decreased trading volume, increased price volatility, concentrated trading positions, limitations on the ability to transfer positions in highly specialized or structured transactions to which they may be a party. It may be impossible or costly for hedge funds to liquidate positions rapidly ....
>
> ***Moreover, these risks may be exacerbated for fund of funds such as those we manage.***
>
> * * *
>
> Investments by one or more hedge funds ... are subject to ***numerous additional risks*** including the following:
>
> - ... [T]here are few limitations on the execution of investment strategies of a hedge fund or fund of funds ....

- Hedge funds may engage in short selling, which is subject to theoretically unlimited loss ....

- We may enter into credit default swags (or CDS) as investments or hedges. CDS involve greater risks ....

* * *

Valuation methodologies for certain assets in our funds ... can be subjective and the fair value of assets established to such methodologies may never be realized, which could result in significant losses for our funds ....

There are no readily ascertainable market prices for a substantial majority of illiquid investments for our investment vehicles ....

* * *

Risk of Loss. Investing in securities involves risk of loss that investors in KKR Prisma Funds and Accounts should be prepared to bear. There can be assurance that the investment objectives of KKR Prisma Fund or Account, including risk monitoring and diversification goals, will be achieved, and results may vary substantially over time.

... Investments made by KKR Prisma Funds and Accounts may involve a high degree of business and financial risk that can result in substantial loss.

In all it took KKR over 15 pages of single-spaced type to describe the true nature of, and risks associated with, its Black Box fund of fund vehicles.

252. The quotes below from Blackstone are taken from filings by Blackstone.

Blackstone warned:

Valuation methodologies for certain assets in our funds can be subject to significant subjectivity and the fair value of assets established ...[,] which could result in significant losses for our funds.

There are often no readily ascertainable market prices for illiquid investments ....

Because there is significant uncertainty in the valuation of, or in the stability of the value of illiquid investments, the fair values of such investments as reflected in an investment

> fund's net asset value do not necessarily reflect the prices that would actually be obtained by us on behalf of the investment fund when such investments are realized.
>
> Many of the hedge funds in which our funds of hedge funds [invest] ... may choose to use leverage as part of their respective investment programs. The use of leverage poses a significant degree of risk and enhances the possibility of a significant loss in the value of the investment portfolio.
>
> * * *
>
> Investments by our funds of hedge funds in other hedge funds, ... are subject to numerous additional risks, including the following:
>
> - Certain of the funds are newly established funds without any operating history or are managed by management companies or general partners who may not have as significant track records as an independent manager.
>
> - Hedge funds may engage in short selling, which is subject to the theoretically unlimited risk of loss ....
>
> - Hedge fund investments are subject to risks relating to investments in commodities, futures, options and other derivatives, the prices of which are highly volatile and may be subject to theoretically unlimited risk of loss in certain circumstances ....
>
> - Hedge funds are subject to risks due to potential illiquidity of assets.
>
> Moreover, these risks may be exacerbated for our funds of hedge funds.

In all it took Blackstone 15 pages of single-spaced type to describe the true nature of, and risks associated with, its Black Box hedge fund vehicles.

253. In a government filing on Form ADV, PAAMCO made similar risk disclosures, requiring a total of 12 pages to set forth all the risks of its hedge funds products.

254. The Hedge Fund Sellers should never have sold these products, no matter what "warning" was buried in the paperwork, and the Investment Advisor and Fiduciary

Advisor never should have permitted the sale of these products to KRS as they were absolutely unsuitable investments for a pension fund in the particular situation KRS was in, and violated the applicable laws, codes and standards. The true nature and extent of the risk of these so-called "investments" was never disclosed to the KRS members or beneficiaries, or Kentucky taxpayers in any, let alone "easily understood," language, and this failure of disclosure to KRS members and beneficiaries and the Commonwealth, was known to the other Defendants because they received and reviewed KRS's Annual Reports.

B. The 2015–2016 Bogus Strategic Partnership, The Secret Advisory Services Agreement and the KKR Prisma Take Over of the Entire Hedge Fund Portfolio

255. The course of misconduct, aiding and abetting, joint enterprise and conspiracy that originated in 2008–2011, when Defendant Cook (then a senior executive of Prisma) and Peden (then a member of the KRS investment staff) worked together to help engineer the initial Black Box purchases, including the conflicted $400+ million Prisma Daniel Boone Fund, continued in 2015–2016 when KKR Prisma's Cook and Michael Rudzik worked in concert with Peden, by then KRS's Chief Investment Officer (CIO), to deliver control over KRS's entire $1.6 billion hedge fund portfolio to KKR — a Wall Street behemoth whose numerous interests conflicted with the interests of KRS and its members — and then allow KKR Prisma and its top executives to leverage that position for their own self-interested benefit, all to the detriment of KRS, its members, and the taxpayers. This was no random match; Peden had worked for Cook and Rudzik when all three had been employed by Aegon, then Prisma, and they had maintained their close relationship thereafter when Peden went on staff at KRS. The plan these three cooked up was to replace KRS's Director of Absolute Return — the single KRS staff

person with direct responsibility for its entire $1.6 billion hedge fund portfolio — with KKR Prisma's own man Rudzik, who would work inside KRS as a quasi-staffer and take charge of the hedge fund portfolio as (in all but name) Director of Absolute Return. The co-conspirators planned to use this effective control to increase KRS's investment in the Prisma Daniel Boone Fund by $300 million, while divesting the other two Black Boxes, BAAM's Henry Clay Fund and PAAMCO's Newport Colonels Fund — even though Prisma's was by far the worst-performing of the three original Black Box funds. Divesting the other two Black Boxes would free up funds to invest in Daniel Boone and in other hedge funds beholden specifically to KKR Prisma. Finally, with Peden's approval and active assistance, KKR Prisma/Reddy/Rudzik planned to leverage their position as overseer and gatekeeper of KRS's large and growing direct hedge fund portfolio (a planned $800 million of direct hedge fund investments, including the purchase of hundreds of millions in new hedge fund investments on the conflicted recommendation of KKR Prisma) to their own self-dealing benefit, all without meaningful supervision other than Peden himself.

256. KKR acquired Prisma and its hedge fund business in 2012 after negotiations that began in 2010. KRS's conflicted $400+ million investment in the Prisma Daniel Boone Fund helped "dress up" Prisma for sale to KKR. With KKR's acquisition of Prisma, Cook and Rudzik became managing directors at KKR. They sold their ownership interests in Prisma to KKR for millions of dollars, most of which was to be paid out over time in contingent performance-based "earnout" payments. The size of these performance-based earnout payments would depend on the growth in revenues and assets under management (AUM) at Prisma. Reddy, Cook, and Rudzik were among a handful of former Prisma owners in line to receive these contingent payments. The

former Prisma owners had split $100 million in 2012, another $123 million in 2014, and were working toward the 2017 payout, which was to be the final performance-based contingent payment. At year-end 2015, the contingent 2017 payments were valued at almost $50 million. Each of these men had a very substantial personal stake in the growth of Prisma's asset base. They planned to, and did, use KRS's hedge fund portfolio to increase KKR Prisma's revenue and AUM and thus increase the likelihood of achieving KKR's performance metrics and of receiving their 2017 performance payments.

257. As a key part of the ongoing course of misconduct and conspiracy in late 2015 and early 2016, Peden and Rudzik worked together behind the scenes to engineer the appointment of Cook to the KRS Board with the help of Steve Pitt. None of Cook, Peden, or Rudzik disclosed their prior wrongdoing as alleged, and in particular failed to disclose the very serious conflict of interest created by the self-dealing provisions of the still-secret ASA — a conflict that continued to benefit Cook after he became a member of the KRS Board. Cook got appointed on June 17, 2016, just days after the May 19, 2016 conflicted investments had been finally approved.

258. In mid-November 2014, Peden was promoted to CIO of KRS. He was contacted by his old boss and long-time friend and business colleague Cook ("***Congratulations Mr. CIO***"). The two met at an IHOP on December 3, 2014 to discuss a strategic hedge fund partnership in which KKR Prisma would provide a dedicated portfolio manager to manage and monitor all KRS hedge fund investments — in effect, to do the job that previously had been filled by an internal and non-conflicted KRS staffer (Director of Absolute Return). The partnership they discussed would also entail upsizing KKR Prisma's Daniel Boone Fund by several hundred million dollars,

while getting KRS out of the other two Black Box funds of hedge funds. The presentation prepared by Cook mentioned that one material benefit to "partnering with KKR Prisma" would be access to and the support of KKR's global infrastructure. The presentation was intended to be secret; it was labeled "Confidential and Proprietary" and stated that it was "confidential" and could not be disclosed.

259. This plan was driven in large part by the desire of Cook, Rudzik, and Reddy to increase their own final KKR earnout payments. Peden was a key and active leader/participant in this scheme. As part of the plan, Peden made it look like he could not find a qualified replacement for Schilling as Director of Absolute Return, creating a rationale for bringing KKR Prisma in to, in effect, fill that role.

260. After more "confidential" (secret) communications among at least Cook, Rudzik, and Peden, and the preparation of another KKR presentation approved by Peden, the KRS Investment Committee agreed on May 5, 2015 to the KKR Prisma "Strategic Partnership" proposal first proposed by Cook. The full KRS Board subsequently approved this action by the I.C. Reddy and Rudzik made the presentation to the I.C., and Peden "strongly" endorsed the plan and helped push it through the I.C. Neither the Investment Committee nor the Board addressed or waived the various conflicts of interest.

261. The arrangement was subsequently formalized in a non-public (secret) Advisory Services Agreement ("ASA"), which was signed by Peden and Thielen, then the Executive Director of KRS. An Amended Advisory Services Agreement ("AASA") was subsequently entered into with the same material terms, signed for KRS by Peden (then the CIO, reporting to Eager). Neither the ASA nor the AASA was included in the minutes or made public by the either the Board or the Investment Committee. It was a

deep dark secret of the conspirators. ***The ASA/AASA explicitly approved self-dealing by KKR Prisma, to benefit it, KKR and the persons entitled to receive the earnout payments, including among others Cook, Rudzik, and Reddy***. The approval of self-dealing by a trust fiduciary was unlawful and constituted a breach of trust by the Trustee, induced and aided/abetted by KKR Prisma, Cook, Reddy, Rudzik, KKR, Kravis and Roberts. All actions taken under this unlawful "permission" were also unlawful and in breach of fiduciary and other duties.

262. The "Strategic Partnership" allowed Rudzik and his team of KKR employees to take up positions inside KRS while still on KKR's payroll, purportedly to assist KRS staff gain "in-house" hedge fund expertise so it could "build out its direct hedge fund portfolio" and thereby reduce the huge fees and low returns the Black Box fund of hedge funds carried. However, the real intent and effect of this "Strategic Partnership" was to hand control over KRS's entire $1.6 billion portfolio of absolute return investments to KKR Prisma/Cook/Rudzik/Reddy and then permit them to manipulate that position for their own personal financial benefit and that of KKR and KKR Prisma. Placing Rudzik and his KKR Prisma team in charge of overseeing the absolute return investments, with no supervision with the exception of Peden himself, was not a plan to "help" KRS staff — it was a plan to replace inside, unconflicted staff with very conflicted KKR executives working inside of KRS in violation of KRS conflict of interest policies and Kentucky law. This scheme (including the secret ASA, with its unlawful approval of self-dealing) reflected anything but the sole interest, exclusive benefit fiduciary regime imposed by Kentucky law.

263. Peden, with the active assistance or acquiescence of at least KKR Prisma, Cook, Reddy, Rudzik, KKR, Kravis and Roberts, inserted a false narrative into

Investment Committee and Board minutes, to the effect that KKR Prisma was willing to perform these "advisory" services for free, because doing so "makes for a stronger relationship with the client [KRS]."[27] But the ASA/AASA revealed that the real "consideration" flowing to KKR included a large increase in KRS investment dollars into KKR Prisma's Daniel Boone Fund, and "the opportunity for [KKR Prisma] to expand its industry knowledge and ***develop further business relationships with third parties through the provision of services under this Agreement***," *i.e.*, use KRS's assets to benefit its business. Thus, Peden not only arranged for KKR Prisma to get hundreds of millions more in its Daniel Boone Black Box, but also for KKR Prisma/Cook/Rudzik to become the gatekeeper (without effective staff oversight) of KRS's entire $800 million direct hedge fund portfolio, and to leverage that gatekeeper position to extract improper self-dealing benefits. This concession was worth many millions of dollars to KKR and KKR Prisma in terms of (at least) information, access and deal flow. That KKR Prisma could also use the arrangement to cause KRS to divest funds managed by KKR Prisma's competitors was an added bonus.

264. The Daniel Boone Fund's since-inception returns trailed the other two Black Boxes by almost 23% when the Investment Committee initially approved the Strategic Partnership with Prisma. And the I.C. made the final decision to invest substantially more in the Daniel Boone Fund at the end of a year in which Daniel Boone lost more than 8% of its value — a one-year loss of more than $40 million. It strains

[27] Whether Peden in fact told this falsehood to the I.C. or Board is unknown. In any event, it is highly doubtful that investment professionals such as Eager would have credited such a tale. Eager certainly didn't blow the whistle on the falsehood when he later became Executive Director with day-to-day contact with the KKR Prisma people inside KRS and with access to all documentation including the ASA/AASA.

credulity to assume under these circumstances that KKR Prisma was chosen for this role entirely on merit, as it was decidedly not best-in-show. Of the $300 million in fresh cash directed to the Prisma Daniel Boone Fund as a result of the I.C. and Board decisions in May 2016, about half ($150+ million) was directed by KKR Prisma into its own proprietary fund, KKR Apex Tactical Fund, a new fund KKR had just launched. The materially higher fees that flowed to KKR Prisma as a result of directing KRS dollars in its own fund provided additional revenue and AUM to KKR Prisma, thus also benefitting Cook, Rudzik, Reddy, and the others potentially entitled to the contingent KKR earnout payments. In addition, KRS invested $285 million in direct hedge fund investments recommended by and/or related to KKR Prisma. KKR Prisma thus gained tremendous leverage over the managers of the $285 million of new hedge funds they recommended, as well as over the existing direct hedge fund managers who knew that KKR Prisma/Rudzik could recommend they be divested at any time.

265. Allowing these KKR executives inside KRS while they remained employed and paid by, and loyal to, KKR was a clear violation of KRS's conflict of interest policy and Kentucky law, even more so since these conflicts were never vetted, no rules were created to avoid or mitigate them, and no information barriers were erected to prevent the conflicted misuse of information. The added power that the secret ASA/AASA explicitly created as a means of exploiting these conflicts for the benefit of KKR Prisma, Reddy, Rudzik, Cook, KKR, Kravis and Roberts – and for the near-certain but currently unknown personal benefit of Peden, without whom this caper couldn't have been pulled off – only exacerbated the conflicts.

266. At the same time that KKR/KKR Prisma were moving inside KRS to take control of its hedge fund investment portfolio, the fund of hedge funds industry was "***an***

industry in crisis." Fund of hedge fund sellers like KKR Prisma were suffering over $262 billion in outflows/redemptions in less than 12 months, a remarkable loss of 30% of the entire industry's assets under management. The industry was imploding — swamped by an unprecedented tsunami of redemptions — and KKR Prisma was being badly hurt. By gaining not only an additional $300 million more in assets under management (including $150+ million into its own newly launched fund), but the economic benefits from running the rest of the $1.6 billion portfolio as well, with a free hand to reap profits and benefits for itself, KKR Prisma ***helped itself at the expense of KRS at a time when the hedge fund industry was badly stressed***.

267. While many other public pension funds and other institutional investors were redeeming their hedge fund holdings, and foregoing new hedge fund investments, the tight grip that Peden, Rudzik and KKR Prisma had on KRS's hedge fund portfolio ensured that KRS remained fully invested in hedge funds and in fact adding to its positions.

268. These "investments" were not made "solely'" in the interests of the members and the beneficiaries of KRS, but to benefit KKR Prisma, Peden, Rudzik and Cook. This violated the KRS Conflict of Interest rules, and it also violated the Kentucky Pension Law:

> § 61.650(1)(c) BOARD OF TRUSTEE FUNDS:
>
> A trustee, officer, employee, ***or other fiduciary*** shall discharge duties with respect to the retirement system:
>
> 1. ***Solely in the interests*** of the members and beneficiaries;
>
> 2. For the ***exclusive purpose*** of providing benefits to members and beneficiaries....

269. The additional $300 million Daniel Boone investment — like the original conflicted deal in 2010–2011 — was a disaster. As of 9/30/19, Prisma's 3-year return of 3% was materially worse than the 3-year return of more than 4.5% on KRS's ***fixed income portfolio,*** and was dwarfed by the 12%+ 3-year return on KRS's U.S. equity portfolio. And KRS was forced to pay more than 2% annually in Management Fees (and an unknown amount in performance/incentive fees) to achieve this 3% growth.

270. Having engineered the plan to embed KKR Prisma inside KRS (in order to expand its influence over KRS's absolute return portfolio earlier in 2015), between December 2015 and January 2016, Cook, Rudzik and Peden began — behind the scenes — to cover their flanks by secretly maneuvering to get Cook appointed to the KRS Board. Peden worked with Rudzik and Steve Pitt, an advisor to the Governor, and others with influence to engineer the appointment of Cook (a just-retired KKR Prisma partner with a multi-million-dollar stake in KKR and huge performance-based payout) to the KRS board, and David Eager as Vice Chairman of the KRS Board. They succeeded, and Cook was appointed to the KRS Board in early June 2016, literally just days after Peden had used his position and information advantage to approve motions to (in Peden's words) "clean up the February 2016 and May 2015 Strategic Partnership decisions to make clear that Prisma Daniel Boone [would] be 50% of the Absolute Return portfolio," thereby upsizing Prisma Daniel Boone by $300+ million at Investment Committee and Board meetings that took place on May 5 and May 19, 2016, respectively.

271. Eager joined the KRS Board in May 2016. He joined the Investment Committee on May 3, 2016, was sworn in, and in his very first acts moved for the approval of not only the $300+ million upsizing of the Daniel Boone Fund, but additional new hedge fund investments recommended by and benefitting KKR Prisma

and its insiders as a result of the self-dealing provisions of the ASA. He again moved for the approval of these conflicted investments at the May 29, 2016 full Board of Trustees Meeting — his first Board meeting as a trustee. When he did so, he knew that these transactions were conflicted, favored the interests of KKR Prisma over the interests of KRS, were not done solely in the interests of KRS and its members, and violated KRS's Conflict of Interest Policy and Kentucky law. His participation and approval were part of — and an indispensable part of the success of — the scheme and conspiracy.

272. Eager quickly left the Board in August 2016 to become CEO/Executive Director of KRS. In that role as the top and responsible officer of KRS, Eager did nothing to expose or put a stop to the conflicted self-dealing that had been secretly and unlawfully "approved" by the ASA/AASA. Eager publicly criticized the Kentucky derivative lawsuit claiming it made it more difficult to get qualified trustees and hindered KRS's access to sellers of investment products. Despite his conflicts of interest, KRS's current Board of Trustees has continued to allow Eager to serve as KRS's CEO and actively participate in matters, claims relating to the 2015-2016 misconduct he was personally involved in, and he has attempted to blunt, deflect and dilute the prosecution of valid claims. Eager, as a trustee — and later as CEO — failed to ensure that the conflicts of interest involving KKR Prisma, Cook, Rudzik, Reddy and Peden were vetted, disclosed, and/or dealt with by the Investment Committee or the Board. He permitted the unlawful ASA/AASA to govern the so-called Strategic Partnership without exposing its contents or subjecting it to scrutiny or a vote by the Investment Committee or the Board.

273. However, political change had swept through Kentucky. This resulted in the appointment of other, new trustees who were not tied to KKR Prisma, Cook, Peden

and/or Rudzik, economically or personally. These new trustees would ultimately disrupt the ongoing conspiracy, despite the resistance of Eager, Peden and others inside or related to KRS.

274. Despite the disruption starting in late 2016, the wrongdoing continued as the proceeds of the illegal conduct continued to flow to key conspirators who took steps to whitewash and cover up their wrongdoing – especially the 2015–2016 misconduct. The secret ASA and surrounding facts did not begin to emerge until 2018 when, as part of a massive Motion to Dismiss filing in the *Mayberry* Action, counsel for Prisma (perhaps accidentally) attached the previously secret ASA as a motion exhibit. But even after counsel for the *Mayberry* Plaintiffs highlighted the fact and illegality of the ASA in subsequent motions, KRS and Eager continued to downplay and attempt to suppress these bombshell facts.

275. In or after August 2016, new KRS trustees publicly disclosed the fresh $300 million KKR Prisma Daniel Boone hedge fund purchase to ***loud public outrage***. *See* John Cheves, *Kentucky Pension System Doubling Down on Hedge Fund that Lost Money*, LEXINGTON HERALD LEADER,
Aug. 29, 2016, *available at* https://www.kentucky.com/news /politics-government/article98676912.html (last visited Dec. 30, 2020) ("One of the biggest investments held by the $14.9 billion Kentucky Retirement Systems is a hedge fund that's also one of its worst performers — and yet the financially troubled agency is doubling down.").

276. In October 2016, literally just weeks after the fresh $300+ million had gone into the Daniel Boone Fund, and after another $285 million into other hedge funds chosen by Prisma had been purchased, a special Investment Committee meeting was

called with the new KRS Chair (Farris) and new Investment Committee Chair (Harris) (both of whom understood hedge funds) in place. Starting then, the Investment Committee began to take a fresh look at KRS's hedge fund exposure. The Committee, with Cook recused and forced to abstain due to his obvious conflict of interest, voted unanimously to "exit[] the 10% allocation to absolute return/hedge funds" — or as one journalist put it, to "***end its controversial investments in hedge funds***." Peden was instructed to draw up (with new Trustee Ramsey) a plan to redeem (sell off) all $1.6 billion in hedge funds as quickly as legally possible. (Soon thereafter Peden, who tried to slow the redemption plan, was fired.) Reflecting this new direction by informed, unconflicted trustees, a presentation at the November 2, 2016 Investment Committee meeting observed that ***"Hedge Funds as a stand-alone self-diversifying allocation make little sense for KRS [because of] high fees [and] unattractive NET returns."*** This informed criticism hit the mark. KRS's "investments" in the so-called "absolute return" Black Boxes did not lower risk, reduce illiquidity, or generate sufficient returns to enable KRS to even approach, let alone exceed, the 7.5% rate of return that KRS and its consultant RVK expected from the Absolute Return investments. They *did* however generate excessive fees for the Hedge Fund Sellers, and poor returns and ultimately losses for the KRS Funds, in the end causing substantial damage to the Tier 3 Class Members.

277. As of 9/30/2020, the "absolute return" investments had in fact returned only 2.84% annually, net of fees, since inception – far less than the expected return the Hedge Fund Sellers had touted while seducing KRS into hedge funds in the first place. The five-year period ended 6/30/2020 was even worse. The so-called Absolute Return portfolio (largely consisting of Prisma Daniel Boone and direct hedge fund investments

recommended/vetted by KKR Prisma) returned a negative (-0.13%) for that five-year period, trailing Core Fixed Income (3.8%) and cash (1.52%) for that period. As little else could, these five-year negative returns, during a raging bull market in U.S. equities, gave lie to the "Absolute Return" myth and confirmed the simple wisdom of Warren Buffett who famously bet $1 million that a low-cost S&P fund would beat a basket of hedge funds over 10 years, largely because the hedge funds would not be able to return a sufficient amount in excess of market returns to make up for the nose-bleed management and performance/incentive fees they charged.[28]

278. The fees KRS has paid in connection with the Black Boxes — though never publicly quantified or fully disclosed — have been truly astronomical, especially in

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[28] Buffett made this highly publicized bet in 2008. KRS trustees should have listened to the Oracle of Omaha, rather than the fast-talking Hedge Fund Sellers. Or paid attention to the well-known 2006 article by Waring and Siegel, *The Myth of the Absolute-Return Investor*:

> The solution of hiring highly compensated entrepreneurs who do not feel bound by a bench-mark is powerfully marketed. … What investors actually get when they hire one of these would-be absolute-return managers is a variety of market-like or beta exposures (which can be hedged away to a net-zero level but which rarely are in practice) plus (or minus) positive (negative) alphas—as one would obtain with any investment—minus fees and other costs. And, on average, before fees and costs, the absolute-return funds are merely average.
>
> Consider again the notion, from our discussion of defining "absolute return," that absolute-return investing somehow delivers returns that are positive and high regardless of the direction of the market. What is wrong with this notion is that it portrays absolute-return investing as a ***magic investment approach*** able to earn outsized total returns with little or no risk of negative returns *simply because the manager disdains benchmarks and may have a low net market exposure* (low beta). ***Markets do not work like this***, and active management cannot generate returns in this way.

comparison to these very disappointing net returns. In connection with funds of hedge funds like these, fees are paid at two levels — fees are paid to the fund of funds manager (here, Prisma, PAAMCO, and Blackstone), and fees are also paid to the managers of the individual underlying hedge funds. Moreover, two different kinds of fees are paid at both levels: "Management Fees," representing a percentage of total assets under management paid annually regardless of performance, and "Incentive Fees," representing a percentage of annual profits based on performance. The total fees — Management Fees plus Incentive Fees, at both levels, are the relevant measure — as total fees impact and constitute a drag on net returns. The chart below depicts total fees charged with respect to each of the Black Boxes, according to an internal KRS staff report dated August 15, 2011.

	Total Management Fees off the top % of total assets annually	Total Incentive Fees % of profits annually
Prisma	2.52	24.7
PAAMCO	1.95	19.7
BAAM	2.12	29.8
Average	2.2	24.73

279. As shown in the chart, ***total Management Fees alone were 2.2% per annum***. With a $1.4 billion initial investment in the Black Boxes, this means that Management Fees alone were almost $31 million in the first year, and they escalated from there based on the size of the Absolute Return portfolio as a whole. ***In other words, from late 2011 through 2016, KRS paid as much as $165 million or more in hedge fund Management Fees***.

280. Incentive Fees were sky high too — KRS was required to pay the hedge funds almost 25% of profits (subject to certain adjustments) — in other words, ***to split profits 3-to-1***, ***on top of the Management Fees***. These Incentive Fees have never been publicly disclosed, but ***a rough estimate is that KRS may have paid as much as another $100 million or more in Incentive Fees to the hedge fund managers***, ***on top of the approximately $165 million in Management Fees***.

281. All told, ***it is likely that KRS paid as much*** (***or more***) ***in total fees as it received in net returns on its hedge fund investments***. These astronomical fees not only represented a drag on annual returns; the compounding effects of year after year of huge, excessive fees has made matters much worse.[29] As one KRS staff memo tartly observed, "it is no surprise that the best performing fund of funds in the Absolute Return portfolio has the lowest fees, and vice versa."

282. These fees have largely been hidden from KRS members and the public. The Court should order the Hedge Fund Sellers to provide a complete accounting of all fees paid — Management Fees and Incentive Fees, both at the fund of funds level, and at the underlying manager level. This information should have been made public years ago. In 2016, Governor Bevin issued an Executive Order requiring KRS to post on its website information reflecting "all … fees and commissions for … each individual manager, including underlying individual managers in fund [of] funds and … shall include any profit sharing, carried interest, or other partnership incentive arrangements or agreements." ***KRS, under Eager's leadership, has never disclosed these***

[29] Over the next 5 years, assuming even a 5.5% rate of expected return, the estimated $265 million paid out in hedge fund fees could have earned $75 million or more had the excessive fees not been taken out of KRS.

fees. The 2016 Comprehensive Annual Financial Report, for example, stated that Management Fees for the Absolute Return portfolio totaled $9.13 million. In fact, however, Management Fees for fiscal 2016 — including Management Fees paid to the underlying hedge fund managers in the Black Box funds of funds — came to $30 million or more. In other words, the 2016 CAFR understated Management Fees for the Absolute Return portfolio by $20 million or more. Whether the "lay" members of the Board understood that Management Fees had been drastically unstated, Executive Director Eager and Investment Committee Chair Cook — both career professionals with long experience in pension fund investing — surely did, especially since the ink on Executive Order 2016-340, which required reporting of fees charged by underlying managers in funds of funds, was barely dry.

283. Unfortunately, before Farris, Harris, Ramsey and the others intervened to disrupt the ongoing conspiracy, the KKR Prisma/Cook/Peden/Rudzik plan largely succeeded. Due to the pernicious "lock-up" provisions hedge fund sellers put into their contracts, they get to keep a client's money — and pocket huge fees — for years after they get it, ***no matter how badly the hedge fund performs***. So, while Farris and others had disrupted the ongoing misconduct, it was too late for the Tier 3 Class Members. Due to disadvantageous "lock-up" provisions, KKR Prisma, KKR Apex Tactical Fund, and other hedge funds related in some way to KKR got to keep hundreds of millions of investment dollars for many more months/years. These May 2016 Cook/Peden/Rudzik — engineered KKR Prisma —conflicted hedge fund investments from KRS helped KKR's hedge fund business through a very rough patch of over $262 billion in hedge fund redemptions, and generated millions in fees and other benefits.

284. The trustees who voted at Investment Committee and Board meetings to approve the formation of the "Strategic Partnership" with KKR Prisma (May 2015), to approve making the "Strategic Partnership" permanent (February 2016), to approve the $300 million upsize of the Prisma Daniel Boone Fund (May 2016), and/or to approve other actions in connection with the "Strategic Partnership" were (i) uninformed as to the material facts (and thus acting in breach of their duties); (ii) uninformed as to the material facts because Peden and/or his co-conspirators misled them; or (iii) knew about the material facts (including, *inter alia*, any or all of the conflicts of interest) and voted in disregard of the material facts and in breach of their fiduciary duties.

C. The Trustees' False and Misleading Statements and Reassurances Enabled the Scheme and Conspiracy and Kept It Going

285. As required by the Kentucky Pension Law, every year the KRS Board published a Comprehensive Annual Report for KRS members, government officials and taxpayers. It is the primary means of communication by the Board to KRS members and Kentucky taxpayers. It was required to be in "easily understood language" to allow KRS members and beneficiaries, government officials and taxpayers to be informed as to the true financial and actuarial condition of the KRS Funds and the stewardship of the trustees.

286. The police, clerks and social workers, the firefighters, sheriffs and the like, who are members of the KRS Plans are not required to be forensic accountants or actuaries or lawyers with fiduciary and trust expertise. They are not required to be private eyes, searching through 180-page-long, two-pound Annual Reports to ferret out if fiduciaries, who are supposed to be looking after them, are telling them the truth as the Kentucky Pension Law requires them to do. The Annual Reports published during

the relevant time period did not give a true, accurate or "fair presentation" of the actual financial and actuarial condition of the KRS Plans in "easily understandable" language. Instead, over the past several years the Board and Defendants (all fiduciaries) have worked together as part of their concerted common course of conduct and enterprise to make or permit to be made, false statements, reassurances and obfuscations to KRS members and beneficiaries and Kentucky taxpayers. KRS distributed the following false statements in Annual Reports that were released by U.S. mail and internet wire communications to KRS members, Kentucky legislators and other officials, and others.

287. The KRS Board promised that the KRS Annual Reports would:

> Provide complete and reliable information ... as a means of determining compliance with statutory provisions, and as a means of determining responsible stewardship of KRS funds.

288. The KRS Website year after year represented:

> The Board of Trustees is charged with the responsibility of investing the Systems assets ... the Board follows a policy of thoughtfully growing our asset base while protecting against undue risk and losses in any particular investment area. The Board recognizes its fiduciary duty not only to invest the funds in compliance with the Prudent Person Rule, but also to manage the funds in continued recognition of the basic long-term nature of the Systems. In carrying out their fiduciary duties the Trustees have set forth clearly defined investment policies, objectives and strategies for the pension and insurance portfolios.

289. The KRS Annual Reports constantly reassured KRS beneficiaries and Kentucky taxpayers how the Board carefully safeguarded and invested the KRS assets:

> The Board of Trustees of the Kentucky Retirement Systems has a statutory obligation to invest KRS' funds in accordance with the "prudent person rule." The prudent person rule states that fiduciaries shall discharge their investment duties with the same degree of diligence, care and skill that a prudent person would ordinarily exercise under similar circumstances in a comparable position.

> The Board has interpreted this to mean that the assets of the systems should be actively managed — that is, investment decisions regarding the particular securities to be purchased or sold shall be the result of the conscious exercise of discretion. The Board has further recognized that proper diversification of assets must be maintained. It is through these policies that KRS has been able to provide significant returns over the long-term while minimizing investment related expenses.

290. Each year from 2010 to 2017 and beyond, in various and multiple communications to KRS members and Kentucky taxpayers, KRS management (acting on behalf of the Board, and induced, and aided and abetted, by the Defendants) created a mosaic of false and misleading statements and reassurances that were intended to and did give a false sense of security as to the Funds and the quality of their stewardship. KRS misrepresented that, in performing their fiduciary duties, the Board "follows a policy of preserving capital," by "protecting against undue losses in any particular investment area" "by means of clearly defined investment policies." KRS consistently misrepresented their investment procedures and practices when they stated (i) "the Board follows a policy of thoughtfully growing our asset base while protecting against undue risk and losses in any particular investments"; (ii) the "portfolios are diversified on several levels … through the use of multiple asset classes [that] represent an efficient allocation to achieve overall return and risk characteristics"; (iii) "portfolios within each of the asset classes are diversified through investment strategies"; and (iv) with "new allocations to the … absolute return buckets — going forward the portfolio is more diversified than ever."

291. Contrary to assurances that the "absolute return" assets and strategies would provide safe diversification and reduced risk and volatility, the funds of hedge funds did not safely increase diversification but rather were a reckless blind bet. The

three $400-plus million plunges into the Black Box funds of hedge funds together were the largest single investments in the history of KRS. These were over-concentrated plunges into essentially identical vehicles with no set investment strategies (*i.e.*, unconstrained investments that can change at any time) and thus no way to forecast reliably any future performance. For fiduciary investors to put $400+ million, let alone $1.5 billion, all at one time into unknown investment vehicles with no set investment strategy other than "trust-us" is extremely reckless. Fiduciary investors test out strategies — they do not plunge into the deep end with a blindfold on. In total, the $1.2+ billion plunge (later $1.5 billion) was the largest one-time investment in a single asset class in the history of the KRS Funds. By comparison, KRS's largest individual domestic equity investments were in the $50–$75 million range and in international equity the largest investment was in the $24–$35 million range. Even in the safe fixed-income area, the largest KRS investment was about $175–$225 million.

292. As Trustees were searching to find a way to quickly boost investment returns in 2009–10, what was put in the KRS Annual Report for 2010 about its internal "asset/liability" study was obfuscation at best, deliberate deception at worst:

> Toward the end of the fiscal year, the Board made an important decision to commission RVK to conduct asset-liability studies for the KRS, CERS, and SPRS pension and insurance plans. The studies … were done because the severe market downturn in 2008 into early 2009 significantly lowered the funded ratio across all investment plans it became evident to the Board that it was necessary to better align the asset allocation decisions of the plans with the future and growing corresponding liabilities.
>
> * * *
>
> The studies revealed several plans, the KRS Non-Hazardous Pension Plan, face the possibility of converting to a pay-as-you-go model. Using "what if" scenarios, analysis shows that under very weak investment market conditions coupled with

> the consistent underfunding of the pension contributions over the next 10 years, the pension fund could deplete its assets in an attempt to meet escalating benefit payments. The asset-liability study assisted the Board with deciding on the most effective asset allocation strategies for each pension and insurance plan under its purview in order to lower risk, control the level of illiquidity in the portfolios, and generate a return expected to exceed the actuarially assumed rate of return of 7.75% .... As of 2010–2011 ... the Board has been transitioning to the new ... asset allocations — in a prudent manner.
>
> * * *
>
> ... ***We expect the Board's continued high standard of care for these assets and commitment to diversification to allow the System to meet its long-term goals and objectives***.

293. In August 2011, just after Trustees were persuaded to put the first $1.2 billion in the Black Boxes, T.J. Carlson (the CIO of KRS) stated:

> The new allocation is part of the system's new absolute-return asset class .... "***The main reason*** (***for the new absolute-return strategy***) ***is to reduce volatility in the portfolio overall*** ... [***and***] ***to get our expected rate of return of 7.75%. Absolute return helps us maintain our expectations but lowers our risks***."[30]

294. RVK's letter to KRS members and Kentucky taxpayers in the 2011 Annual Report again reassured:

> The Systems investment policies as well as the performance of its assets are regularly monitored ... by RVK Kuhns & Associates, Inc. These evaluations include reviews of the investment management firms ....
>
> * * *

[30] In stark contrast, the Hedge Fund Sellers themselves have peddled a story to the court in the *Mayberry* Action to the effect that the mutual expectation was only for very "modest" returns and that expectations would be completely satisfied with net returns in the range of 3% — a far cry from the net return expectations of 7.75% or more at the outset. Who is/was lying?

> We expect the Board's continued high standard of care for these assets and commitment to diversification to allow the Systems to meet its long-term goals and objectives.

295. After Trustees had put $1.5 billion into the Black Box vehicles, in the KRS 2012 Annual Report, RVK stated in a letter signed by Gratsinger:

> Questions surrounding how pension funds will meet their expected return targets and thus fund their liabilities are valid. Many funds are faced with the need to boost returns in this environment and have turned to alternative investments … absolute return strategies…. KRS has also moved in this direction. New target asset allocations were approved … in response to recently completed asset liability modeling studies. These new asset allocation guidelines … call for … new allocations to the … absolute return buckets, so going forward the portfolio is more diversified than ever.

296. Each of RVK's reports in the 2012, 2013, 2014 and 2015 KRS Annual Reports to members and taxpayers, which were signed by Gratsinger, continued to falsely reassure KRS beneficiaries and taxpayers:

> KRS portfolios are diversified on several levels. Portfolios are diversified through the use of multiple asset classes … and represent an efficient allocation to achieve overall return and risk characteristics. The individual asset classes are diversified through the use of multiple portfolios … Finally, portfolios within each of the asset classes are diversified through the selection of individual securities.
>
> The System's investment policies are regularly monitored by KRS staff, the Board and R.V. Kuhns & Associates, Inc. These evaluations include reviews of investment management firms ….
>
> We expect the Board's continued high standard of care for these assets and commitment to diversification to allow the Systems to meet its long-term goals and objectives.

297. Trustees caused key false reassurances by the investment advisor RVK to be blown up and featured in the Annual Reports with extra prominence:

"An uncertain market environment demands careful attention and thoughtful treatment of the assets entrusted to the Board's care by the Systems' employee participants. We expect the Board's continued high standard of care for these assets and commitment to diversification to allow the Systems to meet its long-term goals and objectives."

Rebecca A. Gratsinger
CEO, Principal
R.V. Kuhns & Associates

298. The KRS Annual Reports for the past several years contained a presentation of the actuarial position of the KRS Plans certified by Cavanaugh Macdonald in a report/letter signed by Cavanaugh Macdonald. From 2011 to 2015, the Cavanaugh Macdonald actuarial reports each represented that these "reports describe the current actuarial condition of the Kentucky Retirement System":

> The Board of Trustees in consultation with the actuary sets the actuarial assumption and methods used in the valuations ... These assumptions have been adopted by the Board ... in accordance with the recommendations of the actuary.
>
> * * *
>
> **Progress towards Realization of Funding Objectives**. The progress towards achieving the intended funding objectives, both relative to the pension and insurance funds, can be measured by the relationship of actuarial assets of each fund to the actuarial accrued liabilities. This relationship is known as the funding level and in the absence of benefit improvements, should increase over time until it reaches 100%.
>
> * * *
>
> Based on the continuation of current funding policies by the Board, adequate provisions are being determined for the funding of the actuarial liabilities of the Kentucky Employee Retirement System, ... as required by the Kentucky Revised Statutes. The funding rates established by the Board are appropriate for this purpose.

299. Even though they were under a duty to provide accurate, truthful information regarding the KRS Plans' financial and actuarial condition in the Annual

Reports in a manner that was "easily understood by the members, retired members and the public," during the relevant time period the most ever disclosed by Trustees and/or Officers, the Investment, Actuarial and Fiduciary Advisors and the Hedge Fund Sellers was deep within the 180+ page long reports. That information was that the "Absolute Return" "investments" had "excellent potential to generate income" and "may" have a "higher degree of risk." "May" is not "do." "May" is a statement of the obvious and a highly misleading one given the accompanying false assurances that these "investments" provided "safety and less volatility," "increased diversification," had "excellent potential for increased income," and that they would "help get KRS to" or enable it "to exceed" its 7.75% AARIR — all part of the Trustees' continued "adherence to high standards." In truth, these Black Boxes were secretive, opaque, illiquid vehicles, toxic "investments" that carried excessive and hidden fees, were impossible to accurately monitor or value, had no prior track record of performance, and carried a very high and unacceptably large risk of losses.

300. The Hedge Fund Sellers and each of the other Defendants knew of and approved/permitted these false statements as they were made to continue their scheme and conspiracy, and that they were false.

XI. CERTAIN DEFENDANTS' CONDUCT VIOLATED THE FEDERAL RICO STATUTE

301. This civil RICO claim is brought under 18 U.S.C. §§ 1962(b), (c) and (d) against Defendants Prisma/KKR Prisma, Cook, Reddy, Rudzik, KKR, Kravis and Roberts. The claim involves the misuse of and self-dealing with public funds, misrepresentations and/or omissions (by fiduciaries), and wire and mail fraud, including without limitation honest services fraud involving bribes and (possibly)

kickbacks. Many of the same acts and conduct pleaded earlier that constitute violations of Kentucky law also constitute violations of federal law — § 1962(a), (c) and (d) of the RICO statute. Because the conduct and acts pleaded as violations of Kentucky law involve deliberate and willful dishonest conduct (fraud) — involving a conspiracy — by fiduciaries using false statements distributed by U.S. mail, over the Internet and through interstate delivery services, the wire transfer of billions of dollars and laundering of the fruits/proceeds of the RICO violations and predicate acts all involving interstate commerce, that same conduct by the Defendants named in the RICO count ("RICO Defendants") also constitutes violations of §§ 1962(b), (c) and (d) of the federal RICO statute.

302. The "culpable person" was Defendant Prisma/KKR Prisma.

303. The RICO "enterprise" was an association in fact involving Defendant Prisma/KKR Prisma and non-defendants Peden/Eager/KRS. This enterprise included a group of persons and entities controlled by certain of these persons that came together in 2009–2010, who worked together *i.e.* conspired with and aided and abetted each other to target underfunded public pension plans, in this instance focusing and targeting the underfunded KRS pension fund plans and trusts.

304. The enterprise worked together with the shared common purpose of gaining insider access to KRS, exploiting their insider access to KRS and breaching their fiduciary duties to KRS and its Plan members — including the Tier 3 class members by selling KRS billions in unsuitable high risk and extremely expensive hedge funds and ultimately trying to avoid/dilute legal responsibility for their wrongdoing. They foisted grossly overvalued, highly risky and exorbitantly expensive hedge funds on KRS acting willfully and with actual knowledge of their illegal conduct, deliberately and

intentionally making false and misleading statements which invoked repeated violations of Kentucky law, utilizing and violating the U.S. mail and wire fraud statutes.

305. Defendants Cook, Reddy, Rudzik, KKR, Kravis and Roberts violated 18 U.S.C. § 1962 (d) in that they conspired, each in pursuit of his or its own separate and individual economic advantage, to violate 18 U.S.C. §§ 1962(b), (c).

306. The racketeering/predicate acts include:

- The use of the mail and wires to disseminate misstatements as to Prisma's adherence to fiduciary duties to KRS and its members and beneficiaries despite Prisma, in concert with Peden/KRS, having shifted most if not all of its obligations as a fiduciary — including responsibility for suitability determinations — back onto KRS via its several "Subscription Agreements."

- The use of the mail and wires in connection with the secret Advisory Services Agreement ("ASA"), a copy of which is attached (in the form filed in the *Mayberry* Action by Prisma) as Exhibit A hereto.

- The use of the mail and wires in connection with the secret Amended Advisory Services Agreement ("AASA"), with, as relevant here, substantially the same terms as the ASA.

- The agreement in both the ASA and AASA that – directly at odds with the fiduciary duties publicly avowed – KKR Prisma (and KKR) granted secret "permission" to "expand its industry knowledge [and] develop further business relationships with third parties through [KKR Prisma's] provision of services" to KRS.

- The use by KKR Prisma and KKR of this illegal "permission" to self-deal with KRS trust assets in violation of state law and their own duties as fiduciaries.

- The use of the mail and wires in an "honest services fraud" scheme, involving bribery (*i.e.*, KKR Prisma's provision of "free" services to Peden/KRS) in exchange for the illegal "permission" to self-deal — and possibly kickbacks to Peden and/or others (as to which we have only circumstantial evidence at this time).

307. Information is the life blood of hedge funds. They exist largely to exploit perceived information advantages (legitimate or not) in an ongoing effort to profit from

these perceived information advantages. This is the primary reason hedge funds are so secretive and so intent on keeping what they perceive as valuable information in the strictest confidence. By appointing KKR Prisma as in effect the "gatekeeper" to its $1.6 billion hedge fund portfolio, and empowering KKR Prisma to vet and receive information from third party hedge funds on its behalf, Peden/KRS gave KKR Prisma the means to extract an extraordinary amount of otherwise highly confidential information from these hedge funds – and leverage for KKR Prisma to require these third party funds to give it up to them (or walk away from KRS as a potential client). Then, through the ASA/AASA, Peden/KRS gave KKR Prisma "permission" to "expand its industry knowledge … through [its] provision of services" to KRS — *i.e.*, to use this valuable confidential information to its own business advantage — to self-deal with this valuable intangible asset.

308. The ASA/AASA also gave KKR Prisma "permission" to "develop further business relationships with third parties … through [its] provision of services under this Agreement." In other words, illegal "permission" to leverage to its own advantage its gatekeeper role with respect to hundreds of millions of KRS trust fund dollars.

309. KKR Prisma and KKR intended to and did take advantage of this "permission" structure which they bargained for (*via* the bribe discussed above) on an ongoing basis for many months.

310. Critical RICO events were the 2010–2011 sale of $1.5 billion in Black Box hedge funds to KRS including $400 million of KKR Prisma black boxes, ***followed*** in 2015–2016 by the bogus KKR Prisma/KRS "Strategic Partnership" and the secret ASA/AASA with hundreds of millions more in hedge fund purchases from KKR Prisma

(or funds they designated) and the KKR Prisma takeover of KRS's entire $1.6 billion hedge fund portfolio.

A. The 2010–2011 Sale of $1.5 Billion in Black Box Hedge Funds

311. After the ravages of the great financial crisis caused KRS huge losses during much of 2009 - 2010, the Trustees and KRS's advisers were consumed with attempting to control the fallout from the suspicious payments scandal, and the resulting internal staff and Board dislocation at KRS. This left KRS in 2010–11 with: a new Board Chair (J. Elliott); an Interim Executive Director (Thielen); and an interim CIO (Aldridge) — none of whom knew anything about absolute return assets or fund-of-fund hedge fund investments. After the internal asset/liability "Bombshell" study revealed a dangerous mismatch and a looming liquidity threat, while concealing the true state of affairs, the Trustees searched for some kind of high-yield "home run" investment to rescue themselves from and to cover up their own failed stewardship.

312. In the midst of the internal pandemonium, the Trustees failed to fill the KRS investment staff position for "absolute return" investments — a position created and intended to provide expertise on new, complex investments to the Trustees. An internal KRS memo noted these persistent staff deficiencies and the dangers posed.[31]

> Despite the fact that Ice Miller talks about fiduciary duty every retreat, the KRS Trustees don't appear to be weighing that responsibility and how retaining talented staff and providing stability on the investment team fits that fiduciary duty. To this point the trustees have been willing to put millions of dollars at risk in order to save tens of thousands.

[31] The impaired condition of the KRS Board and staff — which was known to the Hedge Fund Sellers — is important in the context of the Hedge Fund Sellers' common law fiduciary duties arising from the unique facts and circumstances of the relationship with KRS and its members as pleaded.

313. Despite this internal disruption and dislocation, the Trustees continued down the path toward risky absolute return fund of fund hedge funds, guided and encouraged along that path by the Hedge Fund Sellers and disloyal members of the internal KRS staff.

314. The deteriorating status of the KRS funds caught the attention of the Hedge Fund Sellers. They targeted KRS to sell its Trustees extremely profitable (for the sellers) but very expensive (for the buyer), custom-designed "Black Box" funds of hedge funds purportedly capable of producing "tremendous" investment returns to "exceed the Funds' actuarial return assumptions" with safe diversification and down-side protection. *See* Feb. 3, 2009 I.C. Memo. In truth, these Black Box vehicles were secretive, opaque, illiquid, impossible to properly monitor or accurately value, high-fee, high-risk gambles that were unsuitable investments for the KRS Funds, given their particular financial/actuarial situation.

315. The Hedge Fund Sellers had been working with Tosh and Aldridge to get the Trustees to purchase the type of high-fee hedge funds they wanted to sell long before the actual August-September 2011 sale. By 2009, they were already targeting KRS as a buyer of their lucrative, high-fee funds, working with KRS staff to get the Trustees to start to reverse the no hedge funds edict and guide the Trustees toward riskier investments — specifically the high profit Black Boxes they ultimately sold them. For example, as early as 2009, PAAMCO's Buchan was already dealing with Tosh — to get KRS to reverse the prior ban on hedge fund purchases, congratulating him on his success in getting the KRS trustees to take their first absolute return plunge in Arrowhawk (I am sure was "no small feat"), while discussing with Tosh how to restructure the KRS investment portfolio to take on more high-risk hedge fund

investments. During the same time, Prisma/Reddy/Cook/Peden were working together with the same purpose to get KRS to buy billions in black box hedge funds. Memos of 2009 phone calls detail Buchan's involvement with KRS's Tosh and Aldridge in shaping KRS investment policy to get the ban on hedge funds reversed — to facilitate the sale of hedge fund vehicles to KRS:

> 11/9/2009:
>
> Per Von's suggestion, talked with Adam re sales guy. Said to ignore him and it was a shame he was using his name inappropriately. He said he is really ***interested in FOHFs***. ***Likely 1Q funding***. [fund of hedge funds]
>
> * * *
>
> 7/15/2010:
>
> Adam [Tosh] really wants to introduce us to his new CIO (Brent Aldridge, KRS' Interim CIO). ***He said, Brent is a smart guy but has little alternatives experience***. ***We need to help him*** "***get up the curve fast***" ***and perform our*** "***trusted advisor***" ***service to him*** (***he said PASERS just raves about us***). ***He said EVERYONE is going to be after Brent but we are one of only two or three firms that should get this mandate***. He is going to run the outsource CIO role at Rogers Casey. We are going to stay in touch. ***We should figure out how to use him and make our FOHFs one of their solutions***. ***Jane***
>
> * * *
>
> 7/20/2010:
>
> Brent called (first morning as interim CIO). They are gearing up for the FOHF search and we should hear from them by late August. We come "highly recommended" from Adam. He comes out here about 4 to 5 times per year (and I have asked him to stop by next time). He asked for our advice on what to factor into their search…. He seemed to really like this idea. I think he is looking for lots of overall help. This is his first CIO job (he was one of Adam's direct reports).

316. In rapid fashion, in 2011, the Trustees put 10% of KRS's Trust Funds — $1.2 — $1.5 billion in three $400/$500 million pieces — into Black Box fund-of-hedge funds. In addition to being ill-advised, the investments were made without adequate due diligence that would have exposed the ***checkered pasts of the Hedge Fund***

Sellers and made it impossible to prudently do business with them as Trustees.[32]

317. Rather than face the public outcry, uproar, political firestorm and inquiries that would have resulted had they told the truth in 2010–11 as the law required them to do — rather than honestly disclosing the true facts and seriousness of KRS's financial/actuarial situation, so that proper and prudent steps could be taken then to rescue the funds, secure increased state funding at that time and assure the KRS Pension funds were prudently invested going forward — Defendants obfuscated, misled and falsely reassured KRS's Pension members and beneficiaries and bet billions on speculative "absolute return" and "real return" "investment" strategies that failed. When KKR Prisma led the successful sale of $1.5 billion in hedge funds to KRS in 2011 — which generated assured millions in fees for the Hedge Fund Sellers year after year regardless of performance — "conflict of interest" relationships were identified and flagged internally at KRS, but nothing was done.

318. Over the next five years, these Black Box vehicles provided very poor absolute and relative returns. The absolute return portfolio returned a miserable 3.73% from inception and lost over 6% — almost $100 million — in 2015–2016. The very catastrophe they had been warned about occurred when KRS plunged into the 2016–17 financial crisis and nearly collapsed.

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[32] Before they sold these Black Boxes to KRS, the Hedge Fund Sellers were required to affirm they were "registered investment advisers under the 1940 Investment Advisers Act" and "were willing to accept fiduciary responsibility" to KRS for these investments. These fiduciary duties included suitability requirements. *See* August 2, 2011 RVK Memo to I.C. This also made them fiduciaries under Kentucky law. *See* KRS 292.310(11); KAR 10:450 sect. 2.

319. The Hedge Fund Sellers sold the high-fee, high-profit Black Box vehicles to Trustees even though they and RVK knew the extremely high-risk, high-fee, speculative vehicles were unsuitable investments for KRS given its particular financial/actuarial situation. Then, even though the Kentucky Pension Law required Defendants to tell the truth — the complete unvarnished truth — in "easily understood" language to KRS retirees and beneficiaries, the Defendants did not do so.

320. Because they intentionally misled rather than told the truth, Defendants' actions and failures to act alleged in this Complaint are one or more of a civil conspiracy, course of common conduct, and/or a concerted action. The associated false statements created what top Kentucky officials termed a "false sense of security" leading to "smaller than necessary [government] contributions," because instead of complying with the law and telling the truth they "manipulated … actuarial assumptions" used "unreasonably high investment expectations … while using "false payroll numbers" — which was "morally negligent and irresponsible conduct."

B. The 2015–2016 Bogus Strategic Partnership and Takeover of KRS's $1.6 Billion Hedge Fund Portfolio

321. In 2016, while the Trustees were selling off $800 million in high-fee, poorly performing hedge funds, with Cook as the Chair of the Investment Committee, his former employee Peden as the CIO and a KKR Prisma executive (Rudzik) working at their side inside KRS, Trustees put $300 million more of KRS trust funds in the KKR Prisma Black Box *i.e.*, the Daniel Boone Fund, on which the KRS Funds had recently suffered big losses. In fact, this Black Box was the worst performing of the Black Boxes. This "investment" was not done "solely" in the interest of the members and the beneficiaries but to help KKR Prisma and its senior executives. During 2016, Hedge

Fund sellers like KKR Prisma suffered over $100 Billion in outflows/redemptions because of bad returns and expensive fees. The hedge fund industry was described as "an industry in crisis" at the time Cook, Peden and the trustees made this $300 million addition to the Daniel Boone Fund.

322. The so-called "partnership" with a KKR Prisma executive inside KRS acting as a "manager" of and gatekeeper for KRS assets while still being paid by KKR Prisma, while advising KRS what to do with its Black Box fund of hedge fund vehicles, and then directing hundreds of millions of KRS dollars to KKR Prisma while KKR Prisma's hedge business was facing redemptions and increasing outflows and loss of customers, violated the Kentucky Pension Law's conflict of interest prohibitions. Further, the ASA purported to allow KKR Prisma, a fiduciary, to profit from self-dealing with KRS assets.[33]

323. In April 2017, it was reported:

> When Kentucky's public pension put U.S. buyout firm KKR & Co., L.P. in charge of its hedge fund investments ... its board expected the deal to save money and boost its return.
>
> * * *
>
> For the Wall Street firm, the deal paid off. KKR Prisma, increased by nearly half the amount of money it managed on Kentucky's behalf and its fee income rose by at least a quarter, according to KKR Prisma documents seen by Reuters ... Kentucky, so far, has come up short.
>
> * * *
>
> What [made] KKR Prisma ... the top manager of about $1.65 billion in Kentucky's hedge fund investments, ***was an offer to let an executive work for two weeks per month out***

[33] Named Plaintiffs are not presently aware whether Peden or others involved in the proposal, negotiation and/or operation of the "partnership" and/or the ASA violated other Kentucky laws, such as Chapter 521 of the Kentucky Revised Statutes, but it may be reasonably inferred from the nature — and secrecy — of the ASA that improper pecuniary benefits may have been part of the package.

> ***of Kentucky's Frankfort office overseeing the portfolio***.
>
> * * *
>
> It was "***like having a free staff member***," David Peden, who was the pension fund's chief investment officer at the time … ***He said KKR approached him after it learned he could not find a qualified candidate to run hedge fund investments*** …
>
> * * *
>
> Peden who worked at Prisma a decade ago and before it was taken over said the relationship … "***made it … unnecessary to do a competitive process***" … Girish Reddy, co-founder of KKR Prisma, ***described the deal as a strategic partnership*** …

324. This was a false and misleading description of what was actually going on in violation of KRS conflict of interest policies and Kentucky law. Peden has admitted that KRS has had consistent difficulty in hiring experienced and qualified staff, and that because KRS was "***not fully staffed***" he allowed ***KKR Prisma employees*** to act as KRS staff, *i.e.*, "***essentially we use them as an extension of our staff***," while they were still paid by Prisma in what a KKR Prisma employee described as a "partnership." He thus permitted executives of KKR Prisma (Rudzik and others) with adverse legal interests to KRS and against whom KRS had valid and valuable legal claims to have access to its internal operations, data, information, strategies and discussions while causing KRS to agree to put $300 million more into KKR Prisma's Daniel Boone Fund ***and $285 million in KKR Prisma-recommended hedge funds***.

325. The illegal acts of the enterprise involved the same and similar persons who employed common methods, including acting together as disloyal fiduciaries to KRS's members, and corrupting KRS insiders, committing continuing violations of

KRS's conflicts of interest rules, *i.e.*, Kentucky laws, as well as a pattern of false statements, reassurances and concealments.

326. The RICO enterprise had an association in fact — had a common shared purpose. The enterprise had a continuity of structure and persons. The enterprise had ascertainable structure distinct from the pattern of racketeering activity in this case.

327. The RICO defendants — the culpable persons — and their coconspirators committed repeated acts of mail fraud and wire fraud in pursuing the conspiracy and in cheating, defrauding and damaging KRS member beneficiaries, including the Tier 3 class members.

328. They also committed repeated acts of wire fraud to carry out and further their scheme and conspiracy. Billions of dollars were wired by KRS to these hedge funds sellers — much of it wired to NY. These wire transfers are reflected in KRS's internal records as well as those of the Hedge Fund Sellers.

329. Because the wire transfers of billions of dollars were the fruits of illegal conduct in interstate commerce, they constitute illegal money laundering under federal law, and those funds were split between members of the ongoing RICO enterprise and divided among the participants (as profits and distributions) the fruits of their scheme.

330. The false statements made in furtherance of the RICO conspiracy are pleaded at ¶¶ 58–60, 125, 198, 211, 213–214, 233, 285–300 and 322–323. These statements were contained in Annual Reports and releases distributed through the mail and over the Internet by participants in the conspiracy. Reliance on false statements made by fiduciaries is not necessary by trust beneficiaries who are involuntary forced participants in the trust plan and who are damaged by the misconduct furthered by false statements whether they know of them or not.

331. The actions described in the preceding paragraphs were intentional, were in violation of the relevant mail and wire fraud statutes, constituted a pattern of racketeering activity, and affected interstate commerce.

332. Plaintiffs and the Class have been damaged by reason of the violations of RICO alleged above.

XII. STATUTES OF LIMITATIONS

A. Kentucky Claims

333. The relevant statutes of limitations (5 years for Kentucky law and 4 years for RICO) have not run. This amended complaint relates back. Nor has any applicable NY statute of limitations. The claims asserted all involve ***fraud — dishonest conduct by fiduciaries, including false reassurances tolling the running ongoing limitations period***. It was not until late 2016 that the prior wrongdoing of KRS insiders and their assistors and co-conspirators began to become public in sufficient detail that as Tier 3 Class members could have pleaded proper claims under Kentucky law.

B. RICO Claims

334. It was not until August 2017 when the Governor of Kentucky called the conduct of Defendants ***criminal*** and said the KRS CEO should be in ***jail*** and not until 2018 that the secret ASA was discovered, that it was possible to plead essential, necessary elements of a RICO claim — *i.e.*, multiple predicate acts, continuing conduct consistent with Rule 11 and applicable pleading rules requiring specificity of pleading. The ASA had been concealed and the contents and import of the Strategic Partnership misrepresented by Defendants. This amended complaint relates back.

335. The wrongs complained of are continuing and ongoing well into 2020 in terms of egregious ongoing misconduct that continues to this day. Certain KRS insiders are working behind the scenes to weaken and even block these claims to protect themselves individually — a continuing breach of their fiduciary and trust duties. Defendants have actively concealed their wrongdoing and violations of law for years, including publishing a KRS Annual Report, in which they are each identified, and of which they were each aware. And, as late as 2016, the KRS Annual Reports were certified by the Government Finance Officers Association as "satisfying applicable legal requirements." In 2013, legislation was passed to strengthen the KRS Pension Funds. KRS beneficiaries and Kentucky taxpayers were assured: "As a result of this legislation, we fully honor the commitments made to state workers and retirees … [and] address the financial uncertainty that threatened our State's credit rating."

336. The lawsuit filed in Kentucky in December 2017 by KRS Plan Members against Defendants and the Tier 3's proposed Amended Complaint and Complaint in Intervention filed in 2020-2021 tolled any statute of limitations as to all Defendants who then had notice of the facts alleged and potential claims against them.

337. The statute of limitations has been tolled, equitably and because of Defendants' continuing false statements and reassurances, and because the illegal conduct has been and is continuing.

XIII. CLASS ACTION ALLEGATIONS

338. There are about 100,000 Class Members. Plaintiffs bring this action both on behalf of themselves and as a class action pursuant to Rules 23.01 through 23.08 of the Kentucky Rules of Civil Procedure, on behalf of the following Class:

> All persons who became Tier 3 members or beneficiaries of any KRS pension plan/trust after January 1, 2014.

339. This definition specifically excludes the following persons or entities: (a) any Defendants named herein; (b) any of Defendants' parent companies, subsidiaries, and affiliates; (c) any of Defendants' officers, directors, management, employees, subsidiaries, affiliates, or agents and; (d) all governmental entities. Plaintiffs reserve the right to expand, modify, or alter the class definition in response to information learned during discovery.

340. This action is properly brought as a class action for the following reasons:

A. **Numerosity**: The proposed Class is so numerous and geographically dispersed throughout the United States that the joinder of all Class Members is impracticable. While Plaintiffs do not know the exact number and identity of all Class Members, Plaintiffs are informed and believe that there are approximately 100,000 Class Members. The precise number of Class Members can be ascertained through discovery;

B. **Commonality and Predominance**: There are questions of law and fact common to the proposed Class which predominate over any questions that may affect particular Class Members. Such common questions of law and fact include, but are not limited to:

- The extent and duration of the wrongful acts carried out by Defendants in furtherance of the alleged wrongful conduct;
- Whether Plaintiffs and the other members of the Class were injured by Defendants' conduct, have standing and were damaged, and, if so, the determination of the appropriate measure of damages;

- Whether Defendants unjustly enriched themselves to the detriment of Plaintiffs and the members of the Class, thereby entitling Plaintiffs and the members of the Class to disgorgement of all benefits derived by Defendants.
- Whether Defendants' misconduct violated RICO, and
- Whether Defendants' misconduct justifies punitive damages.

C. **Typicality**: Plaintiffs' claims are typical of the claims of the members of the proposed Class. Plaintiffs and the Class have been injured by the same wrongful practices of Defendants. Plaintiffs' claims arise from the same practices and conduct that give rise to the claims of the Class and are based on the same legal theories; and

D. **Adequacy of Representation**: Plaintiffs will fairly and adequately protect the interests of the Class in that they have no interests antagonistic to those of the other members of the Class, and Plaintiffs have retained attorneys experienced in pension fund litigation and class actions and complex litigation as counsel.

341. A class action is superior to other available methods for the fair and efficient adjudication of this controversy for at least the following reasons:

a. Given the size of individual Class Member's claims and the expense of litigating those claims, few, if any, Class Members could afford to or would seek legal redress individually for the wrongs Defendants committed against them and absent Class Members have no substantial interest in individually controlling the prosecution of individual actions;

b. This action will promote an orderly and expeditious administration and adjudication of the proposed Class claims, economies of time, effort and resources will be fostered, and uniformity of decisions will be ensured;

c. Without a class action, Class Members will suffer damages, and Defendants' violations of law *vis a vis* the Tier 3 class members will proceed without a full and adequate remedy while Defendants reap and retain the substantial proceeds of their wrongful conduct; and

d. Plaintiffs know of no difficulty that will be encountered in the management of this litigation which would preclude its maintenance as a class action.

342. Plaintiffs intend to provide notice to the proposed Class by sending notice to Class Members by U.S. mail or email or published notice using contact information for Class Members that is within the custody and control of KRS. KRS maintains mailing addresses and email addresses for each member of the Class, makes periodic mailings to members and has a website, and thus records and means exist that can be used to provide actual notice of the pendency of this action to Class Members.

343. In this case (1) greater than two-thirds of the members of the putative class are residents of the state where the action was originally filed, (2) at least one defendant (Cook) from whom "significant relief" is sought and whose conduct forms a "significant basis" for the claims of the class is a resident of Kentucky, (3) the "principal injuries" resulting from the conduct of "each defendant" were "incurred" in Kentucky, and (4) during the three-year period preceding the filing of the complaint, no other class action asserting the "same or similar factual allegations" has been filed against any of the defendants on behalf of the same or other persons.

XIV. CAUSES OF ACTION

Count I
Against the Hedge Fund Sellers and the Investment and Fiduciary Advisors for Breaches of Statutory, Trust, Fiduciary and Other Duties to KRS

344. Plaintiffs incorporate by reference the allegations set forth in this Complaint.

345. The Hedge Fund Sellers and the Investment and Fiduciary Advisors were all fiduciaries to KRS's members/beneficiaries under the language of the Kentucky Pension Law, because (i) their roles gave them constant access to non-public information of KRS and its Pension Funds, (ii) they held themselves out to be very sophisticated, highly qualified experts with extensive experience and expertise in their respective fields, (iii) they knew the KRS Trustees were dealing with internal turmoil and staff turnover and new and inexperienced investment staff and investment advisors and would be unusually dependent upon their professed, superior experience, expertise, and sophistication in their respective areas of expertise, and (iv) in the case of the Hedge Fund Sellers and RVK, both were also acting as investment advisors and/or investment managers for KRS.

346. Each of these Defendants by their actions and inactions, as alleged herein, acted in a deliberately dishonest manner, committing acts of fraud and failed to fulfill their statutory and other duties, including their fiduciary and trust duties. Reliance on false statements by a fiduciary is not necessary.

347. Class Members have sustained and will continue to sustain significant damages, as alleged in Count I. The damages alleged herein are applicable to each of Counts I, II, III and IV, and consist of any and all provable damages to the Class, which

include, at a minimum, the following: (i) damages for the losses incurred as a result of lost "upside sharing" including excessive plan expenses related to, *inter alia*, the Black Box and other hedge fund investments, unsuitable investments, the loss of trust assets, the loss of prudent investment opportunities and the loss of positive investment returns and accumulations; and (ii) disgorgement of fees from appropriate Defendants which each received from the sale of, the continued holding of, and the management of, unsuitable hedge fund products.

348. Defendants' actions and failures to act were a substantial factor in causing the damages alleged herein.

349. As a result of the misconduct alleged herein, all Defendants named in this Complaint are liable to the Class and its individual members for damages in an amount to be proven at trial.

Count II
Against the Hedge Fund Sellers and the Investment and Fiduciary Advisors for Participating in a Joint Enterprise and/or a Civil Conspiracy, Including One or More of a Scheme, Common Course of Conduct, Common Enterprise and Concerted Action

350. Plaintiffs incorporate by reference all the allegations set forth in the Complaint.

351. Each Defendant knowingly played an important and indispensable part in a scheme, civil conspiracy, concerted actions, common course of conduct, and joint enterprise for their own, and their joint, economic gain to the damage of members of the class. Defendants worked together, knowing the roles of the others and each taking the specific overt acts alleged herein within their special areas of expertise and knowledge to further the civil conspiracy. Each Defendant profited from participation in the scheme. In order for the scheme to succeed as it did, it required the continuing, conscious

mutually supportive and overt acts of each Defendant. Had any one of them complied with their duties, the damages could have been mitigated or avoided.

352. Class members have sustained and will continue to sustain significant damages, as alleged in Count I.

353. Defendants' actions and failures to act made with knowledge of the facts, and Defendants' actions and failures to act, were all substantial factors in causing the damages alleged herein.

354. As a result of the misconduct alleged herein, these Defendants are liable to the class and its individual members for damages in an amount to be proven at trial.

Count III
Against the Hedge Fund Sellers, and
Fiduciary and Investment Advisors for Aiding and
Abetting Breaches of Statutory, Fiduciary and Other Duties

355. Plaintiffs incorporate by reference all the allegations set forth in the Complaint.

356. Each of the Hedge Fund Sellers, and the Fiduciary and Investment Advisors knew that the Trustees and/or other Defendants owed fiduciary and other obligations to KRS and individual plan members.

357. Each of the Hedge Fund Sellers, and the Fiduciary and Investment Advisors knew that the Trustees' conduct and/or other Defendants' conduct as alleged in this Complaint breached those duties to KRS.

358. Each of the Hedge Fund Sellers, and the Fiduciary and Investment Advisors gave the Trustees and/or other Defendants substantial assistance or encouragement in effectuating such Trustees' and/or other Defendants' breaches of their fiduciary duties, by the actions or failures to act as alleged in this Complaint.

359. The overt acts of Defendants named in this Count that constitute substantial knowing assistance are the same overt acts alleged as part of Defendants' participation in the scheme, civil conspiracy and concerted common course of conduct and enterprise detailed throughout this Complaint.

360. Defendants named in this Count had actual knowledge of the existence of the Trustees' and Officers' duties to KRS and its member/beneficiaries, and knowingly provided substantial assistance to the Trustees in the breaches of their duties to KRS and its members/beneficiaries.

361. As a direct and proximate result of these Defendants' breaches of duty and of trust, aided and abetted by the other Defendants named in this Count, class members have been damaged.

362. Class members have sustained and will continue to sustain significant damages, as alleged in Count I.

363. As a result of the misconduct alleged herein, these Defendants are liable to the class and its members for damages in an amount to be proven at trial.

Count IV
Against the Hedge Fund Sellers and the Investment, Actuarial and Fiduciary Advisors for Punitive Damages

364. Plaintiffs incorporate by reference all the allegations set forth in the Complaint.

365. The acts and omissions of each of the Hedge Fund Sellers and the Investment, Actuarial and Fiduciary Advisors constitute willful and wanton conduct, gross negligence, and/or malice and oppression, for which Plaintiffs are entitled to recover punitive damages due to the disregard for the rights of class members. In the alternative, each Defendant authorized, ratified or should have anticipated the acts and

omissions of its employees, agents, both actual and ostensible, and servants, all as alleged herein.

366. The Kentucky Attorney General has been notified of this proceeding.

367. As a direct and proximate result of these Defendants' willful, reckless and wanton conduct, the class and its members are entitled to punitive damages, as determined by the jury.

Count V
Against KKR, Prisma, Reddy, Cook, Rudzik, Kravis and Roberts for Damages, Equitable Relief and Declaratory Judgment in Connection with the Advisory Services Agreement

368. Plaintiffs incorporate by reference all the allegations set forth in the Complaint.

369. The conduct of these Defendants in connection with the proposal, negotiation and execution of the ASA caused damages to the Tier 3 Plaintiffs and Class Members in an amount to be proved at trial.

370. Plaintiffs seek a judicial declaration to the effect that the ASA, and in particular its provision for self-dealing with KRS assets, was and is unlawful and unenforceable.

371. Plaintiffs seek equitable relief in connection with the ASA, including without limitation accounting for and disgorgement of all benefits or proceeds derived from self-dealing conduct.

COUNT VI
Against KKR, Prisma, Reddy, Cook, Rudzik, Kravis and Roberts for Violations of RICO § 1962(b), (c) and (d)

372. Plaintiffs incorporate all prior allegations in this Complaint and specifically reference ¶¶ 301–330, the RICO allegations.

373. The acts alleged constitute violations of 18 U.S.C. § 1962(b) and (c) (as to Defendant Prisma/KKR Prisma) and of 18 U.S.C. § 1962 (d) (as to Defendants Cook, Reddy, Rudzik, KKR, Kravis and Roberts).

374. As a direct and proximate result of these RICO violations, Plaintiffs and the Class have been injured in their business and property in that their property interests in their KRS Fund and their individual pension accounts have been injured.

XV. PRAYER FOR RELIEF

WHEREFORE, the Tier 3 Plaintiffs, on behalf of and for the Class, demand judgment as follows:

1. Declaring that the Tier 3 Plaintiffs may maintain this action on behalf of the class and that they are appropriate representatives;

2. Determining and awarding to the class and its members the damages sustained by them as a result of the violations set forth above from each of the Defendants individually, proportionally and/or jointly and severally, together with interest thereon, as appropriate under Kentucky law and treble damages under RICO;

3. In addition, or in the alternative, to damages, awarding to the class and its members equitable relief, to include equitable monetary relief, making them whole, as appropriate including their share of punitive damages and excessive expenses imposed on their accounts grossed up to obviate any tax impact if necessary;

4. Determining and awarding punitive damages against Defendants, the Hedge Fund Sellers, Investment, Actuarial and Fiduciary Advisors and each of their principals/officers named as Defendants;

5. Ordering a full and complete accounting of all (a) fees or other payments made to any person in connection with the Black Box funds of hedge funds sold to KRS

and managed by KKR Prisma, Blackstone and PAAMCO; (b) fees paid to any sub-funds associated with the Black Box funds of hedge funds; (c) any fee or profit or compensation sharing, splitting or other economic arrangements between the Hedge Fund Sellers, their executives and the Black Box sub-funds or any third person involved in these absolute return strategies or assets; and (d) how the Tier 3 members upside sharing was completed each year and the diversion of any of their contributions to KRS health insurance funds.

6. Awarding Plaintiffs' Counsel reasonable fees and expenses, honoring the fee agreements with the named Plaintiffs who have brought this action on behalf of and for the benefit of themselves and the class;

7. Awarding an incentive fee to the named plaintiffs and other KRS members for their efforts uncovering the scandalous wrongdoing at KRS in the first place, having the courage to expose it in making this suit possible and for their service on behalf of the Class;

8. Granting such further or other legal and equitable relief as the Court deems just and proper.

DEMAND FOR JURY TRIAL

Plaintiffs demand a trial by jury on all issues so triable.

Dated: July 9, 2021

Respectfully submitted,

s/ Michelle Ciccarelli Lerach

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