

MINUTES OF THE JOINT MEETING
OF THE BOARD OF TRUSTEES OF
THE KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM,
THE INVESTMENT COMMITTEE FOR THE
KENTUCKY JUDICIAL RETIREMENT FUND,
AND THE INVESTMENT COMMITTEE FOR THE
KENTUCKY LEGISLATORS RETIREMENT FUND

April 23, 2021

The Board of Trustees of the Kentucky Judicial Form Retirement System (JFRS), the Investment Committee for the Kentucky Judicial Retirement Fund, and the Investment Committee for the Kentucky Legislators Retirement Fund, convened at the Administrative Office of the Courts, 1001 Vandalay Drive, Frankfort, Kentucky 40601 and via Video-Conference utilizing Microsoft Teams on Friday, January 22, 2021, at 10:00 a.m. All Board members were in attendance with the exception of Mr. Stephen LeLaurin. Bo Cracraft, Executive Director, Rebecca Stephens, Assistant to the Director, and Stan Kerrick, Lexington Investments participated in person. Mr. Don Asfahl, Mr. Tom Watkins, and Mr. Andy Means of Hilliard Lyons attended via video-conference. Mr. Wesley Wickenheiser and Mr. Matthew Widick of Findley, Inc. also participated by video-conference.

Chairman Grise called the meeting to order at 10:07 a.m.

The trustees considered the adoption of the previously distributed *Minutes* of the January 22, 2021 meeting. Upon motion by Justice Daniel Venters, seconded by Representative Brad Montell, the Board unanimously approved the *Minutes* of the January 22, 2021 meeting.

The next order of business was the report of Lexington Investments LLC. Chairman Grise recognized Mr. Kerrick. Mr. Cracraft previously distributed electronic copies of *Lexington Investments' Kentucky Judicial & Legislators Retirement Funds* as of March 31, 2021. In accordance with Board policy, the System maintains a copy of the *Reports*.

Mr. Kerrick confirmed the Funds were in compliance with the Investment Policy Statement with equity allocations for the Judicial Fund at 76.5% and Legislators Fund at 75.1%. He advised that more than 50% of each Fund's equity positions have paid dividends for the last five consecutive years. He also advised that there were no individual equity market values exceeding 8% of total equity market values as of March 31, 2021. Any time an individual equity value exceeds 8% of the Funds' total equity market, Mr. Kerrick advises the Executive Director of JFRS.

Next, Mr. Kerrick examined the rates of return in the Performance Analysis for each fund, pointing out that JFRS continued to experience strong positive performance and outperformed the policy benchmarks as of March 31, 2021. He discussed how indexes continued to climb, in the face of what was an eventful political and COVID related quarter, reaching

record highs during the month of February. Both the JFRS defined benefit (DB) plans had not only participated in this growth, but had significantly outperformed the S&P 500 index during the quarter. He reviewed the Portfolio Statement, Cash Reconciliation Reports and the Brokerage Fees Report for each fund. During this review, he pointed out that Hilliard Lyons had rebalanced the portfolios in late January, because the equity allocations in both funds had grown very close to an 80% maximum allocation. While reviewing the Legislators Fund, Mr. Kerrick advised that the Fund is nearly identical to the Judicial Retirement Fund.

In response to a question from Judge George regarding income and cash withdrawals, Mr. Kerrick stated that income generated is credited to the custodian account at State Street. Cash is reinvested by Hilliard Lyons unless it is needed for the purpose of paying retiree benefits or other system expenses. Staff periodically need to withdrawal cash from the custody account and those withdrawals are reflected in his Cash Reconciliation Report.

In response to a question from Senator Bowen regarding negative returns on cash, both Mr. Kerrick and Mr. Cracraft noted that cash was earning a very small amount of interest, but the administrative fees incurred had exceed interest recently and resulted in the reported negative return.

Lastly, in response to a question from Rep. Montell regarding any differences in the LRP and JRP portfolios, Mr. Kerrick advised that two portfolios are nearly identical. Given the smaller size, he noted the bond portfolios can look slightly different, but the equity portfolios and returns have been very similar.

Mr. Kerrick departed the meeting at 10:57 a.m.

Chairman Grise recognized the representatives of Hilliard Lyons Trust Company, who joined the meeting virtually via Microsoft Teams. Mr. Cracraft previously distributed copies of Hilliard Lyons' *Investment Review for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement Fund* dated April 23, 2021. In accordance with Board policy, the System maintains a copy of the *Investment Review*.

Mr. Watkins began Hilliard's Market Commentary with a review of his quarterly article, "The Willing Suspension of Disbelief" which highlighted three general areas of excessive speculation. First, he highlighted how unprofitable technology companies were seeing extreme levels of valuations. Given the lack of profit, investors were valuing these companies based on total revenues, rather than cash flow or earnings, which Hilliard believes, is not logical. Secondly, he pointed to an increase in day trading and investors with a short-term gambling mentality. Lastly, he noted the rise in popularity of assets Hilliard calls nonproductive assets, or assets that do not produce cash flows, such as commodities, cryptocurrencies, and collectibles. He discussed how speculation was leading to a fear of missing out, but many of these assets have no intrinsic value, cannot be forecasted, and future gain relies on the hope that someone in the future will pay more than today's price. While Hilliard believes periods of speculation can last longer

than expected, they continue to choose not to participate and instead will continue to own profitable business that are run by talented leaders.

Mr. Asfahl reviewed the current asset allocation and discussed recent portfolio activity. He referenced a rebalance performed in late January because of equity allocations, but also stated the investment team was currently in process of taking some additional equity exposure out of the portfolio. He stated the goal was to reduce the portfolios overweight to equity and deploy those funds into the fixed income portfolio.

Mr. Means reviewed a snapshot of the portfolio, which included relative sector weightings, top performers and largest holdings. He pointed the investment team's long-term investment mentality, evidenced by the fact that no stock changes had been made to the portfolio outside of rebalancing for several months. The recent strong performance was the result of seeds planted months ago and a healthy balance between companies that well positioned in the early stages of COVID and others that have benefit from more recent re-opening efforts. He highlighted the portfolios current overweight to financials, discretionary, and communication services, while also pointing out the portfolio had zero holdings in five sectors.

In response to a question from Judge John Grise regarding Hilliard's lack of consumer staples and energy holdings, Mr. Means stated it was not a top-down, macro decision, but rather a result of the portfolio's bottom up approach and a lack of attractive businesses in those sectors. He noted the portfolio had owned consumer staple companies in the past, but current growth rates were fairly low, while valuations a bit high, so the team was finding better opportunities elsewhere.

Mr. Asfahl concluded the presentation with a short review of the fixed income portion of the portfolios, a summary of risk statistics, as well as trailing period performance of the portfolios. He advised that the portfolios were well-positioned, continued to produce strong risk adjusted results, and had outperformed the blended index over each measured time period.

Mr. Don Asfahl, Mr. Andrew Means, and Mr. Tom Watkins departed the video conference at 12:10.

The meeting recessed for lunch at 12:10 and reconvened at 12:30 p.m.

For the next agenda item, Chairman Grise recognized Mr. Wesley Wickenheiser and Mr. Matthew Widick of Findley, Inc., the Systems' Actuary. Mr. Cracraft previously distributed copies of Findley's *Pension Plan Experience Study* and *FY 2020 Actuarial Update* dated October 23, 2020.

Mr. Widick began reviewing of the results of the plan's experience study, which the board had initially reviewed during the October 2020 meeting. He outlined the various demographic and economic assumptions that were reviewed, including retirements, turnover,

retirement age, mortality rates, salary scales, and non-legislative compensation loads. He stated Findley was recommending modest changes to a few assumptions, which included the adoption of revised mortality tables.

In response to a question from Senator Bowen regarding the improvement scale incorporated into the mortality tables, Mr. Wickenheiser stated that Findley was recommending the use of a 2020 improvement scale, but was not recommending updating the improvement scale annual given the limited changes generally experienced and given JFRS conducts an experience study every five years

Senator Joe Bowen made a motion, seconded by Judge Douglas George, to approve the 2020 Experience Study and adopt revised assumptions as of July 1, 2021 and for use in the fiscal year 2021 annual funding valuations and benefit commencements on or after July 1, 2021. The motion passed unanimously.

Next, Mr. Wickenheiser began a discussion regarding the biennial funding valuation process that will begin after the close of the year. He referenced two unique approaches the Board had taken concerning the cash balance plans. First, the cash balance plans have been evaluated completely separate from the defined benefit plans actuarially. Secondly, the Board has adopted a lower assumed rate of return for the cash balance plans as compared to the larger, legacy plans. Mr. Wickenheiser discussed a few reasons the Board choose this route, which included a desire to account for the new plans properly and for the actuarial cost of the new plans to reflect actual cost in the early stages of their development.

Looking ahead to the July 1, 2021 valuations, Mr. Wickenheiser proposed consolidating those valuations into one report for JRP and LRP each. While the cash balance plans have been treated separately, he noted they were actually just a separate tier of benefits under either the Judicial Retirement Plan or Legislator Retirement Plan. Providing a consolidated report would more accurately reflect the current funding health of each system, while underlying data regarding the two separate tiers could continue to be reported.

Mr. Wickenheiser discussed two different methods the Board could choose to follow if they did decide to consolidate the valuations. First, the board could choose to use an additive approach, which would effectively take the current process of performing two separate valuations and then adding the results together to create a total JRP or total LRP result. Mr. Wickenheiser noted this would be the less evasive method of providing one report, but did point out it could create a situation where required contribution results did not necessarily reflect actual needs. The second method, which would involve a bit more change, would evaluate JRP or LRP, both defined benefit and cash balance, completely together to produce a consolidated or total funding level, liability, and required contribution. Mr. Wickenheiser reiterated the underlying tiers of benefits would continue to be evaluated and identifiable, but the most notable change under this method would be the usage of a consistent return assumption across both plans. It would result in a true consolidated report and would eliminate those potential pitfalls with the additive approach.

In response to a question regarding investment differences from Representative Brad Montell, Mr. Cracraft responded the defined benefit and cash balance assets were not invested together in single pool of assets. He stated that assets from each tier were held in separate accounts, but being managed to the same exact asset allocation targets. The cash balance plans have very limited assets at this point, so they were also being managed passively in exchange traded funds rather than individual stocks. Mr. Cracraft stated that he believed the assets could be held in a single account from a legal standpoint, but accounting for the allocation between the two tiers was an issue. All assets were JRP or LRP assets, but managing them in separate accounts help from an accounting standing.

After some discussion, the Board agreed to revisit this topic during the next quarterly meeting and finalize a plan for the upcoming funding valuations.

Mr. Wickenheiser and Mr. Widick departed the meeting at 1:35 p.m.

Chairman Grise recognized Mr. Cracraft, who reported on administrative matters. The trustees discussed the items and took action as noted.

(A) Public Pension Oversight Board (PPOB). Mr. Cracraft gave a summary of the PPOB meetings since the last JFRS Board meeting.

- **February 22, 2021.** Each state-administered retirement system provided an investment and cash flow update as of December 31, 2020. Mr. LeLaurin joined Mr. Cracraft on behalf of JFRS.

The March meeting was cancelled and Mr. Cracraft stated JFRS was not on the agenda for the April meeting, which was schedule for Monday, April 25.

(B) 2021 Regular Session of the General Assembly. Mr. Cracraft provided a quick review and referenced the *2021 Regular Session Summary* that was included in the meeting materials.

(C) 2021 Personal Service Contracts. Mr. Cracraft provided an update since the January meeting. He state that Investment, Legal and Custody agreements were in process.

Audit Services. Mr. Cracraft stated the Board had adopted a motion to issue an RFP for audit services during the January meeting; however, Staff had since confirmed the Commonwealth's Auditor of Public Accounts (APA) is planning to conduct the FY2021 Audit. He stated the APA does not generally compile financial statements, but rather just audits completed ones. He stated that during the most recent APA audit in 2016, JFRS contracted with Blue and Company, who was serving as the systems auditor, to compile statements on the systems behalf.

Mr. Cracraft expressed some concern with conducting a RFP to hire a new audit firm and ask to compile financial statements and assist JFRS during the APA when they would be new to the account and would have little or no historical background or experience with the system.

Mr. Cracraft recommended that JFRS contract with their current accounting firm, MCM Advisors for one additional year for the sole purpose of compiling fiscal year 2021 financial statements and assisting staff with the upcoming APA audit. JFRS would then issue a full RFP in early 2022.

(D) Administrative and Personnel. Mr. Cracraft provided the Board with a summary of JFRS's organizational structure and a list of service providers as requested during the January meeting. He directed trustees to a one-page snapshot that was included in the meeting materials.

Mr. Cracraft also provided an update on the retirement and replacement of Ila Moody. He said staff had spent time revising and updating JFRS job descriptions and aligning them more accurately with the daily activities handled by each staff member. Staff of the Administrative Office of the Courts (AOC) reviewed the descriptions and Mr. Cracraft expected to have an open job positing when the next week.


(E) Senate Bill 104 Implementation. Mrs. Stephens provided an update on implementation of Senate Bill 104, passed during the 2017 Regular session.

During the June 2020 meeting, she had informed the Board that JFRS had received a Private Letter Ruling (PRL) and it was determined that only DB members with a contribution rate of 6.00% can transfer to the HBC plan because it, too, has a contribution rate of 6.00%. As of the date of the meeting, that would include 27 LRP members and 33 JRP members.

Mrs. Stephens discussed recent activity concerning implementation and notified the board that staff would be returning in July with some final steps for implementing.

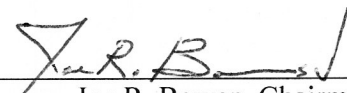
(F) Technology Update. Mr. Cracraft provided the Board with a short update of several projects in process. First, he stated the phone system had been upgraded and staff had transitioned to a voice over internet phone system, which has given staff added flexibility and features. Secondly, he notified the Board that staff had engaged with Kentucky Interactive for the purpose of revising and refreshing the systems website, branding and logo. Lastly, he stated that staff had entered the very early stages of work on evaluating pension administration software and hoped to be in a position to issue a request for information or proposals during they July meeting.

There being no further business, the meeting adjourned at 2:32 p.m.



Judge John R. Grise, Chairman
Judicial Form Retirement System Board of Trustees

Stephen F. LeLaurin, Chairman
Judicial Retirement Fund Investment Committee



Joe R. Bowen, Chairman
Legislators Retirement Fund Investment Committee



Bo Cracraft, Executive Director