

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

July 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 on Friday, July 23, 2021, at 10:00 a.m. All Board members were present. JFRS staff present included Bo Cracraft, Executive Director, Rebecca Stephens, Retirement Programs Administrator, and Melissa Gilchrist, Retirement Programs Specialist. Guests joining the meeting included Don Asfahl, and Andy Means of Hilliard Lyons.

Chairman Grise called the meeting to order at 10:02 a.m. He recognized and introduced Representative Scott W. Brinkman, who was jointly appointed by the Speaker of the House and President of the Senate to the Board in late April.

The trustees considered the adoption of the previously distributed *Minutes* of the April 23, 2021 meeting. Upon motion by Mr. Stephen LeLaurin, seconded by Representative Brad Montell, the Board unanimously approved the *Minutes* of the April 23, 2021 meeting.

Chairman Grise recognized Mr. Cracraft, who notified the Board that Stan Kerrick, Lexington Investment Partners, was not going to make the meeting due to an illness. He noted for the record that *Lexington Investment's Report as of June 30, 2021* was included in Board materials distributed to the trustees in advance. In accordance with Board policy, the System maintains a copy of the *Report*. As stated on page one of the *Report*, each Plan is within its prescribed allocation guidelines.

Chairman Grise recognized Mr. Cracraft, who reported on several administrative matters. The trustees discussed the items, but none required action.

(A) Introduction of New Staff. Mr. Cracraft opened by recognizing and introducing Melissa Gilchrist as the newest staff member of the agency. Mrs. Gilchrist had joined JFRS in June and was able to spend several weeks in training with Ila Moody prior to her retirement.

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

May 24, 2021 – Each state-administered retirement system provided an investment and cash flow update as of December 31, 2020. Mr. Cracraft presented on behalf of JFRS.

June 24, 2021 – Teachers Retirement System provided a review of their recently completed Experience Study. Notably, they reduced their assumed Rate of Return to 7.1% and lowered their payroll growth assumption from 3.5% to 2.75%.

July 20, 2020 – Teachers Retirement System and the Kentucky Public Pensions Authority staff provided a review of sick leave accrual benefits and the impact on pensions

(C) District and Circuit Judicial Colleges. Mr. Cracraft informed the Board that JFRS staff had attended two Judicial Colleges during the Month of June. After a one-year break due to the global pandemic, Mr. Cracraft noted there was quite a bit of interest for member account reviews. Between the two colleges, staff met with over 45 judges and also hosted several virtual account reviews for judges unable to attend or meet with staff while onsite.

(D) APA Fiscal Year 2021 Audit. As confirmed during the April meeting, Mr. Cracraft noted the Auditor of Public Accounts was conducting the Fiscal Year 2021 Audit of JFRS. By statute, the APA must conduct the audit at least once every five years and their most recent audit was conducted for Fiscal Year 2016.

Mr. Cracraft reported that the process had begun and staff had welcomed the lead accountant, Adam Gordon, to their Frankfort offices multiple times. Mr. Gordon had already conducted initial narrative interviews, observed staff performing key administrative task, and had interviewed Chairman Grise as a part of their standard audit protocols.

Mr. Cracraft stated that member and service provider confirmation letters were due to be mailed in the next week and that staff had provided the initial financial data to MCM Advisors so the financial statements. Mr. Cracraft noted the target date for completion of the Audit was October and that he hoped to have the auditor provide an update during the October meeting, but no later than January of 2022.

(J) Pension Administration Software. Mr. Cracraft informed the Board that staff was in the final stages of developing a Request for Bid or Proposal to begin a search for a new Pension Administration System. Mr. Cracraft reported that staff had been working with the Administrative Office of the Courts to prepare and post the request on the Commonwealths' procurement website. Staff plans to begin the search by the end of August and will update the Board in October with any progress.

Chairman Grise welcomed Hilliard Lyons Trust Company, who arrived and joined the meeting at 11:01 a.m. Mr. Cracraft had previously distributed copies of Hilliard Lyons' *Investment Review for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement*

Fund dated July 23, 2021. In accordance with Board policy, the System maintains a copy of the *Investment Review*.

Prior to the quarterly review, Mr. Means and Mr. Asfahl updated the Board on a few organizational updates. First, Mr. Means informed the Board that John Watkins had recently been promoted to a co-portfolio manager of the Large Cap Equity team. Mr. Means emphasized that Mr. Watkins had been actively adding value and had a voice in managing the portfolios for some time, but now joined him as a true partner, with a 50% vote on what is added to or removed from the portfolio. Next, Mr. Asfahl announced that the team had moved into its' new office space in downtown Louisville and welcomed the Board to host a future meeting on site if possible. Lastly, Mr. Asfahl also informed the board that Hilliard Lyons Trust was going to assume the name of Baird Trust as of September 30, 2021.

Next, Mr. Means began the quarterly review with a few comments regarding Hilliard's quarterly Market Commentary, "Why all this talk about inflation?," which recognized that inflation was present and visible, but highlighted the reality that predicting inflation is very difficult and determining how much inflation is permanent versus transitory is very much up for debate. Mr. Means pointed out several drivers behind higher inflation, which included substantial government stimulus and unemployment insurance, leading to higher personal savings and income for consumers. As these consumer exit a global pandemic, they bring pent up demand for goods and services, yet at the same time global supply chains have been significant disrupted due to the shutdowns. Thus, a limited supply and excess demand is leading to rising prices. However, while evident, the bigger question is whether or not this current inflation is temporary or longer term. He noted that the Federal Reserve believes it will prove temporary, while many investment professionals believe inflation has yet to peak.

As for a path forward for the Hilliard Lyons team, Mr. Means readily admitted they did not have confidence in their ability to predict future inflation. Instead, they continue to focus on a portfolio they believe is well prepared for the uncertainty ahead. They have the types of businesses that have strong pricing power and can raise prices if need, but are also well managed companies with sustainable advantages.

Mr. Asfahl discussed several charts pointing to a recovering economy, which included consumer confidence, personal savings, growing GDP and employment levels. He noted that consumer balance sheets are stronger than ever, with both personal income and savings at historic highs. Lastly, Mr. Asfahl discussed current treasury yields, valuations, and earnings growth rates.

In response to a question from Justice Daniel Venters concerning personal savings, Mr. Means pointed to the unique situation where consumers had received multiple stimulus checks during a period of such economic downturn and limited ability to spend. This added income, along with an inability to spend, has led historic highs in consumer savings.

In response to a question from Representative Scott Brinkman with regards to any concern with the Federal Reserve shrinking their balance sheet and valuations above historic averages, Mr. Means stated the Fed would have to shrink and begin to make financial assets less attractive. They have to transition and begin to create dry powder in the event it is needed in the future. As for valuations, he did agree that current valuations were higher than average, but when compared to periods of similar volatility, higher valuations were evident.

Mr. Asfahl reviewed the current asset allocation, annual estimated income, and the current yield on the JRP legacy portfolio. He discussed the fixed income portfolio and schedule of maturities. 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 goal is to significantly outperform the S&P 500, which means the portfolio will look quite a bit different than the index. He discussed current overweights to financials and communication services, while also pointing out the portfolio had zero holdings in five sectors. Lastly, he discussed the portfolios top 10 performers and largest holdings.

In response to a question from Judge John Grise regarding how the team was managing Microsoft, which was reaching a portfolio limit of 8% of the equity portfolio, Mr. Means stated the team was closely monitoring. He noted the policy does not require an immediate sell, but allows the team to trim as the stock continues to significantly exceed the 8% policy limit. Microsoft is a very attractive company with a great manager, so the team is comfortable with the stock close to the policy limit.

In response to a question from Judge Grise regarding how a single CEO can make such a difference in large, global organizations, Mr. Means agreed that one employee is not making all the important decisions, but what a CEO does is build a corporate culture that attracts, empowers, and influences smart and bright employees. Mr. Means compared it to a good coach, who has a significant impact on a team that has not recently experienced success. Mr. Means referenced Microsoft and how Satya Nadella had effectively rebranded the company's culture from an old, boring company that was not attracting young, entrepreneurial employees into a hip, cutting edge, attractive company.

In response to a question from Senator Bowen regarding the impact on the portfolio's exposure to financials in a rising interest rate market, Mr. Means stated two thirds of the financials exposure was in four distinct business, which all would be impacted differently by a rise in interest rates and ultimately what was driving the increase (such as inflation). For instance, a rise in rates would benefit JP Morgan Chase, which Hilliard believes is the finest bank, led by one of the brightest bankers in Jamie Dimon. Another holding, Berkshire Hathaway, while listed as a financial, is truly a conglomerate of holdings and led by another proven investor. He also referenced Progressive, which is an insurance company, and Schwab, which is a consumer centric asset gatherer, as the other larger financial holdings.

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.

The meeting recessed for lunch at 12:00 and reconvened at 12:25 p.m.

Chairman Grise recognized Mr. Cracraft to discussing three additional investment related topics. First, Mr. Cracraft informed the Board that JFRS staff, in coordination with Hilliard Lyons, had completed the annual cash balance interest credit calculation. He reminded the trustees that annual interest is guaranteed at 4%, but the member and plan shared any upside at a 75/25 split, based on the plans trailing 5-year plan. For the period ending June 30, 2021, the annual interest credit (guarantee + upside sharing) was calculated as 11.13% for JRP and 11.10% for LRP.

Next, Mr. Cracraft informed the Board that JFRS staff had held discussions with Hilliard Lyons concerning proxy voting. He stated that the agency's current process is to manually vote the proxies internally, however given the lack of available research and formal proxy voting policy, he had asked Hilliard Lyons if the manager would be willing to handle given their discretion to invest the funds and more intimate knowledge of management teams and corporate policies. After a discussion and some research, Hilliard Lyons does have the ability to vote and is willing to do so on JFRS's behalf.

Mr. Don Ashalf discussed the Hilliard Lyons current practice of voting proxies and said the Large Cap team did vote proxies on behalf of other accounts. While he indicated the team almost always votes in line with management team, the firm also receives proxy voting research through a third-party provider, Glass Lewis, to supplement and support staff in their decisions.

After some discussion, Justice Daniel Venters made a motion, seconded by Mr. Stephen LeLaurin to authorized Hilliard Lyons Trust (also known as Baird Trust) to vote proxy proposals on behalf of the Judicial Form Retirement System in a manner consistent with their fiduciary duty to maximum returns in a risk aware and prudent manner.

Lastly, before departing the meeting Mr. Cracraft asked Hilliard Lyons if the management team would have any concern if the Board were to adopt a higher assumed rate of return for the cash balance portfolio of assets. He stated a current assumption of 4% was currently being utilized actuarially, but the Board was going to discuss a potential change to mirror the traditional defined benefit portfolio of assets, which assumed 6.5%. Mr. Means and Mr. Asfahl discussed current target allocations, historical performance, along with recent capital market assumptions and stated they did not believe any changes would be required to the portfolio's asset allocation to reach the proposed assumption change.

In a response to questions from Rep. Montell and Mr. LeLaurin regarding active management for the cash balance portfolios, Mr. Asfahl indicated that he believed the team could

begin to diversify the equity allocation, but the fixed income portfolios still would have to utilize exchange traded funds. There was a discussion regarding how active management could be incorporated into the portfolios and the Board asked Hilliard Lyons to begin researching options with an expected update during the October 2021 meeting.

Mr. Asfahl and Mr. Means departed the meeting at 12:46 p.m.

Chairman Grise recognized Mr. Cracraft to continue reports on administrative matters. The trustees discussed the items and took action as noted.

(E) 2021 Funding Valuations. Mr. Cracraft revisited a discussion from the April Board meeting concerning the 2021 actuarial valuations. He reviewed the memo *July 1, 2021 Biennial Funding Valuations* from staff that was included in the Board materials and distributed in advance of the meeting. Mr. Cracraft expressed a belief that producing a single actuarial valuation report for JRP and LRP was more consistent with how the plans were operating. Mr. Cracraft also pointed out that moving to a truly consolidated report would require a change to the assume rate of return used for the Cash Balance tier.

In response to several questions regarding the assumed rate of return, Mr. Cracraft noted the Board had discussed this topic with their actuary on several occasions in the past and did expect there would be a need to revisit as the new tier of benefits developed and matured. He referenced two factors the actuary had pointed out during the April meeting. First, beginning with the 2020 fiscal year, upside sharing had begun and active CB member accounts were receiving an interest credit beyond the 4% guarantee. Secondly, cash balance assets, while currently managed passively, shared the same policy asset allocation as legacy assets and actual performance has exceed the current assumption. Mr. Cracraft noted that active management would be added to the portfolios in the near future, but even with the passive approach, Hilliard Lyons did not express any concern with using the same assumption.

Following a healthy discussion, Mr. Stephen LeLaurin made a motion on behalf of the Investment Committee for the Judicial Retirement Fund, which was seconded by Justice Daniel Venters, and Senator Joe Bowen made a motion on behalf of the Investment Committee for the Legislative Retirement Fund, which was seconded by Mr. Stephen LeLaurin, to produce a single funding valuation report for JRP and LRP each, using a consolidated approach and adopting a revised targeted return assumption for the cash balance tier of benefits of 6.5% (from 4.0%) for use in the July 1, 2021 biennial funding valuations. The motions passed both committees unanimously.

(F) Special Circuit Judge Opinion. Mr. Cracraft referenced the *Special Circuit Judge Compensation* memo and legal opinion that was included in the Board materials. He quickly provided some background and what lead staff to request a legal opinion from Mr. Alan Pauw.

After a discussion of Mr. Pauw's opinion and review of several statutes, Judge Douglas George made a motion, which was seconded by Justice Daniel Venters, to adopt the opinion

provided by Mr. Alan Pauw with regards to how compensation earned by a Special Circuit Judge would be treated at retirement. The motion passed unanimously.

(G) Senate Bill 104 Implementation. Mr. Cracraft referenced the *Senate Bill 104 – Voluntary Election to Participate in Cash Balance* memo from staff that was included in the Board materials. Mr. Cracraft noted this was a follow up item from the April meeting and the memo represented staff’s formal implementation plan for addressing the legislation.

After a short discussion, Senator Joe Bowen made a motion, which was seconded by Representative Brad Montell, to adopt staff’s Senate Bill 104 Implementation plan as outline in the attached memo. The motion passed unanimously.

(H) Fiduciary Liability Insurance. Mr. Cracraft pointed out that the Board’s current Fiduciary Liability Policy was set to expire on September 30, 2021. The current policy was the result of an extensive repricing process and request for bid issued by JFRS in 2020.

Mr. Cracraft indicated that a renewal application was completed and JFRS’ independent insurance agent, Assured Partners, had initially advised to expect an increase of 5% to 15% from the prior year premium. He acknowledged the initial renewal bid was both a wide range of cost and potentially a significant increase. In response, Mr. Cracraft stated that he had reached out to the Commonwealth’s State Risk and Insurance Service Division to gather some feedback concerning the insurance market and recent premium growth experience. The initial response was the global pandemic had disrupted the insurance industry quite a bit and like a lot of businesses, there has been a shrinking in providers. Mr. Cracraft discussed option, which were limited given the agency’s size and the timing of the current policy.

After discussion, Representative Brad Montell made a motion, which was seconded by Judge Douglas George, to authorize Judge Grise and Mr. Cracraft to purchase fiduciary liability insurance for coverage equal to current coverage with variance in premium cost up to 15%. The motion passed unanimously.

(I) Retiree Health Insurance. Mr. Cracraft handed out a *Medicare Eligible Retiree Health Insurance – 2022 Renewal Rates and Coverage* memo that included Humana’s 2022 Medicare Advantage Plan renewal information.

To avoid a conflict of interest, Justice Venters, Judge George, Representative Brinkman, and Senator Bowen did not participate in the discussion, consideration, or vote with regards to 2022 medical benefits provided to Medicare eligible members and recipients. Following a discussion among the remaining trustees, Representative Brad Montell made a motion, seconded by Mr. Stephen LeLaurin, to renew its hospital and medical insurance contract with Humana for calendar year 2022, and to set the 2022 monthly contribution level at \$323.43 for each JFRS Humana Medicare Advantage plan policyholder.

Next, Mr. Cracraft advised that staff had not received final rates for the Kentucky Employees Health Plan (KEHP), but had been advised premiums were expected to increase 3% to 4% from the 2021 plan year. He noted the Board had adopted the Living Well PPO plan as the maximum coverage in 2021, which had a maximum cost of \$1,841.08 for family coverage.

To avoid a conflict of interest, Representative Brad Montell and Representative Scott Brinkman did not participate in the discussion, consideration, or vote concerning 2022 medical benefits provided to non-Medicare eligible members and recipients.

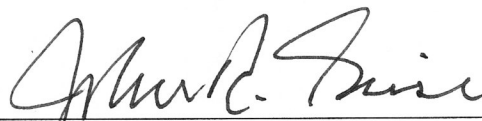
Following a discussion among the remaining trustees, Mr. Stephen LeLaurin made a motion, seconded by Judge John Grise, to utilize the Kentucky Employees' Health Plan (KEHP) to provide non-Medicare eligible retirees and dependents health insurance coverage with a monthly contribution level for each classification (single, couple, family) equivalent to the Living Well PPO plan monthly contribution. The percentage of payment by the respective plan is dependent upon the retiree's years of service and any balance will be deducted from the retiree's monthly benefit. If a retiree failed to comply with the 2022 Living Well promise, the \$40.00 monthly KEHP assessment will be the member's responsibility and deducted from their monthly allowance.

The next agenda item was Executive Session. Upon motion by Justice Daniel Venters, seconded by Representative Brad Montell, the Board unanimously agreed to go into Executive Session for the purpose of discussing personnel and confidential member information of an employee. The motion passed unanimously.

Upon motion by Judge Douglas George, seconded by Mr. Stephen LeLaurin, the Board unanimously agreed to come out of Executive Session. No action was taken in Executive Session.

Upon motion by Judge Douglas George, seconded by Senator Joe Bowen, the Board unanimously authorized a raise in the salary of Carlos "Bo" Cracraft as the Executive Director of JFRS effective 08/01/2021 to an annual salary of \$120,000 per year, paid semi-monthly on the 15th and the 30th of each month. The Board of Trustees will conduct another review of Mr. Cracraft's performance at the quarterly meeting tentatively scheduled for January 21, 2022.

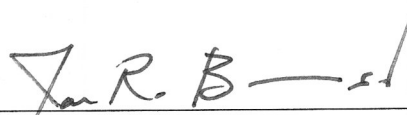
There being no further business, the meeting adjourned at 2:22 p.m.



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