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

August 5, 2022

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 offices of Baird Trust Company, 500 West Jefferson Street, Louisville, KY 40202 on Friday, August 5, 2022, at 10:00 a.m. All board members were present, with the exception of Judge Doughlas George and Senator Jimmy Higdon. 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, John Watkins, John Craddock and Andy Means of Baird Trust Company, along with Alan Pauw, McBrayer, LLC.

Chairman Grise called the meeting to order at 10:02 a.m. The trustees considered the adoption of the previously distributed *Minutes* of the April 22, 2022 meeting. Upon motion by Representative Brad Montell, seconded by Mr. Stephen LeLaurin, the board unanimously approved the *Minutes* of the April 22, 2022 meeting.

Chairman Grise recognized Mr. Cracraft, who notified the board that Stan Kerrick, Lexington Investment Partners, was not going to make the meeting. He noted for the record that *Lexington Investment's Report as of June 30, 2022* was included in board materials distributed to the Trustees in advance. In accordance with board policy, JFRS maintains a copy of the *Report*. As stated on page one of the *Report*, each plan is within its prescribed allocation guidelines.

Chairman Grise welcomed Baird Trust Company, who joined the meeting at 10:11 a.m. Mr. Cracraft had previously distributed copies of Baird's *Investment Review for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement Fund* dated August 5, 2022. In accordance with Board policy, the System maintains a copy of the *Investment Review*.

Mr. Means began the review with a few comments regarding Baird's quarterly Market Commentary, "Psychology of a Bear Market." He highlighted how disruptive the past two and half years had been and how speculation fueled by investor greed had blinded some investors to downside risks. He pointed to large returns in 2021 from meme stocks, crypto, and other innovation stocks that saw huge gains. However, since January, the emotional pendulum had swung in the direction of fear and many of those same companies have lost 50% or more in value as investors had fixated on risk and losses and ignored company fundamentals and potential for positive surprises. He emphasized the goal for investors, during both up and down periods, is to remove emotion and operate rationally. However, Mr. Means acknowledged that human nature doesn't always lend itself to rational behaviors, especially when confronted with negative news, growing feelings of fear, and investment portfolios dominated by losses.

While markets often become "popularity" contests, Mr. Means stated the team at Baird tries to remove emotion from the process by focusing on the underlying companies they own, the management teams that run those businesses, and by having a private-market mentality of their portfolios. The Baird team generally does not participate during these extreme moments of volatility, which was evident in the lack of transaction activity in the second quarter of the calendar year. Looking forward, Mr. Means expressed some hope for the future and pointed to historical performance. Mr. Means noted the portfolios have historically rebounded well, largely driven by the fact they hold good companies, with strong management teams, who have consistently produced long-term growth.

In response to a question from Mr. Ben Allison, concerning how the team managed companies, such as Home Depot, which experience short-term excessive gains, Mr. Means reiterated the teams desire to be long term owners, but admitted this desire had to be balanced with consideration of the current position of a company. In the case of Home Depot, they recognize the recent gains and accept that in the short term the company might weather a more difficult period, but like the long-term potential of the stock. Mr. Watkins added that in rating current holdings, the team often created ranges, such as cheap, about right, or expensive. A company, like Home Depot, might move from the cheap or attractively valued range, to about right, but if the team doesn't have really attractive alternatives, they tend to rely on the long-term relationship with management and their past experience of managing the business during times of headwind.

In response to a question from Representative Scott Brinkman regarding some recent tax changes concerning share repurchases, Mr. Means stated the changes might have served as a minor deterrent, but overall had not really influenced the portfolios. He also noted that several companies had utilized free cash flow for other purposes, such as providing dividends or reinvesting for growth or expansion.

In response to a question from Chairman John Grise regarding new opportunities, Mr. Means indicated the team had been very active in research, but had not acted as of yet. He expressed a desire for new ideas to be a marginally better choice than what they already own. In response to a follow up from Chairman Grise regarding Disney and its recent performance, Mr. Means agreed that Disney had continued to suffer through a difficult period. Some was self-inflicted and connected to a CEO's misstep politically in Florida, but a larger and primary reason was a lack of tourism and declines in the streaming side of their business. Mr. Watkins added that a focus for Disney over the past couple of years has been on streaming and sentiment had been huge. More recently, this has changed dramatically and he referenced Netflix as a prime example, where the stock had climbed to over $700 only to drop to $200 recently. Alternatively, Mr. Watkins pointed to increased park visits and recent theatrical successes, such as the new Top Gun movie as bright spots for the company. He indicated Disney was now valued in the cheap bucket and the team was confident that stock was currently mispriced relative to actual business fundamentals.

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. Watkins reviewed a snapshot of the equity portfolio, which included relative sector weightings, top performers and largest holdings. He discussed current overweights to financials and communication services, while also pointing out the portfolio had zero holdings in five sectors.

In response to a question from Chairman John Grise regarding the portfolios lack of energy exposure, Mr. Watkins pointed to a couple factors that made energy stocks less attractive. First, and primarily, was the volatile nature of their valuations and ever changing price of oil. Secondly, he stated the amount of government intervention had served as quite the headwind.

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.

In response to a question from Mr. Ben Allison regarding the corporate yield curve, Mr. Craddock stated he did believe yields would continue to improve, but the team would need to be tactical with allocation given the expectation for rates to continue to climb over the near term.

In response to a question from Chairman Grise regarding the use of cash on hand, Mr. Means emphasized that those stocks deemed cheapest by the team did not necessarily indicate the team's best ideas or expected performers. He pointed to Apple as a good example, where the stock was not valued as cheap, but had continued to perform very well. The team wants their portfolio to be weighted according to best ideas. Therefore, the use of cash at times will reflect those principals rather than just adding to those stocks which are most undervalued.

Chairman Grise recognized Mr. Cracraft to discuss one additional investment related topic. Mr. Cracraft informed the board that JFRS staff, in coordination with Baird, 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, 2022, the annual interest credit (guarantee + upside sharing) was calculated as 7.37% for JRP and 7.35% for LRP.

The meeting recessed for lunch at 11:50 and reconvened at 12:25 p.m. Mr. Asfahl, Mr. Means, Mr. Watkins and Mr. Craddock departed the meeting.

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

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

April 25, 2022 – Each state-administered retirement system was on the agenda and provided an investment update along with a review of the system's ESG and Proxy Voting Policies. A copy of the JFRS presentation had been included in the board materials.

May 23, 2022 – TRS was the only administrator on the agenda, but JFRS did attend the meeting. TRS provided a follow-up review of their sick-leave program in response to questions raised during the April Meeting. In addition, LRC staff provided a general overview of Retiree Health Benefits and Funding, which Mr. Cracraft had included in the board materials.

July 19, 2022 – KPPA was the only administrator on the agenda, but JFRS did attend the meeting. A discussion on retiree COLAs, led by two public retiree groups, opened the meeting. After, KPPA staff provided a presentation with regards to recent Pension Spiking provisions.

(B) PPOB Actuarial Audit. Mr. Cracraft gave a verbal update on the actuarial audit commissioned by the PPOB. The audit is in response to a statutory requirement, outlined under KRS 7A.250(8), which outlines that an actuarial audit be performed every five years, by a firm retained by the PPOB, to evaluate the reliability of each system's actuarial assumptions and methods.

Mr. Cracraft informed the board that LRC has hired Milliman Solutions to conduct the Level 1 full scope audit. Milliman had made an initial request for information to both JFRS and the systems actuary, USI. Mr. Cracraft indicated that both USI and JFRS had provided the requested information. He believed results of the audit would be presented in the next quarter or two.

Lastly, he noted that KRS Chapter 6, which creates the PPOB, also outlines that any actuary services hired by the oversight board shall be paid by those systems impacted. Given all three systems were included in this audit the expenses had been prorated and the total cost for JFRS was estimated at $25,000 in total. In addition to the fees paid to Milliman, JFRS will also have to pay USI for their time in prepping and providing Milliman the historical data and answering questions. USI has estimated that cost at $3,000 to $5,000.

(C) Audit Services RFP and Recommendation. Mr. Cracraft revisited a discussion from the April meeting concerning audit services and a follow-up request for proposal (RFP) that had been issued by staff. He reviewed the process followed by staff and a summary of communication with potential candidates since the prior meeting.

After the response to the second RFP, staff had settled on Blue and Co, LLC and were making a recommendation to the Board to hire them for audit services. Mr. Cracraft expressed some frustration with the increase in fees, but pointed to COVID, consolidation in the industry, and a general lack of appetite for governmental GASB audits as primary drivers for why fees were going up. He expressed confidence in Blue as a firm and noted that JFRS had worked with them in the past.

After discussion, Mr. Stephen LeLaurin made a motion, which was seconded by Justice Daniel Venters, to enter into a Personal Service Contract with Blue and Co, for accounting services subject to successful negotiation and terms.

(D) Retiree Health Insurance. Mr. Cracraft referenced the *2023 Retiree Health Insurance – KEHP and Medicare Advantage Plan Premiums* staff memo that was included in the meeting materials and outlined proposed rates for the upcoming plan year.

Mr. Cracraft began with a discussion on the Kentucky Employees Health Plan (KEHP), in which retirees and dependents who are under the age of 65 participate. He reviewed rates for three different KEHP plans and highlighted that 2023 premiums were increasing approximately 6.5% on average. He also reminded the trustees that as of June 2021, both the LRP and JRP health insurance trusts were funded at a level well above 100% and had a surplus of actuarial assets.

Following a discussion, Justice Venters made a motion, seconded by Mr. Ben Allison, 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.

Next, Mr. Cracraft reviewed the proposed premiums for the Humana Medicare Advantage plan, which retirees and dependents who have reached the Age of 65 and older utilize. In addition to the renewal of 2022 benefits, staff had asked Humana to also provide premium cost information for adding basic dental and vision coverage to the Medicare plans. Mr. Cracraft recognized that increasing benefits at any level needed to be considered carefully, but given the funding levels of both plans, he believed it was prudent to have a discussion. He noted that dental coverage was something that more plan sponsors had be considering recently and noted that dental cover was added to the Medicare Plans of KPPA for the 2022 plan year.

There was a healthy discussion among the trustees regarding the Medicare plans and adding any additional dental or vision benefits. In response to the discussion, the trustees requested staff provide additional financial information and the projected financial impact on the plans for each of the options.

(E) <u>Fiduciary Liability Insurance.</u> Mr. Cracraft pointed out that the boards current fiduciary liability policy was set to expire on September 30, 2022. 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 provided a renewal estimate that was approximately 30% higher than 2022. He acknowledged the increase was significant, so he had asked Assurance Partners to provide additional renewal estimates assuming JFRS increased their annual deductible, which had historically been $5,000. Given the size of the policy, he had been advised that many clients had considered $25,000 and $50,000 deductibles to help manage the cost of premiums. After a lengthy discussion, the trustees asked staff to request additional information from the broker regarding higher annual deductibles.

(F) <u>Pension Spiking.</u> Mr. Cracraft referenced the *SB104 – Pension Spiking* staff memo that was included in the meeting materials. He informed the Board that this process was in response to language added by SB 104 during the 2017 regular session. The language tries to address situations where a retirees income increases significantly in their final years of service and results in what is often called a "spike" in their pension benefit. Mr. Cracraft indicated that given the number of retirement expect at the end of the current calendar year, staff wanted to review their research and share a summary of their proposed process with the board.

Mr. Cracraft indicated this topic was primarily a LRP issue. While JRP did have similar language, lack of salary reciprocity and the fixed judicial salary model made any circumstance of spiking very rare. On the other hand, LRP does have salary reciprocity and thus, there are some circumstances where staff will have to implement the provisions. Mr. Cracraft stated the most obvious case would be a scenario where a legislator moves into the executive branch. But, in addition to the reciprocity issue, several other factors, such as the way legislators are compensated and the variable days worked, had created some cloudiness in review. He referenced several internal discussion amongst staff regarding circumstances where income might be subject to spiking or not. The lack of clarity ultimately led staff to ask Alan Pauw, the agency's legal counsel, to assist with a review of these various situations or circumstances.

Mr. Cracraft introduced Mr. Pauw to the meeting and highlighted his memo, which had been to the memo provided by staff. Mr. Pauw reviewed his memo, which served to answer several questions posed by staff. Mr. Pauw stated that after review, given the language and intent of the added language, any increase in salary for a legislator, resulting from working a longer session, a special session, or taking on leadership duties would not qualify as income subject to spiking.

After a short discussion amongst the trustees and Mr. Pauw, Mr. Cracraft indicated staff was not looking for formal action on this topic, but his intent was to just inform and share the research conducted. He stated that staff was planning administer according to this memo.

(G) <u>2022 Valuations.</u> Mr. Cracraft provide a quick verbal updated on the 2022 GASB roll forward valuations. He informed the Trustees that staff was in the final stages of providing the annual data to actuaries. He hoped to have results by the October meeting.

(H) <u>Pension Administration Software.</u> Mr. Cracraft provided a quick verbal update on the Pension Administration Software project. Since the April meeting, a licensing agreement had been finalized and the team had hit the ground running. The project had officially kicked off on May 19. JFRS had provided plan information, shared an initial copy of the data, and also completed a pretty significant update to forms that will be utilized in the new system.

Milliman plans to provide a beta version as soon as November 15 and by the end of January the plan is to have MARC programed to begin reviewing calculations and reporting. Mr. Cracraft highlighted the work being done by Mrs. Stephens and Mrs. Gilchrist to help both in the design and data cleansing portion of the project.

There being no further business, the meeting adjourned at 1:59 p.m.

John R. Grise

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

S F LeLaurin

Stephen F. LeLaurin, Chairman
Judicial Retirement Fund Investment Committee

Brad Montell

Rep. Brad Montell, Chairman
Legislators Retirement Fund Investment Committee

Bo Cracraft

Bo Cracraft, Executive Director