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 21, 2023

The Board of Trustees of the Kentucky Judicial Form Retirement System (JFRS), the Investment Committee for the Kentucky Judicial Retirement Plan (JRP), and the Investment Committee for the Kentucky Legislators Retirement Plan (LRP), convened at the Administrative Office of the Courts, 1001 Vandalay Drive, Frankfort, Kentucky 40601 on Friday, April 21, 2023, at 10:00 a.m. All Board members, with the exception of Representative Brad Montell, were present.

JFRS staff present included Bo Cracraft, Executive Director, and Rebecca Stephens, Retirement Programs Administrator. Guests attending the meeting included Stan Kerrick of Lexington Investments, Inc. and Don Asfahl and John Watkins of Baird Trust Company. Guests attending the meeting virtually via Microsoft Teams video-conferencing included Andy Means of Baird Trust Company and Alan Pauw of McBrayer, PLLC.

Chairman Venters called the meeting to order at 10:02 a.m.

The trustees considered the adoption of the previously distributed *Minutes* from the January 20, 2022 meeting. Upon motion by Representative Scott Brinkman, seconded by Mr. Ben Allison, the Board unanimously approved the *Minutes* of the January 20, 2022 meeting.

The next order of business was the report of Lexington Investments LLC. Chairman Venters recognized Mr. Stan Kerrick. Mr. Kerrick distributed to the trustees Lexington Investments' *Report of the Kentucky Judicial & Legislators Retirement Funds* as of March 31, 2022, dated April 21, 2022.

Mr. Kerrick began with a compliance statement, which noted both plans were within their prescribed asset allocation guidelines. He also highlighted that neither plan currently had any individual equity positions that exceeded the 8% maximum weighting as of December 31, 2022. Mr. Kerrick also pointed recent activity in the portfolios. Mr. Kerrick also reviewed the dividend yield of the equity portfolio and duration of fixed income allocation and stated both complied with the investment policy. Lastly, Mr. Kerrick discussed recent transactions, which only included a few equity transactions, and projected cash flow in the portfolios.

Chairman Venters welcomed Baird Trust Company, who arrived and joined the meeting at 10:50 a.m. Mr. Cracraft had previously distributed copies of Baird's *Investment Review for Kentucky Judicial Retirement Fund and Kentucky Legislators Retirement Fund* dated April 21, 2023. In accordance with Board policy, the System maintains a copy of the Investment Review. Mr. Kerrick departed the meeting.

Mr. John Watkins began the quarterly review with a few comments regarding Baird's most recent quarterly market commentary, titled "Expecting the Unexpected," which highlighted the recent failure of Silicon Valley Bank in March of 2023. Mr. Watkins began with a quick review of what happened, pointing out a few key factors that led to the bank's failure. First, the bank had a very high concentration of deposits, both geographically and in type of customers (local, tech-based startups), which resulted in many large business accounts. Secondly, much blame rested with the bank's leadership team, who bought long-term government bonds during a very low interest rate period. While these bonds had little or no credit risk, they were exposed to interest rate risk, and in the current rising rate environment, the bank saw the value of these bonds decline and their balance sheet deteriorate. In response, many depositors lost faith in the bank and tried to exit and withdraw funds at the same time, leaving the bank unable to meet the demand.

Mr. Watkins noted that many in the industry had immediately tried to compare the Silicon Valley Bank failure back to 2008 and the Global Financial Crisis. However, in reality, the two are very much different. Banks today do not have large portfolios of toxic loans or exotic financial instruments hidden within their balance sheets. In addition, most banks have a very different depositor base than Silicon Valley, which makes its failure more of an outlier than norm. There is a question of how the financial sector will respond to these failures, but Mr. Watkins pointed how strong the U.S. banking industry is and how banks are in a much better position than during the years prior to 2008.

Mr. Asfahl reviewed several economic statistics and highlighted recent consumer activity. The Fed continues to try and slow inflation, but not at the expense of jobs. He noted that the CPI index had come down and inflation seems to have peaked, but likely still above the target of 3%. He pointed to growing consumer demand, which represents about seventy percent of GDP. While not back to pre-2020 levels, consumer confidence is up and more money has been spent by consumers on non-core goods, travel, and entertainment. Mr. Asfahl continued with a review of current asset allocations, annual estimated income, and the current yield on the portfolios. He discussed the fixed income portfolio and schedule of upcoming maturities.

Next, Mr. Watkins reviewed a snapshot of the portfolio, which included relative sector weightings, attribution, top performers and largest holdings. He emphasized sector weightings were not the result of any macro or top-down decisions, but rather completely driven by the underlying stocks. He pointed out the portfolio's highest overweight was still in the financial sector, driven primary by four companies (Berkshire, JP Morgan, Progressive, and Schwab) that all provide different exposure to the sector. He referenced a recent reclassification by Standard and Poor's regarding how VISA, MasterCard, and PayPal are categorized, which has resulted in the portfolios overweight actually coming down relative to prior quarters. In addition, he highlighted the overweight to technology, for which Apple and Microsoft accounted for the majority of that overweight.

Next, Mr. John Watkins highlighted top performers and pointed out that General Electric had been the portfolios top performer over the past twelve months. Mr. Means commented on the company's recent success and the impact a new CEO can have on a business. In addition, he cited it as an example of where Baird's long-term approach and patience proved to bear fruit. Next, Mr. Watkins discussed sector attribution along with top and bottom contributions over the past five years. In the short term, the financial and consumer discretionary sectors were the biggest detractors. Schwab, which the portfolio holds, was down quite a bit in response to the bank failures and some decline in deposits with the banking side of Schwab. Baird does not have concern here, largely due to nature of deposits, which are very different from Silicon Valley bank. On the discretionary side, Mr. Watkins noted that not holding Tesla and Amazon, which were two very strong performers, resulted in some negative relative performance. Looking out over the longer, 5-year period, Mr. Watkins pointed out the portfolio had added over two percent of excess return and that performance was very balanced with almost every sector adding value during that period.

In response to a question from Mr. Cracraft regarding Disney and the team's decision to add more exposure during the quarter, Mr. Watkins stated that decision reflected the team's confidence with Bob Iger and his return as CEO. He admitted the prior CEO had made some real missteps, but since Mr. Iger's return, they had seen a return to the company's roots. The streaming side is still a huge drag, but a recommitment to the company's creative assets and parks, along with a belief that a bruised political relationship can be healed were reasons for the further investment.

In response to a follow up question from Judge Grise regarding Disney and concern over companies that get tangled up in political controversies, Mr. Means stated the preference would be that companies never get involved. However, he did point out that Disney's success historically had fallen with its creative side and that side of the business is largely dependent on those employees and people creating content. Many of those individuals fall within the LBGTQ+ community and so as their employer, Disney would have some incentive to support and show alignment of interest. Otherwise they run the risk of alienating a group of employees who have been large piece of the company's success.

Lastly, in response to a question from Judge Grise regarding Pfizer and its recent underperformance, Mr. Watkins stated the company was feeling the effects of the COVID vaccine cliff. The company definitely benefited with the vaccine, but now there is some cloudiness as to whether it's an annual process or less periodic. However, Mr. Watkins noted that the recent cash flow has allowed the company to invest in several new developments and have positioned them for good long term success. But a current head wind exists in the short term.

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 are well-positioned, continue to produce strong risk adjusted results, and have outperformed the blended index over each measured period.

Lastly, Mr. Asfahl quickly reviewed allocation, returns, and holdings for the LRP legacy portfolio and two smaller Cash Balance portfolios. He referenced the Board's recent decision to diversify the portfolios and pointed to the most recent quarterly performance as evidence of how performance of the two portfolios had tightened.

Lastly, at the request of Mr. Cracraft, Mr. Watkins and Mr. Asfahl discussed the equity portfolio proxy voting policy and stance on Environmental, Social, and Governance (ESG) investing. Mr. Cracraft highlighted a recent piece of legislation that passed during the 2023 Regular Session and addressed fiduciary duty and how the plan votes proxies. Mr. Watkins reviewed the team's proxy voting process. He stated the team was using Glass Lewis, which is a third party provider, for research purposes, but that he personally reviewed all proxies and specifically where Baird's policy might differ from Glass Lewis. He noted a few minor situations, one involving Warren Buffett and Berkshires Board of Directors, when the team voted differently than the research provided by Glass Lewis.

Mr. Asfahl discussed ESG and acknowledged that more and more conversations are occurring concerning the topic. He emphasized that the team did not use any ESG related factors to screen potential investments nor did they know what a specific company's ESG score is at any given time. He stated that the team reviewed the legislation and did not believe it would require any change in how the portfolios are managed. He also stated the team had prepared reports to begin disclosing quarter proxy voting.

The meeting recessed for lunch at 12:05. Mr. Asfahl, Mr. Watkins, and Mr. Mean's all left the meeting at 11:58 a.m. and the meeting recessed for lunch.

The meeting reconvened at 12:25 p.m. Mr. Asfahl and Mr. Watkins left the meeting. Chairman Venters recognized Mr. Cracraft, who reported on several administrative matters. The trustees discussed the items and took action when noted.

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

January 30, 2023 – JFRS was not on the agenda. A handful of proposed legislative changes were discussed.

February 27, 2023 – Milliman presented the results of the recent actuarial audit commissioned by the PPOB. JFRS did have the opportunity to respond.

March 2023 – The Oversight Board did not meet in March.

The **April Meeting** is set to meet on Monday, April 24th. JFRS is on the agenda and has been asked to provide an update on investments and cash flow.

(B) 2023 General Session. Mr. Cracraft referenced the *2023 Regular Session – Legislative Update* memo from staff included in the Board materials. He discussed the recently adjourned regular session, which only included one piece of legislation that directly impacted JFRS.

Mr. Cracraft indicated House Bill 236, sponsored by Representative Sharp, was really the only bill that will require some action in the near term. The bill was titled as "an ACT related to fiduciary duties," but it specifically focused on ESG investing and proxy voting. First, the bill added language to further defined fiduciary duty, requiring fiduciary to rely on pecuniary factors solely, while not considering non-pecuniary interests, which broadly represented ESG factors. Secondly, the legislation add some requirements regarding the proxy voting process, required the Board adopt a policy, and included additional reporting on the systems website. Mr. Cracraft indicated the topic would be revisited during the July 2023 meeting and staff would make a recommendation concerning a proxy voting policy.

(C) Deferred Retiree Benefit Accrual Discussion. Mr. Cracraft referenced a memo titled *Deferred Vested Retiree Benefit Accruals* that was included in the Board materials. He noted this as a topic staff had become aware of while working with a few deferred retirees and on the new pension administrative software project. After a review of current statutory language and member cases, staff found the agency's interpretation and administration of benefits were consistent. However, given a lack of clarity found statutorily, staff requested Alan Pauw, the systems third-party legal and fiduciary counsel, review to provide an opinion to better direct staff going forward and . Mr. Pauw had provided a memo, which was included in the meeting materials.

Mr. Cracraft introduced Mr. Alan Pauw of McBrayer, who joined the meeting virtually via Microsoft Teams at 12:40 p.m. Mr. Pauw summarized his memo, which reviewed various sections of statutes governing LRP, JRP, and other state administered pension plans. Mr. Pauw agreed that statutes could be clearer, but he did believe JFRS's interpretation was within reason. He noted the terms "deferred vested" and "recipient" were not defined, which left interpretation up to administration. In addition, there are a few unique aspects of JRP and LRP, including that vested members did not have a provision to receive a refund. Unlike other plans, once vested, members of JRP and LRP receive the right to receive benefits at early or normal retirement. He suggested the Board may want to seek additional statutory language or adopt administrative regulations to clarify, but apart from a legislative change, he did not recommend staff change the way they were administering benefits.

There was a hearty discussion amongst the trustees and with Mr. Pauw regarding his memo and potential action. After the discussion, Judge John Grise made a motion, which was seconded by Judge Doughlas George, to confirm the agency's current interpretation and application of benefits for deferred vested members who joined LRP or JRP prior to January 14. The motion served to provide staff with Board action and record, while giving them direction to continue administering benefits prospectively apart from future statutory change. The motion passed unanimously.

(D) Custody/Asset Consolidation Discussion. Mr. Cracraft provided a verbal update concerning the agency's custody arrangement. He noted the system was currently utilizing the services of two different custodians for legacy and cash balance assets. He acknowledged the Board discussed the topic in the past and that staff intended to move to a single custodian in the future. He stated the Commonwealth's Master Agreement with State Street was currently set to expire June 30, so he was awaiting the results of a request for proposal. While moving to State Street would likely be the simplest solution, Mr. Cracraft expressed some frustration with the level of service staff receives from State Street and multiple errors that occurred recently. He indicated that staff considered issuing a request for proposal and contracting with a custodian directly, but that would involve some additional due diligence.

Mr. Cracraft indicated that staff was awaiting results from the Commonwealth's RFP, but depending on those results, a next step might include asking the Board to authorize staff to seek proposals for a custodian directly.

Somewhat related to this discussion, Mr. Cracraft also suggested the Board consider whether the legacy assets and cash balance assets needed to continue being invested separately.

He acknowledged there were specific reasons in 2014 to separate the assets, but several of those reasons were no longer material or needed. The CB assets had reached 5-years of history and were invested with the same target return and asset allocation standpoint, so moving to a single custodial relationship would serve as an ideal time to also consider consolidating all the assets. He mentioned staff had begun a discussion with Alan Pauw to discuss any fiduciary concerns and that staff would likely bring this topic back before the Board at a later date and once the custodial arrangement had more clarity.

(E) Medicare PPO Update. Mr. Cracraft provided a verbal update and informed the Board that Humana and Vanderbilt had settled their dispute and came to an agreement. He indicated that no JFRS retirees experienced any break in service and all participants would have the same level of coverage as prior to the disagreement.

Mr. Cracraft also acknowledged that the Board might want to look at issuing a request for information or proposals at some point in the next couple of years. He stated that JFRS has utilized Humana for Medicare participants since 2014 and how it makes good sense to periodically bid this type of service for competition. However, Mr. Cracraft admitted he had very little knowledge and no real experience that gave him confidence in facilitating such a request. He noted that JFRS had contracted with a health care consultant in the past to assist and that staff would be happy to do the same. One hurdle would be identifying such an individual and Mr. Cracraft said staff would look to reach out to KPPA, TRS, and any other potential resource that might be suggested.

(F) Pension Admin Software Update. Mr. Cracraft provided a verbal update on the Pension Administration Software project. He was excited to inform the Board that staff was very close to going live with the new system. The project was in the final testing phase and staff expected to start using in June.

(G) Administrative, Budget, & Personnel. Mr. Cracraft referenced the A*dministrative & Personnel Update – FY24 Budget Salary Increases* memo that was included in the Board materials. He noted the General Assembly had passed HB 444 and appropriated approximately $89 million dollars that had been set aside to address raises for state workers for the 2023-2024 fiscal year. He quickly reviewed the memo, how the budget increases applied to JFRS and asked the board to provide more feedback on how he should implement.

Upon motion by Judge John Grise, seconded by Chairman Venters, the Board unanimously agreed to go into Executive Session for the purpose of discussing personnel and confidential member information of employees. The motion passed unanimously.

Upon motion by Judge Doughlas George, seconded by Justice Daniel Venters, the Board unanimously agreed to come out of Executive Session. No action was taken in Executive Session.

Upon motion by Judge Doughlas George, seconded by Mr. Ben Allison, the Board unanimously authorized providing staff raises, which included a $2,000 increase to the base salaries of both full time employees, plus a 6% increase in salary or hourly rate of all three current JFRS staff members effective July 1, 2023. The motion passed unanimously.

There being no further business, the meeting adjourned at 2:12 p.m.

Daniel J Venters (Jul 19, 2023 09:40 EDT)

Justice Daniel Venters, Chairman
Judicial Form Retirement System Board of Trustees

Ben D Allison
Ben D Allison (Oct 17, 2023 11:26 EDT)

Ben Allison, Chairman
Judicial Retirement Fund Investment Committee

Brad Montell (Aug 28, 2023 14:27 EDT)

W. Brad Montell, Chairman
Legislators Retirement Fund Investment Committee

Bo Cracraft, Executive Director