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 14, 2023

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, July 14, 2023, at 10:00 a.m. All board members were present. JFRS staff present included Bo Cracraft, Executive Director. Guests joining the meeting included Don Asfahl, John Watkins, John Craddock and Andy Means of Baird Trust Company, along with Wesley Wickenheiser and Matthew Widdick of USI, Inc.

Chairman Venters called the meeting to order at 10:08 a.m. The trustees considered the adoption of the previously distributed *Minutes* of the April 21, 2023 meeting. Upon motion by Judge Doughlas George, seconded by Representative Brad Montell, the board unanimously approved the *Minutes* of the April 21, 2023 meeting.

Chairman Venters 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 Compliance Report as of June 30, 2023* was included in board materials distributed to the Trustees in advance. Mr. Cracraft highlighted page one of the *Report*, noting that each plan is within its prescribed allocation and policy guidelines. In accordance with board policy, JFRS maintains a copy of the *Report*.

Chairman Venters 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 July 14, 2023. 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, titled "the Dawn of Artificial Technology." He noted that innovation had been constant throughout history and the development of artificial intelligence (AI) was now being seen as the next potentially life-changing innovation that will impact business and society as a whole. However, Mr. Means acknowledged it was hard to know or predict exactly how much AI would change the world. He referenced the internet, which proved to influence virtually every industry. He noted that in many cases the internet has led to new opportunities, growth, and increased productivity, but in other cases, it has been a disruptive and destructive force. For the

Baird investment team, their approach does not change. They do not believe they can predict the future or know exactly how AI is going to influence and impact the world. However, the team does the most successful business and management teams will likely figure out the best ways to integrate and utilize AI. And so the team plans to continue with their long-term business owner mindset, looking for strong companies led by strong management teams who they believe will invest and allocate capital in a prudent and profitable manner.

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 Mr. LeLaurin, regarding the need for a healthy level of skepticism, Mr. Means stated there is much left to be learned and the team wants to be disciplined and focused on valuation rather than just having exposure. He did note the portfolio does have some exposure through the likes of Apple, Microsoft, Meta and Google. Mr. Means pointed out that the team's healthy level of skepticism and discipline had at times led to short-term underperformance, but historically that discipline had served their clients very well when looking at longer term investment periods.

In response to a question from Mr. Ben Allison regarding major equity indexes and the increasing level of technology exposure, Mr. Means agreed that technology, especially as it relates to domestic exchanges and indexes, continue to grow and reflect just how strong the US has been in this industry. Interestingly enough, he also noted how companies like Google, which are largely acknowledged as tech companies aren't always classified as technology companies by index providers. And he noted the portfolio's current underweight to IT as a prime example of why the team doesn't overly concern themselves with sector or industry weightings.

Mr. Asfahl reviewed several economic statistics and discussed recent employment and consumer spending trends. He stated that jobs growth seemed to be slowing, but unemployment figures were still on lower end. CPI had declined more recently, however still above the Fed's target of 3 to 3.5 percent.

In response to a question from Representative Brad Montell regarding consumer debt and any concerns with its recent growth, Mr. Means highlighted employment as the key factor with regard to the consumer and their ability to handle debt. He also pointed out that current levels represented a bit of a normalization post the global pandemic, when we saw debt levels come way down as spending slowed. Lastly, he noted consumer debt was rising, but not at a tremendous rate and that was coupled with the fact that average banking balances had also rose at a similar rate.

Mr. Asfahl continued with a review of 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 equity portfolio, which included relative sector weightings, top performers and largest holdings. He pointed out the underweight to technology and stated the team had trimmed positions in Apple and Microsoft as valuations had risen and the team wanted to reduce a little exposure. In exchange, the team added to two existing holdings in Parker Hannifin and Schwab. Mr. Means also reviewed sector attribution and key individual contributors for several trailing periods.

In response to a few questions from trustees regarding Disney, its recent performance, and the future of streaming, Mr. Means agreed that the company was struggling and had been a mess on a couple fronts over the past year or so. He expressed confidence in Bob Iger and his return as the CEO and stated the team continued to own the stock because of what they believe it is worth in the long term and not necessarily today. As for streaming, Mr. Means referenced some recent news with regard to Hulu and Disney Plus becoming a bundle, which he thought would also come with some price increase. Mr. Watkins also stated that he believed Disney would cut back on some content creation and try to follow the proven road map of Netflix to profitability.

In response to a question from Chairman Venters regarding any holdings the team might be losing confidence in, Mr. Means stated that any position in the portfolio with a smaller allocation generally reflected less confidence and used US Bank as an example.

Mr. Craddock continued the presentation with a short review of the fixed income portion of the portfolios. He highlighted upcoming maturities and the team's plan for reinvestment. He noted rising rates have provided more opportunities for longer term bonds, but stated the portfolios duration would likely be just short of the index.

In response to a question from Mr. Ben Allison regarding the Plans' cash flow profile and need for cash to meet benefit needs, Mr. Craddock stated he was not overly concerned at this point given how manageable the cash flow needs were and the team's ability to ladder maturities. He did acknowledge there could be some slight drift at times, but the team could always sell shorter maturities if needed to keep good profile.

Mr. Asfahl continued the presentation with a review of recent performance and the portfolios' risk statistics. Mr. Asfahl also quickly highlighted the cash balance plans, which currently have a very similar risk and return profile. He reminded the trustees that all account held identical equity portfolios, while the two cash balance portfolios utilized a basket of ETFs to try and best mirror the fixed income allocations. Over the shorter, 1-year period, the ETFs had slightly outperformed the legacy portfolios.

In closing, Mr. Asfahl drew attention to a few pages in the board materials that staff had requested related to a statutory requirement to review the Board's actuarially assumed rate of return. Mr. Asfahl noted the Board was going to hear from their actuary after lunch, but staff had asked the Baird investment team to provide some capital market information as another data point to consider. Mr. Asfahl reviewed several items, included a summary of expected returns and risk given several portfolio allocations. At the current target allocation of 70% equity and 30% fixed income, the expected portfolio return was 6.87%, which was in line with the Board current assumption of 6.50% annually.

Chairman Venters 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 the base annual interest rate is 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, 2023, the annual interest credit (guarantee + upside sharing) was calculated as 8.18% for JRP and 8.13% for LRP.

The meeting recessed for lunch at 12:00 and reconvened at 12:20 p.m. Mr. Asfahl, Mr. Means, Mr. Watkins and Mr. Craddock departed the meeting.

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

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

April 24, 2023 – Each state-administered retirement system was on the agenda and provided an investment update. A copy of the JFRS presentation had been included in the board materials.

May 22, 2023 – CERS was the only retirement plan on the agenda, but JFRS staff did attend the meeting. CERS reviewed results of a recent experience study, specifically relating to their Board's decision to raise their assumed rate of return from 6.25% to 6.5%. In addition, LRC staff provided a short presentation concerning projected employer contributions and the expected impact of those on the general state budget.

Mr Cracraft noted the Oversight Board did NOT meeting in June and had already decided to not meet in July.

(B) Proxy Voting Policy. Mr. Cracraft stated the next item was a follow up to a discussion held by the Board during their April meeting. It was a follow up to House Bill 236, which had passed during the 2023 regular session and addressed fiduciary duty, ESG investing, and proxy voting.

After doing some research, JFRS staff provided the Board with a proposed Proxy Voting Policy for review and adoption. Mr. Cracraft stated the Board of Trustees would adopt the policy, but the underlying language of the policy would delegate voting of all proxies to Baird according to their approved policy. In addition, staff included additional language to clearly make sure the additional voting and reporting requirements of HB236 were outlined. Mr. Cracraft stated that members of the Baird team had reviewed the proposed draft and did not express any concern.

After a short discussion amongst the trustees, Mr. Ben Allison made a motion on behalf of the Investment Committee for the Judicial Retirement Fund, which was seconded by Judge John Grise. Representative Brad Montell made a motion on behalf of the Investment Committee for the Legislative Retirement Fund, which was seconded by Mr. Stephen LeLaurin, to adopt the JFRS Proxy Policy, as drafted by staff, effective July 14, 2023. The motions passed both committees unanimously.

(C) Actuarial Related Items. Mr. Cracraft recognized Mr. Wesley Wickenheiser and Mr. Matthew Widick of USI, Inc. (USI), the Systems' Actuary. Mr. Wickenheiser joined the meeting in person, while Mr. Widick joined virtually to review the Plans' current economic assumptions.

Mr Cracraft reminded the trustees of HB 76, which as passed during the 2022 Regular Session and required JFRS conduct an actuarial investigation of economic assumptions every two years rather than the previously required five-year period. Mr. Cracraft also referenced a *Biennial Review of Economic Assumptions (HB 76)* staff memo that was included in the meeting materials and served to summarize some the information. In addition, staff asked USI to provide additional information to support the Board and discussion.

Mr. Wickenheiser began his presentation with a review of the Plans' assumed rate of inflation. He noted that almost all economic assumptions incorporated inflation as a building block component. However, concerning JRP and LRP, based on his research he stated the Board, at least more recently, had not always explicitly approved a separate inflation rate. During the PPOB actuarial audit, it was noted that both JRP and LRP were assuming a rate of 3.0%, but Mr. Wickenheiser noted that probably had been the case for over 15 years. During that same 15 year period, he pointed out the plan revised their assumed rate of return and wage growth assumptions on multiple occasions. Mr. Wickenheiser reviewed some trailing period averages, a recent NASRA brief, along with the JFRS staff memo, and acknowledged the 3.0% assumption was probably a bit high. He recommended the Board take the opportunity to adopt a separate inflation assumption of 2.5%.

Next, Mr. Wickenheiser began to review the Plans' assumed rate of return, or discount rate. He started with reviewing recent investment performance and the current allocation of assets. Using the Portfolios' current allocations, he reviewed expected returns that were based on capital market assumptions available to USI through Principal Financial. Using a broad market index return, Mr. Wickenheiser stated the expected total portfolio return was estimated to be 6.37%, which was built upon a 2.5% inflation estimate and 3.87% expected real rate of return. While this estimate was below the Plans' current assumption of 6.5%, Mr. Wickenheiser reminded the Board these estimates were based off of index returns and did not incorporate active management. Historically, both JRP and LRP posted returns in excess of their blended performance index. In an attempt to incorporate some active component, USI provided a summary of 10-year weighted returns, using a mix of historical and expected performance. Mr. Wickenheiser highlighted that at a 6.5% assumption, only one had to weight historical performance at 10% to meet the assumption, which he noted would be a conservative and prudent level of active risk. Lastly, Mr. Wickenheiser reviewed industry trends, which have shown a steady decline in assumptions over the past 20 years. However, at 6.5%, JFRS remains below the median and average assumptions of 7.0% and 6.92%. In closing, Mr. Wickenheiser stated he believed the 6.5% assumption was reasonable, even with a lower inflation assumption.

Mr. Cracraft also highlighted two additional economic assumptions, which included the Plans' wage growth assumption and a non-legislative compensation load utilized in the LRP plans. First, related to wage growth, he highlighted that recent budgetary salary increments have likely exceeded short-term assumptions, but over the longer term, it was difficult to suggest making a change at this time. In addition, he noted that as the plan matures and the membership becomes more cash balance oriented, the impact of salary increases is not as material. Concerning the non-legislative compensation, Mr. Cracraft acknowledged the load had garnered some attention during the actuarial audit and expressed belief that a lot of that attention was due to the unusual but significant nature of the assumption. While he admitted both were true, he also referenced the most recent Experience Study, which reflected actual data that was in in line with the assumption. He stated that staff was trying to better track members who may be subject to non-legislative compensation and that the number is dwindling given few legacy members are left. Given the current funding level of LRP and the fact that employer contributions have not been received for several years, being conservative with the assumption makes sense.

There was a healthy discussion amongst the trustees regarding the information provided by staff, USI, and previously presented by Baird Trust. Following the discussion, Mr. Ben Allison made a motion on behalf of the Investment Committee for the Judicial Retirement Fund, which was seconded by Judge John Grise. Mr. LeLaurin made a motion on behalf of the Investment Committee for the Legislative Retirement Fund, which was seconded by Representative Brad Montell. Both motions were to adopt an assumed discount rate of 6.5%, which was built upon a 2.5% assumed rate of inflation and 4.0% assumed real rate of return. The motions passed both committees unanimously. The Board did not take any action regarding wage growth and non-legislative compensation load assumptions.

(D) Retiree Health Insurance. Mr. Cracraft referenced the *2024 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 the three different KEHP plans and highlighted that 2024 premiums were increasing on average 11.6% from the prior year. He also reminded the trustees that as of the June 2021 funding valuations, 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, Judge Doughlas George 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, parent-plus, couple, family) equivalent to the Living Well PPO plan premium. 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 2023 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 2023 benefits, staff asked Humana to also provide premium cost information for adding basic vision and hearing coverage to the Medicare plans. Mr. Cracraft acknowledged that increasing benefits at any level needed to be considered carefully, but reminded them that the Board considered vision coverage in the prior year and other state sponsored plans had considered and added basic dental, hearing, and vision coverage over the past couple of years.

There was a discussion amongst the remaining trustees regarding the Medicare plans and adding vision benefits. Staff provided the Board with an estimate of the total cost for LRP and JRP with and without the vision coverage. Following the discussion, Judge John Grise made a motion, seconded by Mr. Stephen LeLaurin, to renew its hospital and medical insurance contract with Humana for calendar year 2024, and to set the 2024 monthly contribution level at $365.91, which includes the addition of a basic vision policy for each JFRS Humana Medicare Advantage plan policyholder. To avoid a conflict of interest, Chairman Daniel Venters, Judge Doughlas George, Representative Brad Montell, and Representative Scott Brinkman did not vote concerning 2024 medical benefits provided to Medicare eligible members and recipients. The motion passed unanimously.

(E) EOY Processing/Annual Financial Audit. Mr. Cracraft provided an update on the fiscal year end activities. He informed the Board that staff was very close to closing out the year financially and is hoping to quickly start the annual financial process. He also noted staff was working on a budget request, annual member statements, and gathering the actuarial valuation data.

(F) Pension Administration Software. Mr. Cracraft provided an update on the Pension Administration Software (MARC) Project and informed the Board that staff officially went live with the new system as of that week. Staff had a lot of work still left to complete, but look forward to generating annual statements and taking advantage of the many enhancements it has to offer.

There being no further business, the meeting adjourned at 2:24 p.m.

Daniel J Venters (Feb 10, 2024 22:01 AST)

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

Ben D Allison
Ben D Allison (Feb 9, 2024 13:38 EST)

Mr. Ben Allison, Chairman
Judicial Retirement Fund Investment Committee

Brad Montell
Brad Montell (Feb 9, 2024 14:11 EST)

Rep. Brad Montell, Chairman
Legislators Retirement Fund Investment Committee

Bo Cracraft, Executive Director