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## INVESTMENT POLICY STATEMENT

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Effective as of April 23, 2022

This Investment Policy Statement amends and completely replaces the Investment Policy Statement of the **Investment Committees for the Kentucky Judicial Retirement Fund** and the **Kentucky Legislators Retirement Fund**, dated October 25, 2019.

The purpose of this **Investment Policy Statement** is to establish a clear understanding between the **Investment Committees for the Kentucky Judicial Retirement Fund** and the **Kentucky Legislators Retirement Fund**, hereinafter referred to as the “Committees,” and **Baird Trust Company**, hereinafter referred to as the “Manager,” of the investment policies and objectives of the Committees. This *Statement* will outline an overall philosophy that is specific enough for the Manager to know what is expected, but sufficiently flexible to allow for changing economic and securities markets. The Manager shall be responsible for individually managing the investments for the retirement plans administered by **Judicial Form Retirement System** (hereinafter referred to as JFRS), including the Defined Benefit Fund and the Hybrid Cash Balance Fund for the Kentucky Judicial Retirement Fund, and the Defined Benefit Fund and the Hybrid Cash Balance Fund for the Kentucky Legislators Retirement Fund.

## A. OBJECTIVES

The assets of the two Defined Benefit Funds and the two Hybrid Cash Balance Funds (collectively the “Funds,” or individually a “Fund”) must be invested with the care, skill and diligence that a prudent person acting in this capacity would undertake. The Manager’s primary objective will be to provide growth of principal and income of each Fund’s assets. This objective should be pursued as a long-term goal designed to maximize portfolio results without exposure to undue risk, as defined herein. The Committees understand that fluctuating rates of return are characteristic of the securities markets, thus, the Manager’s greatest concern should be long-term appreciation of the Funds’ assets and consistency of total portfolio returns.

The Committees recognize that short-term market fluctuations may cause variations in performance in each Fund’s portfolios; however, over three-year rolling time periods, the Committees expect the total portfolios of each of the four Funds to achieve or exceed a total return equal to the composite performance of securities markets, as represented by broad market indexes similar to but not limited to the S&P 500 Index (Equity), and the Bloomberg Barclays Intermediate US Government/Credit Bond Index (Fixed Income).

## B. POLICIES AND RESTRICTIONS

The Committees intend the investment policies and restrictions presented in this *Statement* to be used as a framework to help the Manager achieve the investment objectives of the Funds, at a level of risk the Committees deem acceptable. The Committees allow the Manager discretion in the asset allocation and diversification of the Funds, for the purposes of increasing investment returns and/or reducing risk exposure in accordance with the policies and restrictions of this *Statement*. When appropriate and from time to time, the Committees may also give the Manager broad responsibility in writing to shift the commitment of any of the Funds’ investments among asset classes, industry sectors, and individual securities or funds of securities to pursue opportunities presented by long-term secular changes within the capital markets.

All Fund investments shall be consistent with those permitted for Trust Funds by law in the Commonwealth of Kentucky. Investments shall be limited to readily marketable securities or funds of such securities, and no investment shall be made in mortgages.

## ASSET ALLOCATION



### C. ASSET ALLOCATION GUIDELINES

The Committees expect each of the four Funds' asset allocation policies to separately reflect, and be consistent with, the investment objectives and risk tolerances expressed throughout this *Statement*. These policies, developed after examining the historical relationships of risk and return among asset classes, are designed to provide a high probability of maximizing the Committees' return objectives while minimizing risk. Although dynamic capital markets may cause fluctuating risk and return opportunities over a market cycle, the following standards and limits will be used to evaluate the asset allocation and Fund performance (as measured at market value) over a full market cycle not to exceed five years.

Each of the Funds' investments shall be separately managed under allocation rules as follows:

1. Cash and cash equivalent balances will be held separately for each Fund as a liquidity reserve for the payment of certain Fund expenses, pension or qualified refund payments, and insurance premium requirements. Such liquidity reserve balances will be held separately from a Fund's overall investment portfolio as managed by the Manager.
2. Equities (generally, common stock investments) in each Fund's investment portfolio will have a target allocation of 70% of the total portfolio market value, not including cash and cash equivalents balances, of such Fund. The Manager is granted discretion to vary from this portfolio allocation within a range of 60% to 80% (inclusive) of the Fund's portfolio market value, unless otherwise granted an exception by a Committee in writing.
3. Fixed income investments in each Fund's investment portfolio will have a target allocation of 30% of the total portfolio market value, not including cash and cash equivalent balances, of such Fund. The Manager is granted discretion to vary from this portfolio allocation within a range of 20% to 40% (inclusive) of the Fund's portfolio market value, unless otherwise granted an exception by a Committee in writing.
4. If a Fund's portfolio allocation falls outside of its targeted range, the Manager will notify the applicable Investment Committee, or its designee, of the status of the Fund's portfolio allocation percentages. Such Committee may direct the Manager to, on a timely basis, adjust the Fund's applicable allocation percentage to bring the Fund's portfolio back into its targeted range. If the Committee does not make a rebalancing recommendation, the Manager, at its discretion, may or may not adjust the Fund's portfolio allocations. The Committees' designee will review all of the Funds' portfolio allocations on a monthly basis and will make quarterly or more frequent reports to the Committees, if the target portfolio allocations fall outside of the parameters above.

## **D. EQUITY GUIDELINES**

The Committees expect the Manager to maintain each Fund's equity portfolio at a risk level approximately equivalent to that of the domestic equity markets as a whole, with the objective of exceeding its results. Equity investments shall be selected from any security listed on the New York, American and Regional Stock Exchanges, or at the NASDAQ markets.

At the Manager's discretion, equity allocations may be achieved by the purchase of individual securities, shares of one or more registered mutual funds invested substantially in equities, and/or shares of one or more registered exchange traded funds (ETFs) invested substantially in equities.

Should the Manager elect to invest in mutual funds or ETFs for a Fund's equity allocation, the aggregate of such funds' investments must be consistent with the Equity Guidelines herein for such Fund, and must in the aggregate generally comply with the underlying diversification characteristics, risk and limits in the Equity Guidelines for such Fund as described herein. The Committees understand that any mutual funds or ETFs utilized by the Manager may allow broader latitude, but whose investment objective, in the Manager's opinion, is consistent with the Fund's investment guidelines.

The Committees also understand that any mutual fund or ETFs utilized under these Guidelines may utilize derivative instruments for exposure, efficiency, or risk management purposes and are not used as a speculative nature. Any mutual fund or ETF selected by the Manager must generally be consistent with these Guidelines.

The Manager is prohibited from investment in private placements, unregistered securities, hedge funds, letter stock, uncovered options, common trust funds or collective investment funds, or from engaging in short sales, margin transactions or other specialized investment activities. The Manager may write covered options against common stocks held by the Funds to increase investment returns and/or reduce risk. No investments shall be made in proprietary funds of the Manager without written consent of the Committees.

Within the above guidelines, the Committees give the Manager discretion for equity security and fund selection, timing, turnover, and benchmark selection for each of the four Funds, subject to the following limitations:

1. Each Fund's investment in equities (generally, common stocks) shall be from those stocks that meet the statutory standards for investment of trust funds, except that 50% of the total equity portfolio of each Fund may not be invested in common stocks with a dividend payment history of less than five years.
2. Investment in an individual security, at time of purchase shall not exceed 5% of a Fund's then current market value of such Fund's equity portfolio. At a time when a security's value reaches 8% of such Fund's equity portfolio market value, the Manager shall promptly notify the applicable Investment Committee, or its designee. Upon notification of a security value reaching 8%, the Committee may recommend a course of action to the Manager; absent a Committee recommendation to reduce the equity holding, the Manager, at its discretion, may or may not reduce the equity holding.

3. Investment in a particular sector of a Fund's equity portfolio shall not exceed more than 20% of the sector's weighting in the S&P 500.

If an individual sector weighting reaches a 40% weighting of a Fund's total equity portfolio, the Manager shall promptly notify the applicable Investment Committee, or its designee. Upon notification of a sector reaching a 40% weighting, the Committee may recommend a course of action to the Manager; absent a Committee recommendation to take action, the Manager has discretion, as long as the weighting does not exceed more than 20% of the sector weight in the S&P 500.

4. Any equity benchmark selected by the Manager for any Fund must be a broad market benchmark and must reasonably reflect the nature and risk of the underlying investments of such Fund's equity portfolio.

Unless corrective actions are otherwise provided for in these Equity Guidelines, or unless a Committee provides corrective or rebalancing directions to the Manager, should any Fund's equity portfolio no longer comply with the Equity limits and requirements as described immediately above, the Manager shall take, with notice to the applicable Committee or its designee, reasonable steps to bring such Fund's equity investments into compliance with these Equity Guidelines.

## **E. FIXED INCOME GUIDELINES**

The Committees expect the Manager to maintain each Fund's fixed income portfolio at a risk level approximately equivalent to that of the domestic fixed income markets as a whole, with the objective of exceeding its results.

At the Manager's discretion, fixed income allocations may be achieved by purchase of individual securities, shares of one or more registered mutual funds investing substantially in fixed income, and/or shares of one or more registered ETFs investing substantially in fixed income. Should the Manager elect to invest in mutual funds or ETFs for a Fund's fixed income allocation, the aggregate of such funds' investments must be consistent with the Fixed Income Guidelines herein for such Fund, and must in the aggregate generally comply with the underlying diversification characteristics, risk and limits in the Fixed Income Guidelines for such Fund as described herein.

The Committees also understand that any mutual fund or ETFs utilized under these Guidelines may utilize derivative instruments for exposure, efficiency, or risk management purposes and are not used as a speculative nature. Any mutual fund or ETF selected by the Manager must generally be consistent with these Guidelines.

At its discretion, the Manager may select for either or both of the Hybrid Cash Balance Funds' fixed income portfolios one or more low cost registered fixed income mutual funds or ETFs utilizing an indexing strategy, and/or utilizing a targeted sector or style strategy, and/or utilizing an actively managed strategy, provided that in the aggregate such selected funds are consistent with the Hybrid Cash Balance Fund's overall fixed income benchmark and Fixed Income Guidelines for such Fund as described herein.

The Manager is prohibited from investing in private placements, from speculating in fixed income or interest rate futures, and from arbitrage or any other specialized investments. No investments shall be made in proprietary funds of the Manager without written consent of the Committees.

Investments in fixed income securities will be managed actively to pursue opportunities presented by changes in interest rates, credit ratings and maturity premiums. The Manager may select from appropriately liquid preferred stocks, corporate debt securities, obligations of the U.S. Government and its Agencies and issues convertible to equities.

Within the above guidelines, the Committees give the Manager discretion for fixed income security and fund selection, timing, turnover, and benchmark selection for each of the four Funds, subject to the following limitations:

1. No individual fixed income security (with the exception of those of the U.S. Government and its Agencies) may be purchased with a modified duration of more than 15 years at time of purchase.
2. Investments in individual fixed income securities of the U.S. Government and its Agencies may be purchased with a maturity of up to 30 years at time of purchase, but the weighted average maturity of those securities in each Fund shall not exceed ten years.
3. Investments for any Fund in an individual security at time of purchase of a single issuer (with the exception of U.S. Government and its Agencies) must not exceed 5% of the market value of such Fund's fixed income portfolio.
4. Only corporate debt issues that meet or exceed a credit rating of BBB from Standard & Poor's and/or a Baa rating from Moody's, may be purchased.
5. Preferred stocks must be rated A or better, by Moody's and/or Standard & Poor's at the time of purchase.
6. Only ETF or Mutual Fund securities whose fixed income investments have a dollar-weighted average credit rating of BBB from Standard & Poor's and/or Baa rating from Moody's, may be purchased. No ETF or Mutual Fund shall have a total allocation of more than 5% in below investment grade rated holdings.
7. Investment in bonds will be limited to those eligible for purchase by national banks.
8. Individual fixed income security maturities will be reasonably spaced with due consideration given to call provisions.
9. Each Fund's fixed income portfolio duration, defined as the weighted average of the modified durations of all of the Fund's fixed income investments, including ETF or Mutual Funds, shall at all times be within one year of the duration of its fixed income benchmark.

10. The fixed income benchmark selected by the Manager for any Fund shall be approved by the Committee' and must be a broad market benchmark that reasonably reflects the nature and risk of the underlying investments of such Fund's fixed income portfolio.

Unless corrective actions are otherwise provided for in these Fixed Income Guidelines, or unless a Committee has provided corrective or rebalancing directions to the Manager, should any Fund's fixed income portfolio no longer comply with the Fixed Income limits and requirements described immediately above, the Manager shall take, with notice to the applicable Committee or its designee, reasonable steps to bring such Fund's fixed income investments into compliance with these Fixed Income Guidelines.

## **F. CASH AND CASH EQUIVALENT GUIDELINES**

The Committees expect the Manager to invest each Fund's portfolios substantially in equity and fixed income investments as described in this *Statement*. As noted in the Asset Allocation Guidelines above, certain cash and cash equivalent balances will be held as liquidity reserves separately from each Fund's investment portfolios, as necessary to provide for certain Fund expenses, insurance premiums, and underlying plan participant cash flow and pension payment requirements. The Manager may also maintain cash and cash equivalent balances as part of a Fund's portfolio allocations in anticipation of liquidity reserve needs or as temporary Fund investments pending longer term portfolio investments.

Any cash and cash equivalent investments held in the liquidity reserves or within Fund portfolios may be made in the following types of short-term investments, with limits and requirements as described below:

1. Treasury bills;
2. Commercial paper investments and marketable short-term money market securities, each with time of purchase ratings of as least A-2 or P-2 by Standard & Poor's or Moody's, respectively, and each with time of purchase maturities of no longer than 270 days;
3. Marketable short-term money market funds of marketable short-term securities, under the following limits for each such fund:
  - a. fund ratings at least AAA or Aaa by Standard & Poor's or Moody's, respectively, at time of purchase;
  - b. final maturities of underlying fund investments of no longer than 13 months from dates of acquisition;
  - c. fund weighted average maturity of underlying fund investments of no longer than 60 days at all times;
4. Corporate cash equivalent investments with maturities no longer than one year, provided any such investment shall be restricted to not more than 7% per issuer;
5. Repurchase agreements relating to and consistent with the instruments described in these Cash and Cash Equivalent Guidelines provided such agreements have a maturity deemed to be no longer than the scheduled maturity period remaining on the underlying securities covered by such agreement; and/or

6. All other cash and cash equivalent investments with maturities no longer than one year from their dates of acquisition.

Additionally, the Manager may invest no more than 10% of the market values of either of the two Defined Benefit Funds' portfolios, and no more than 5% of the market values of either of the two Hybrid Cash Balance Funds' portfolios, in cash or cash equivalents of a single government agency other than U.S Government agencies. Investment in obligations of the U.S. Government and its agencies are not restricted.

Unless corrective actions are otherwise provided for in these Cash and Cash Equivalent Guidelines, or unless a Committee has provided corrective or rebalancing directions to the Manager, should any Fund's portfolio no longer comply with the Cash and Cash Equivalent limits or requirements described immediately above, the Manager shall take, with notice to the applicable Committee, reasonable steps to bring such Fund's short term investments into compliance with these Cash and Cash Equivalent Guidelines.

## **G. OTHER ASSETS**

The Manager will not purchase assets other than those described herein without the prior written consent of the Committees. Investments in commodities and currency exchange contracts are strictly prohibited.

The Manager may invest in or hold ETF or mutual funds which make use of derivatives securities, for the purpose of gaining exposure, cost efficiency and risk management purposes as long as such investments do not cause the Funds to be leveraged beyond a 100% position. All derivative securities utilized shall be sufficiently liquid and expected to be able to be sold at or near its most recently quoted market price.

Under no circumstances shall the Manager purchase securities on margin or take positions in derivative securities that leverage the Funds' investments beyond a 100% invested position. The Manager shall not hold ETF or Mutual fund securities that holds underlying securities on margin.

Investments not specifically addressed by this *Statement* are forbidden by the Committees without prior written consent.

## **H. SALES AND PURCHASES**

The Manager shall have discretion in selecting brokers or institution(s) to execute transactions, unless directed otherwise by the Committees.

The Manager shall immediately notify the JFRS Executive Director, or approved brokers of all transactions, with specific data as to settlement and delivery instructions. The JFRS Executive Director or approved brokers will in turn notify the custodian of the Funds to execute such sales and purchases.

## **MONITORING**

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## I. COMMUNICATIONS AND COMPLIANCE

The JFRS Executive Director will maintain contact with the Manager as necessary and will advise the Manager of available funds for reinvestment with respect to each of the Funds. The Manager is required to give the Committees monthly Fund portfolio appraisals, and to give the Committees promptly at the end of each quarter a quarterly account review. Such quarterly account reviews shall include but not limited to detail regarding each Fund's value and investment characteristics, each Fund's time-weighted investment performance and strategy, and each Fund's compliance with investment guidelines. The Committees or their designee must also receive information about changes in the Manager's investment philosophy, management, ownership and key personnel in a timely fashion.

Meetings between the Committees and the Manager will generally be held on a quarterly basis. In the event a quarterly meeting with the Manager is not held, the Committee's designee will provide a quarterly update. All such meetings with or updates shall include:

1. Each Fund's holdings and characteristics, investment performance and risk levels in light of the stated objectives, policies, guidelines, and benchmarks.
2. A review of each Fund's portfolio investment positions during the prior quarter in comparison to the guidelines of this *Statement*, along with any exceptions. The Manager shall include an assessment of the financial effects of any compliance exceptions and proposals for corrective actions.
3. The Manager's view on any important recent or anticipated developments within the economy and the securities markets, and their potential effect on investment strategy and Fund performance.
4. The effects of any recent or anticipated changes within the Manager's organization on investment philosophy, strategy and performance.
5. Amendments to the policies and objectives presented in this *Statement* as desired by the Committees or recommended by the Manager.

In addition to requiring that the Manager provide compliance reporting as described above, JFRS may also engage an independent third party to provide the Committees with a periodic compliance assessment for each Fund.

The Committees, or designee, may call more frequent meetings if significant concerns arise about the Manager's performance, strategy, personnel and organizational structure.

By **executing** this *Investment Policy Statement*, the Manager agrees to its terms and conditions. Should the Manager believe at any time that changes, additions or deletions to this *Statement* are advisable, it will be the Manager's full responsibility to recommend them to the Committees on a timely basis.

Executed on this, the 16th day of June, 2022.

**Investment Committee  
Kentucky Judicial Retirement Plan**

By: *Stephen F LeLaurin*  
Stephen F. LeLaurin (Jun 16, 2022 10:38 CDT)  
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Stephen F. LeLaurin, Chairman

**Investment Committee  
Kentucky Legislators Retirement Plan**

By: *Brad Montell*  
Brad Montell (Jul 1, 2022 15:47 EDT)  
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W. Brad Montell, Chairman

**Baird Trust Company**

By: *Don Asfahl*  
Don Asfahl (Jul 5, 2022 08:41 EDT)  
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Donald L. Asfahl, Chairman