

**MINUTES OF MEETING
KENTUCKY RETIREMENT SYSTEMS
INVESTMENT COMMITTEE MEETING
NOVEMBER 10, 2022, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the November 10, 2022 meeting of the Kentucky Retirement Systems' (KRS) Investment Committee, the following Committee members were present: Prewitt Lane (Chair), John Cheshire, Ramsey Bova, David Adkins, and Pamela Thompson. Staff members present were David Eager, Rebecca Adkins, Victoria Hale, Steve Willer, Anthony Chiu, Joseph Gilbert, Jared Crawford, Ashley Gabbard, Phillip Cook, Katie Park, and Sherry Rankin. Also in attendance were Kentucky Retirement Systems' CEO John Chilton and County Employees Retirement System's (CERS) CEO Ed Owens, III. Others in attendance included David Lindberg and Craig Morton with Wilshire Advisors, LLC.

Mr. Lane called the meeting to order.

Ms. Hale read the Opening Statement.

Ms. Rankin took Roll Call.

There being no *Public Comment*, Mr. Lane introduced agenda item *Approval of Minutes – August 9, 2022*. Mr. Cheshire made a motion and was seconded by Mr. Adkins to approve the minutes as presented. The motion passed unanimously.

Mr. Lane introduced agenda item *Quarterly Trust Budget*. Mr. Steve Willer presented the Quarterly Trust Budget. Mr. Willer stated that this was the first year that trust expenditures have been budgeted. He encouraged the KRS Investment Committee to continue to provide feedback and suggestions on the reporting of the Trust Budget. To increase transparency, the Trust Budget will be reported to the CERS and KRS Investment Committees on a quarterly basis moving forward, said Mr. Willer. He advised the Committee that a section was added to include a description of services provided by each vendor, as requested by Trustees.

Mr. Lane introduced agenda item *Investment Review and Update*. Mr. Willer presented the Investment Review and Update. He advised that the theme in markets continues to be elevated volatility. Mr. Willer presented the Wilshire asset class performance chart which illustrated the volatility within the first nine months of 2022. Mr. Willer reported that U.S. public equity markets were down 4.5%, non-U.S. equity markets were down almost 10%, and developed markets were down over 11% for the quarter. Core bonds represented by the Bloomberg Aggregate Index were down almost 5% for the quarter, said Mr. Willer. High-yield bonds were down almost 15% and real assets were also down for the quarter. Mr. Willer highlighted the key struggles occurring in markets. He advised the Committee that elevated volatility is expected and that rates will continue to rise to combat inflation. As a result, growth will slow, and unemployment will rise. Mr. Willer reported that the plans held up relatively well with strong relative performance. The pension plans returned between -2.07% and -2.6% and outperformed the IPS benchmarks by between 116 and 160 basis points, which equals about \$55 million in outperformance. Mr. Willer stated that the current allocations are sound and that the underlying mandates within the allocations are performing well. Performance within the insurance plans was similar, said Mr. Willer, as returns

were between -2.31% and -2.61% for the quarter. These plans outperformed their benchmarks by between 159 and 189 basis points. Next, Mr. Willer presented the Plan Sponsor Peer Group Analysis; return, standard deviation, and sharpe ratio. He advised that the plans remained broadly underweight in real assets allocation targets. There were small underweights to some plans in real estate and corresponding over weights in proxy assets such as specialty credit and cash. Mr. Willer announced that there was a recent capital call in one of the real estate mandates in which capital was committed several months ago and advised that there is still significant capital committed in the real estate space. He expects this remaining capital to be deployed in the coming quarter, depending on the market. In real return and real assets, Mr. Willer stated that he is working on potential mandates and may request a Special Called KRS Investment Committee meeting in the coming weeks to present recommendations for the funding of mandates. Mr. Eager asked Mr. Willer to identify the amount of committed capital in asset classes and how far below the ranges each asset class is. The committed capital is in various asset classes and vary in size, said Mr. Willer. He advised that the committed capital is primarily in real estate (\$300 million), however, there is some committed capital in specialty credit. Further, Mr. Willer stated that several of the plans are within range and others are slightly out of range. He stated that if all the capital were to be called and once the real estate searches are completed, Staff will top off existing real estate mandates which would achieve target or make all plans within range. Mr. Eager asked how close plans are to their ranges once capital is called and gave SPRS as an example. Mr. Willer stated that due to the general fund allocation received in SPRS, the committed capital will not get SPRS into target. Mr. Eager added that it is beneficial to understand how the committed capital helps get into range. Mr. Willer stated that what is committed for KRS will help get the plans into range and anticipates that all will be in range once capital is called. Mr. Anthony Chui touched on the benefits

of prudently deploying capital and the negative side effects of rushing the deployment of capital. Mr. Willer agreed with Mr. Chiu and added that the plans are positioned well.

Mr. Lane introduced agenda item *Investment Policy Statement Discussion*. Mr. Willer stated that there have been several discussions regarding the under allocation to certain asset classes and being below the range in the Investment Policy Statement (IPS). The drivers of these issues and how to address them have also been a topic of extensive discussion, said Mr. Willer. Mr. Lane stated that it has been difficult to get a substantial increase in the asset classes. He advised that he and Mr. Willer are reviewing a few options that will be added to the IPS. The change would phase-in over 18 months, said Mr. Lane. He emphasized the need to be in compliance and stated that a recommendation will be presented to the KRS Investment Committee soon. Mr. Cheshire thanked Mr. Lane and Mr. Willer for not rushing through the issue. Mr. Willer commented that there may be pressure at times to deploy capital quickly or to be in compliance, but he advised that there is general language in the IPS which may provide some flexibility, such as proxy voting language. Mr. Willer reminded the Committee that these changes to the allocations will take time. Mr. Cheshire commented that money rushed to be placed does not typically provide the best outcome. Mr. Lane agreed with Mr. Cheshire.

Mr. Lane introduced agenda item *Investment Compliance Report*. Mr. Jared Crawford, Investment Research Officer and Compliance Officer, stated that he and the Office of Investments are working to reduce redundancy in the Investment Compliance Report. He emphasized the need for the Compliance Report to accurately reflect the Investment Policy Statement. Mr. Willer added that the Office of Investments has researched best practices for fractional shares and is requesting that

the Investment Committee adopt a de minimis exception for the internally managed S&P portfolio. Mr. Willer advised that this exception would exclude positions that are individually less than \$10,000 and in aggregate are less than \$100,000; therefore, the fractional shares would be excluded from the Compliance Report. Mr. Joseph Gilbert advised that he reached out to the custodian and consultant and that there is no universally agreed upon best practice, however, he reported that others transfer the fractional shares out of the internal account to a different holding account, write-off the fractional shares due to their market value, or implement the de minimis exception. Mr. Lane emphasized the importance of transparency. Mr. Gilbert stated that a de minimis exception would not erase the fractional shares and that they would continue to be shown on the quarterly report which shows every holding. This report can be reviewed on the KPPA website. Mr. Willer added that the role of the Compliance Report is to highlight important issues needing attention. Mr. Eager stated that this has been an ongoing discussion and asked Ms. Hale if Staff could make the decision or if Board approval is required. Ms. Hale advised that Board action is required to change the Investment Policy Statement (IPS); however, Staff may present an amended IPS for presentation and recommendation to the Board. Mr. Willer stated that the Office of Investments will redline the IPS. He asked Ms. Hale to clarify what is needed of the KRS Investment Committee to bring the amended IPS before the KRS Board of Trustees. Ms. Hale advised that the Committee must approve the amendments and bring the action to the Board of Trustees for ratification, or it may be added to an agenda for a Special Called KRS Investment Committee meeting. Lastly, Mr. Gilbert provided an update on proxy voting. Ms. Hale advised that the Board had already voted and approved what they wished the proxy voting policy to be; therefore, Staff is authorized to amend and implement the policy. Mr. Willer stated that the Office of Investments is working to implement the policy. Mr. Chilton asked if there are guidelines given to managers

regarding how to vote. Mr. Willer stated that KRS and CERS each have a proxy voting policy and that the managers vote according to the provided proxy voting policy. Ms. Thompson asked if there is a reviewing process to see how managers have voted. Mr. Gilbert stated that he receives proxy voting reports which may be reviewed, if needed. Ms. Hale also advised that the Compliance Officer may conduct an internal audit of those votes to confirm that the managers voted according to the policy. Mr. Adkins asked Mr. Eager if there has been any effort to coordinate voting on issues among State pension plans. Mr. Eager stated that there has been collaboration at the State Attorney General level regarding ESG issues.

Mr. Lane introduced agenda item *Staffing Update and Other Planning Issues*. Mr. Eager stated that he was asked by the Public Pensions Oversight Board (PPOB) if/how proxy voting is monitored. Mr. Eager expressed that he would be comfortable with auditing a sampling of votes and urged Staff to complete that audit as soon as possible. He reported that the approved Senior Investment Analyst position was approved by the Personnel Cabinet and that the request for the compensation for that position is with the Governor's office. Mr. Willer has requested support to begin recruiting for the Private Equity Portfolio Manager position, said Mr. Eager. Mr. Eager advised that conversations with Mr. Willer and Dr. Hackbart have taken place regarding staffing needs. It was agreed to begin researching the utilization of more passive assets and bringing additional assets in-house. Mr. Eager stated that approximately \$215 million is spent on investment management fees and would like to bring an additional 10% of assets in-house. Mr. Willer added that the immediate need is to fill existing positions to provide relief to Staff. Mr. Lane mentioned a target of 35% of assets in-house, said Mr. Willer, and believed that to be a realistic and long-term goal once fully staffed. Ms. Thompson asked how often the fee with Wilshire Associates is

reviewed. Mr. Willer stated that the contract needs to be amended and that relationship is continually being evaluated. Mr. Eager added that the relationship with Wilshire has been about five years thus far and should be reviewed and evaluated to ensure that they are meeting current needs. Mr. Adkins asked if multiple states have thought to come together to create an investment office. Mr. Willer stated that he was not aware of this but agreed that it would make sense from an investment standpoint. Mr. Eager commented that KPPA is doing that, in a way, as the Office of Investments runs five different pensions and five different insurances. Mr. Eager stated that the topic of a broader combining effort in Kentucky with Kentucky Teachers' Retirement and Deferred Compensation has been on the table in the past but gains no traction. Ms. Hale stated that she is unaware of any cross-border occurrences; however, she indicated that approximately six states have investment boards. These state investment boards invest for local, municipal, and state systems which subscribe. Mr. Lane stated that he had completed an analysis in the past which indicated that the State would save approximately seven million dollars to merge all Bloomberg contracts, consulting, etc.

There being no further business, Mr. Cheshire made a motion and was seconded by Mr. Adkins to adjourn the meeting. The motion passed unanimously.

Copies of all documents presented are incorporated as part of the minutes of the Kentucky Retirement Systems Investment Committee meeting held November 10, 2022.

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CERTIFICATION

I do certify that I was present at this meeting and I have recorded above the action of the Committee on the various items considered by it at this meeting. Further, I certify that all requirements of KRS 61.805-61.850 were met in connection with this meeting.


Recording Secretary

I, as Chair of the Kentucky Retirement Systems Investment Committee, do certify that the Minutes of the meeting held on November 10, 2022 were approved by the Kentucky Retirement Systems Investment Committee on February 14, 2023.


Committee Chair

I have reviewed the Minutes of the Kentucky Retirement Systems Investment Committee Meeting on November 10, 2022 for form, content, and legality.


Office of Legal Services