

**MINUTES OF MEETING  
KENTUCKY RETIREMENT SYSTEMS  
INVESTMENT COMMITTEE MEETING  
AUGUST 24, 2021 AT 10:00A.M.  
VIA LIVE VIDEO TELECONFERENCE**

At the August 24, 2021 Investment Committee Meeting, the following members were present: Prewitt Lane (Chair), John Cheshire, Kelly Downard, Keith Percy, and Joseph Grossman. Staff members present were David Eager, Steven Herbert, Rebecca Adkins, Erin Surratt, Michael Board, Victoria Hale, Jared Crawford, Steve Willer, Anthony Chiu, Joseph Gilbert, Carol Johnson, Ashley Gabbard, Sherry Rankin, Crystal Smith, Shaun Case, Phillip Cook, and Glenna Frasher. Also in attendance were Danny White and Janie Shaw from GRS.

Mr. Prewitt Lane called the meeting to order.

Ms. Victoria Hale read the Legal Public Statement.

Ms. Carol Johnson called roll.

Mr. Lane introduced agenda item *Public Comment*. Ms. Carol Johnson stated that no public comments were submitted.

Mr. Lane introduced agenda item *Approval of Minutes – May 4, 2021*. Mr. Joe Grossman made a motion and Mr. John Cheshire seconded to approve the minutes as presented. The motion carried.

Mr. Lane introduced agenda item *Discussion of Standard Reports*. Mr. Steven Herbert began by stating that this is a bit of housekeeping in that prior to the split standardized reports were given to the Board as a whole. He wanted to give an overview of the Reports that were being given to the Board previously, and describe how these reports will look going forward. Mr. Herbert stated that some of the reports, such as the Monthly Report, are currently being posted on the website, and will most likely continue to be going forward. Other reports, such as the Commissions Report and

Capital Calls Report could be replaced with reports that provide information that is more meaningful to the Board for planning purposes when it comes to private assets. Mr. Herbert just wanted to address the issue and wanted the Committee to know he is doing research on what reports would be more beneficial. For example, he suggested doing a Transaction Cost Analysis type of report on a periodic basis or having an asset class with a manager at each meeting going forward. In summary, Mr. Herbert would just like to see better reporting that would be more beneficial to the Committee as a whole. Mr. Lane followed up with stating that great progress is being made to provide information that is more meaningful rather than an information dump and that will just strengthen the Committee's fiduciary responsibilities.

Mr. Lane introduced agenda item *Performance Report*. Mr. Lane began by making an editorial comment stating that he wanted to give credit to the staff for a great job this past year. When looking at the long-term performance, the asset mix is the determining factor on whether or not the Board was successful in meeting their goals. Underneath that is the ability to choose managers who create excess return over and above their goals and the staff has done an amazing job the last couple of year in positioning the plans. Many of the managers have out-performed their benchmarks and that is a great commendation to the investment staff who were able to get the plans into that position. Mr. Herbert then spoke about the time constraints of the meeting and that he would not be reviewing the full report, but wanted to highlight a few areas. Mr. Herbert went over the market performance during the last quarter. Mr. Herbert then reviewed the Asset Allocation vs Targets chart, Risk Categorization Summary, Total Performance, Total Asset Allocation Over Time, Total Summary Growth Chart, for the KERS Plans, the SPRS Plan, and the Insurance Trust Plan were all reviewed by Mr. Herbert. Mr. Grossman asked Mr. Herbert if he had a timeframe for when the Plans would get back into compliance with the allocations set forth in the IPS? Mr. Herbert responded that he thinks with real estate, it may take a little longer and it may be by the end of the year. Mr. Grossman then commented that he wasn't pushing to get there, but felt like they needed to discuss and understand why the Plans are outside the IPS and then decide if it's good or not. He felt like discussions were needed about where we are outside of the allocations within the IPS, why we are outside, and if and/or when we would back within them. Mr. Herbert answered that the reason we are outside of the real estate allocation is due to policy change and the inability to get a new manager; for the real returns it is more due to market issues.

Changes are being implemented and he is hopeful that things will align closer to the allocations more toward the end of the year. Mr. Lane remarked that through the years the staff has brought forth several discussions about things such as farm land, timber, things that after researching it further, while they are real returns, the cash on cash doesn't exceed our 6 ¼ so it makes it difficult. While they look like they would have a good return, it just is not a good enough real return. Mr. Grossman indicated he did not disagree but only wanted to ensure that it was at least discussed and preserved in the minutes of the meetings.

Mr. Lane introduced agenda item *Public Equity Search*. Mr. Lane began by indicating this was an excellent search in a relatively difficult space. The decision was made earlier in the year to expand into the non-US market, specifically the Small Cap market. That is a much less efficient market, but does respond well with good management. The search was completed with the assistance of Wilshire and Associates, who worked with investment staff throughout the process. One unique aspect of this search was that once a short list was compiled of the final candidates, Wilshire and the investment staff conducted reviews of the candidates independently and then brought their findings together afterwards. This process just added another risk factor layer. Mr. Joe Gilbert reviewed his report on the External Manager Search and Section Report for Non-US Small Cap Equity. The report was a review of the competitive search process utilized by the investment staff in accordance with the Investment Policy Statement and the Investment Procurement Policy in an effort to improve market access within the Non-US equity allocation. Utilizing the database from Wilshire and Associates containing over 12,000 strategies, and applying the screening criteria, narrowed the list to 11 candidates. Those 11 candidates were sent a Request for Information, which the investment staff and Wilshire reviewed independently of each other, and a list of the top five potential candidates was formed. These five finalists were given the opportunity for presentations before the final decision was made. The finalist was a company called Axiom, founded in 1998 and headquartered in Connecticut. Axiom is a 100% employee owned company whose focus is on global, international, and emerging market strategies. Mr. Gilbert reviewed Axiom's Investment Philosophy, Investment Process, and Portfolio Construction. Mr. Gilbert stated that the investment team is not asking the Board to invest in a new market, as KRS has been investing in Non-US small cap for quite some time, staff just feels they can do it in a more efficient manner that's likely to produce an out performance over a market cycle. The investment team

would recommend funding the Axiom mandate from the existing mandates in Northern Trust and Black Rock. The initial funding would be at the current 3.2% level, and staff is seeking approval for up to 5% to allow for future growth and rebalancing. Mr. Kelly Downard asked if it was staff's plan to grow the fund from 3.2% to 5% initially? Mr. Gilbert responded that no, the initial plan is to invest at the same 3.2%, and as staff gains experience with the strategy and sees what different opportunities in the market unfold, they wanted the ability to rebalance if an opportunity presents itself, and it is to the Plan's advantage. Mr. Downard asked a question on whether staff has this same flexibility with our other managers. Mr. Gilbert indicated that staff does, but historically staff had made recommendations based on a dollar amount, and as the portfolio grew, there became a need to transition to a percentage basis instead of a dollar amount basis. Mr. Joseph Grossman asked the question about whether the IPS lists a minimum and maximum so that this flexibility is already built in. Mr. Gilbert indicated that they are at the asset level, but these are at an individual strategy level. Mr. Grossman then asked if staff was just asking the Board to give them the flexibility here that staff has in the overall IPS. Mr. Herbert responded yes, the IPS does have the flexibility to add and subtract from specific strategies. Mr. Grossman asked a question regarding the fees. He referenced a figure stated by Mr. Gilbert in his presentation, which was a fee of 68 basis points, but is the Plan currently paying a fee in their current active management. Mr. Gilbert indicated that yes, the Plan is paying a fee currently, and these fees would be higher obviously because we are in an export portfolio. Mr. Gilbert indicated that the investment team is very mindful of fees, and would only suggest moving forward if it was to the Plans advantage. Mr. Larry Totten asked a question regarding a chart shown in Mr. Gilbert's presentation where it shows that as of June 30, 2021, there was \$159.2 million invested, and then a different chart is showing that we will be investing \$159.2 million with Axiom. The question was whether Axiom is just taking over the management? Mr. Gilbert indicated that currently the \$159.2 million is invested over two portfolios, Northern Trust and Black Rock, so if approved, the Plans will be transitioning those funds to Axiom. Mr. Cheshire made a motion and Mr. Grossman seconded to retain Axiom Investors as the manager for the Non-US Small Cap Equity mandate, subject to successful contract negotiations. The motion carried. Mr. Grossman questioned what would occur if the CERS Investment Committee did not vote to retain Axiom. Mr. David Eager mentioned that the vote would have to be revisited if that would occur.

Mr. Lane introduced agenda item *Research Management System Presentation*. Mr. Steven Herbert reviewed the software program that is intended to centralize the manager research assets to bring efficiency to internal document processes. The main purpose is to not only assist the Division Directors, but will be able to assist with investment reporting and compliance as well. Mr. Herbert provided some screenshots of what a “wall” would look like and how much information can be monitored using this program. Mr. Herbert indicated that this is an ongoing project and is hopeful to be using this toward the end of the year.

Mr. Lane introduced agenda item *GRS Stress Test*. Mr. David Eager commented that this is becoming an increasingly used process of most state retirement systems. Mr. Eager was recently asked at the PPOB meeting whether the Plans would be conducting a stress test, and Mr. Eager was able to respond that this is already in the process. There is an awareness of the tool and a growing appreciation for the information it can provide. Mr. Danny White and Ms. Janie Shaw presented the 2020 Stress Test Analysis for the Kentucky Retirement Systems. This report was based on the June 30, 2020 Actuarial Valuation, but does not reflect the 2021 legislation nor does it reflect the 2021 investment experience. The analysis types include contribution risk, investment return volatility, stochastic simulations, deterministic projections and outcome based events. Mr. White then reviewed the Investment Return Volatility chart and the outcome based events. He indicated that this stress test was only performed on the Pension Funds, but the same would hold true with the Insurance Trust Funds. Ms. Shaw reviewed the key points derived from the test. Prior to the passing of House Bill 8, for the KERS Non-Hazardous Pension Fund, there was a continual decline in covered payroll that was a significant risk to the participating employers. Even with the passing of House Bill 8, the contribution risk is still a significant risk to the KERS fund because of its current funded status. Ms. Shaw indicated that the biggest risk to the KERS Non-Hazardous Pension Fund is still receiving less than the actuarially determined contributions. In 2019, the amortization period reset to 30 years, and while that is not necessarily bad, if it occurs more frequently, it can cause further detriment to the fund. Ms. Shaw then discussed the investment risk of the KERS Non-Hazardous Pension Fund, citing the significant less risk to the fund as measured by the change in required contributions. This is because it has a relatively lower funded ratio than the other systems. Ms. Shaw then moved to the KERS Hazardous Pension Fund, which has the most investment risk, measured by the change in contribution rate. This is because

it is significantly better funded than the other two funds. Ms. Shaw indicated that the projected funded ratio is expected to improve under the “more likely than not” scenarios. This is in part because of the relatively strong funding policy. Ms. Shaw then reviewed the key points in the State Police Retirement System Pension Fund, which is more similar to the KERS Non-Hazardous Pension Fund. The biggest risk to the SPRS Pension Fund is receiving less than the actuarially determined contributions. Again citing the issue of the resetting of the amortization period as a potential detrimental component. Ms. Shaw reported that the contribution rates would continue to increase if covered payroll continues to decline. The potential volatility in future contribution rates for the SPRS Pension Fund is relatively high because the Fund has a higher leverage of liability to payroll. In the SPRS Fund, \$22 in liability for every \$1 in covered payroll, compared to KERS Non-Hazardous Fund where \$11 in liability for every \$1 in covered payroll. This concluded the presentation of the Stress Test performed by GRS. Mr. Grossman asked a question regarding the resetting of the amortization period every 6 years. In that, didn’t that occur back in 2019? Mr. Eager spoke and indicated that the amortization did occur in 2019, but the issue would be if they continue to reset it every 6 years or so. Mr. Grossman asked if this was a one-time reset. Mr. White answered that the State claims it was a one-time reset, but has a habit of doing it repeatedly, as this is like the third or fourth time the funding period has been reset to 30 years. With this latest reset, the State did indicate that any new funding is to be based on a 20-year period, so it is hoped that this will break the cycle. Mr. White stated that the biggest risk is the budget risk, of the State not putting in the calculated rate or if they alleviate or try to make the contribution rate smaller. Mr. Eager stated that the Plans now have Ed Owens and John Chilton added to the team. It is one of the Plan’s duties to educate the legislators and the governor’s office, but the legislators primarily, about the impact of the legislative decisions on the systems. The Plans cannot control the investment returns to a large extent, but we try to understand what might happen; the Plans do not control the payroll; and they do not control the resets of the amortization periods. However, what the Plans can do is educate the legislators on the negative impact of doing these things and now that the Plans have this information, it will be shared with them.

Prior to the adjournment, Lynn Hampton, as a new Trustee, wanted to thank the Committee for the invitation to watch these proceedings. Mr. Eager reported that there are three (3) new Trustees going through orientation later in the week.

Mr. Grossman made a motion and Mr. Cheshire seconded to adjourn the meeting. The motion carried.

Copies of all documents presented are incorporated as part of the Minutes of the Kentucky Retirement Systems Investment Committee meeting held August 24, 2021.

### **CERTIFICATION**

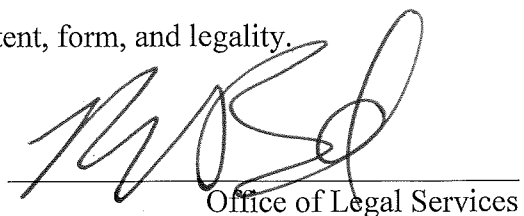
I do certify that I was present at this meeting, and I have recorded the above actions of the Committee on the various items considered by it at this meeting. Further, I certify that all requirements of KRS 61.805-61.850 were met in conjunction with this meeting.

  
Recording Secretary

I, as Chair of the Investment Committee of the Board of Trustees of the Kentucky Retirement Systems, do certify that the Minutes of Meeting held on August 24, 2021 were approved by the Committee on November 3, 2021.

  
Committee Chair

I have reviewed the Minutes of the August 24, 2021 Investment Committee Meeting of the Board of Trustees of the Kentucky Retirement Systems for content, form, and legality.

  
Office of Legal Services