

**MINUTES OF MEETING
COUNTY EMPLOYEES RETIREMENT SYSTEM
INVESTMENT COMMITTEE MEETING
AUGUST 31, 2022, 2:00 P.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the August 31, 2022 County Employees Retirement System' (CERS) Investment Committee Meeting, the following Committee members were present: Dr. Merl Hackbart (Chair), George Cheatham, Dr. Martin Milkman, William O'Mara, and Jerry Powell. Staff members present were David Eager, Erin Surratt, Michael Board, Victoria Hale, Steve Willer, Joseph Gilbert, Jared Crawford, Anthony Chiu, Shaun Case, Ashley Gabbard, Katie Park, and Sherry Rankin. Also in attendance were CERS CEO, Ed Owens, III, CERS Trustee Betty Pendergrass, KRS Trustee Prewitt Lane, as well as LouAnn Eisenhut, David Lindberg, Craig Morton, and Chris Tessman with Wilshire Advisors, LLC.

Dr. Hackbart called the meeting to order.

Ms. Hale read the Legal Opening Statement.

Ms. Rankin took Roll Call.

Ms. Rankin informed the Committee that two *Public Comments* were received and read the first comment from Patricia Thorpe aloud to the Committee:

I wrote a letter to my Representative on June 27, 2022 regarding a cost of living adjustment (COLA) on my CERS police pension. We have not had any COLA since July 2011. In response to my letter, Mr. Kevin Bratcher informed me "it is not the legislature that would fund a COLA, it is the CERS Board's decision-please contact them on this issue." I am hereby contacting you as instructed and hoping that the CERS Board will take the necessary steps to assist us former employees who dedicated our life in careers to helping others in the commonwealth of this state. Now we need your help. Since 2011 there has been a cumulative price increase of almost 30%. The most recent rise was the highest in over 40 years. I hope this Board will take all of this into consideration and do what you can to facilitate a much needed raise and work with the General Assembly as deemed necessary. I thank you for any assistance you can give in this matter. Sincerely, Patricia and my brothers and sisters in blue.

Ms. Rankin read aloud the second comment from Terra Long:

I am respectful requesting that our COLA be added back to our retirements. It has been many years since it was frozen and what use to be a decent retirement now is not. We gave many years of our service at lower pay than that of the private sector and were promised a pension that included COLA. Our representative have failed to support retired works time after time in our reinstatement of our COLA only to vote themselves a 8% raise. It's time to do the right thing and take care of the people who took care of our state for so many years. Thank you for your consideration.

A response to the submitted public comments was made by Mr. Michael Board, Executive Director of the Office of Legal Services on behalf of the CERS Investment Committee:

Thank you for your comment regarding cost of living adjustments (COLA). It is an issue that has received a lot of attention over the past several months. The CERS Investment Committee recognizes the significant length of time since a COLA was granted to members of CERS. The decision of when to grant members of CERS a COLA does rest solely with the General Assembly. KRS 61.691 states the General Assembly must pre-fund any COLA if the underlying system is not 100% funded. This statement is true for the KERS and SPRS retirement plan documents. Chapter 78 of the Kentucky Revised Statutes which governs the retirement plan documents for CERS states at KRS 78.5518 that a COLA can only be paid to beneficiaries if: (1) the plan is 100% funded; or (2) the General Assembly directs payment of employer contributions to fully pre-fund the increase described by this subsection in the year the increase is provided. Your representative was correct in that any COLA for members of CERS would be paid for by the CERS trust. However, only upon direction by the General Assembly to pre-fund the increase. Consequently, the COLA decision for CERS members remains a function under General Assembly control.

Dr. Hackbart requested that the above response be sent to those who submitted the public comments.

Dr. Hackbart introduced agenda item *Approval of Minutes – May 25, 2022*. A motion was made by Dr. Milkman and seconded by Mr. Powell to approve the May 25, 2022 minutes as presented. The motion passed unanimously.

Dr. Hackbart introduced agenda items *Quarterly Performance Report and Investment Office Update*. Mr. Craig Morton with Wilshire Advisors, LLC briefly reviewed the economic growth,

consumer activity, inflation and employment, U.S. equity market, non-U.S. equity market, U.S. fixed income, and asset class performance for the second quarter. Mr. Willer presented the KPPA Monthly Performance Update and portfolio returns. He stated that June was a difficult month for the markets. The CERS Nonhazardous portfolio was down 4.49%, CERS Hazardous was down 4.55%, CERS Nonhazardous Insurance was down 4.29%, and CERS Hazardous Insurance was down 4.22%. All plans underperformed against their benchmark index for the month of June between 43 and 79 basis points. Mr. Willer reported that an underweight in real return was a negative driver of performance across the plans. There were also underperformance in private equity and real estate relative to their benchmarks. Despite a very volatile 12-month period, the plans held up relatively well in the fiscal year ending June 30, 2022, said Mr. Willer. The CERS Nonhazardous pension was down 5.9% with 51 basis points of outperformance, CERS Hazardous was down 6.07% with 34 basis points of outperformance, CERS Nonhazardous Insurance was down 5.43% with 79 basis points of outperformance, and CERS Hazardous Insurance was down 4.99% with 123 basis points of outperformance. He stated that the largest positive contributors to performance in an asset allocation within an asset class were high-yield, specialty credit, and core fixed income. The Plan Sponsor Peer Group Analysis for the CERS Pension Plan was reviewed which included return, standard deviation, and sharpe ratio metrics. Mr. Willer reported that markets were also volatile in July with global equities up over 7%. The U.S. markets outperformed their non-U.S. counterparts and the funds were up about 4.5% for an outperformance of approximately 70 to 75 basis points. Mr. Willer stated that the Office of Investments continues to be cautious and opportunistic due to the unprecedented volatility and uncertainty of the markets. Dr. Milkman asked for additional explanation regarding the sharpe ratio metrics. Mr. Willer explained that the sharpe ratio indicates the amount of return relative to the amount of risk taken.

Mr. Hackbart asked Mr. Morton what is to be expected from the Federal Reserve Board (Fed) in the future. Mr. Morton stated that Wilshire Advisors, LLC is not one to predict the actions of the Fed; however, Mr. Morton stated that he believes that the Fed will continue to raise rates in order to combat inflation. Mr. Willer added that it will take time for inflation to decrease and that the Fed will need to see weakness in the job market before they stop increasing rates. Dr. Hackbart stated that there are many variable factors which affect the overall performance of the economy for the Fed to consider. Mr. Cheatham asked when the June 2022 Asset Class Assumptions (meeting materials, p. 7) were last reviewed and reassessed. Mr. Morton advised that the assumptions are updated quarterly. Next, Mr. Willer presented the CERS Pension Plan Asset Allocation Compliance for the period ending June 30, 2022. He reiterated that asset allocation was a hindrance on performance. The most significant divergences from allocation targets were in public equities, specialty credits, and real return. Mr. Willer reported that about one billion dollars was invested in public markets across the pension and insurance trust with about 650 million of those funds for CERS Nonhazardous and CERS Hazardous pension and insurance. He stated that about 85% of that activity took place in the month of June. Additionally, there is about 400 million in committed capital for both real estate and private equity mandates. Mr. Willer reported that the Office of Investments is currently engaged in several searches in various stages including multi-asset inflation-sensitive commodities, agriculture, infrastructure, and a variety of unique real asset strategies. Staff is also evaluating using liquid public securities and short-term proxies for the private asset classes. Mr. Willer stated that the approved asset allocation ranges are the guide under which Investment Staff will continue to operate moving forward. He advised that the asset allocations are reviewed annually per the Investment Policy Statement (IPS). Mr. Cheatham asked for a timeline regarding moving the real return and specialty credit allocations into range as they

have been outliers for about a year. Mr. Willer stated that it will take several mandates to move those allocations back into range and reach their targets. Mr. Willer advised that he is working towards making significant progress by the end of the year. Mr. Willer directed the Committee to the meeting materials and advised that a new Compliance Report, Unit Holding Report, and additional informational reports have been provided. Dr. Milkman asked Mr. Willer if KPPA utilizes too many external managers. Mr. Willer stated that he believes so and plans to reduce the number of external managers in the future. Mr. Jared Crawford reviewed the CERS Compliance Report for the period ending June 30, 2022. Mr. Crawford stated that the report is a work-in-progress and welcomed feedback from the Investment Committee. He reviewed the various visual aids and graphics in the report illustrating plan asset allocation ranges and targets. Mr. Crawford stated that he receives a compliance report daily and is notified of any changes. He advised that the only area not in compliance was the S&P 500 portfolio due to fractional shares held. Mr. Crawford said that implementing a de minimus rule for exceptions has been discussed internally. Mr. Willer added that the fractional shares cannot be sold but can be cleaned up via BNY Mellon. Dr. Milkman asked for the total value of the fractional shares in dollars. Mr. Joe Gilbert stated that the combined value is approximately \$3,000. Further, Mr. Gilbert stated that he may be able to sell the Kyndryl Holdings, Inc. if it is a full share; however, the others will need to be cleaned up on the account. Mr. Cheatham urged Mr. Willer to remedy the S&P 500 portfolio compliance issue. Mr. Willer said he would draft a de minimus exception and seek feedback on what the appropriate threshold should be. Dr. Hackbart was pleased with that approach. Mr. O'Mara advised that other organizations must face the same issue and may be a helpful source for best practices on fractional shares.

Dr. Hackbart introduced agenda item *Initial Trust Budget*. Mr. Steve Willer presented the Initial Trust Budget. Mr. Willer stated that this was the first year that KPPA budgeted trust expenditures. KPPA is required to report all investment expenses to the Public Pension Oversight Board (PPOB) by statute beginning November of 2022. In response, a working group was formed to discuss the Administrative Budget and the Trust Budget. Mr. Willer advised that the Trust Budget will be reported to the CERS and KRS Investment Committees on a quarterly basis moving forward. The Trust Budget includes four main categories: consulting services, legal and auditing services, and contractual services. Mr. Willer stated that investment-related expenditures are paid directly from trust funds, but are not included in the administrative budget. Mr. Willer stated that a key or detailed description of the services provided by fee will be added for each line item to provide context. Mr. Cheatham expressed concern and stated that the trust budget had increased drastically over the past five years. He asked if the Trust Budget had been reviewed or approved by the Board of Trustees. Mr. Willer advised that the Trust Budget had not been presented in the past. Mr. Cheatham stated that per the presented Trust Budget, the BNY Mellon Custodial fees had increased by 100%. Mr. Willer explained that this high-increase was due to five quarters of fees being paid in one fiscal year; whereas, three quarters were paid in another fiscal year. Additionally, Mr. Willer explained that custodial fees are dependent on accounts and transactions. Mr. Cheatham added that there was an increase of 102% in legal fees. Mr. Willer stated that all legal fees are related to investment litigation. Mr. Michael Board confirmed that these legal fees are indeed due to investment-related litigation in Kentucky and other states. Mr. Board stated that these fees have increased substantially in recent years as litigation continues. Dr. Hackbart asked Mr. O'Mara if the CERS Finance Committee was also reviewing the Trust Budget. Mr. O'Mara stated that he was a part of the group which reviewed the Administrative Budget and requested that a Trust

Budget be created and shared with the Investment Committees. Mr. O'Mara explained that the CERS Finance Committee does not have oversight, but the CERS and KRS Investment Committees do have oversight of the Trust Budget moving forward. Mr. O'Mara added that the budget may improve in accuracy overtime as oversight increases. Dr. Hackbart stated that the discussed appendix/key to the Trust Budget would be beneficial and suggested that perhaps a special called meeting be held to further review the Trust Budget, if needed.

Dr. Hackbart introduced agenda item *Staffing Update*. Mr. Willer provided an update on staffing within the KPPA Office of Investments. He stated that the Division has limited bandwidth, however, the Staff has been successful in navigating all challenges faced and have been able to consistently meet investment objectives. Mr. Willer announced that he is working with KPPA Human Resources and the Governor's Office on the development of new Junior and Senior Investment Analyst positions. Mr. Willer stated that those roles would provide support across asset classes and functions. Mr. Willer stated that recruiting has been challenging and it will take time to fill these roles with the right candidates. Mr. Milkman stated that he had heard predictions of layoffs on Wall Street; therefore, the coming months might be a good time to recruit for those positions. Mr. O'Mara thanked Mr. Willer and his Staff for the expanded reporting which provides additional transparency and improves Trustee knowledge of investment activities.

Dr. Hackbart thanked Wilshire Advisors, LLC, Mr. Willer, and Staff for their presentations and requested a motion to adjourn. A motion was made by Mr. O'Mara and seconded by Mr. Cheatham to adjourn the meeting. The motion passed unanimously.

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 County Employees Retirement System Investment Committee of the Board of Trustees of the County Employees Retirement System, do certify that the Minutes of the meeting held on August 31, 2022 were approved by the County Employees Retirement System Investment Committee on November 22, 2022.


Committee Chair

I have reviewed the Minutes of the County Employees Retirement System Investment Committee Meeting on August 31, 2022 for form, content, and legality.


Office of Legal Services