

**MINUTES OF MEETING
COUNTY EMPLOYEES RETIREMENT SYSTEM
INVESTMENT COMMITTEE MEETING
FEBRUARY 16, 2022, 2:00 P.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the February 16, 2022 County Employees Retirement System' (CERS) Investment Committee Meeting, the following Committee members were present: Dr. Merl Hackbart (Chair), George Cheatham, II, Jerry Powell, William O'Mara and Dr. Martin Milkman. Staff members present were David Eager, Steven Herbert, Victoria Hale, Rebecca Adkins, Ashley Gabbard, Erin Surratt, Steve Willer, Anthony Chiu, Joseph Gilbert, Jared Crawford, Ann Case, Natalie Young, Kristen Coffey, Sherry Rankin and Carol Johnson. Also in attendance were CERS' CEO Ed Owens and Kentucky Retirement Systems' CEO John Chilton and CERS Trustee Betty Pendergrass.

Dr. Hackbart called the meeting to order and Ms. Hale read the opening statement.

Dr. Hackbart introduced agenda item *Roll Call* and Ms. Johnson called roll.

Dr. Hackbart introduced agenda item *Public Comment*. Ms. Johnson stated that no public comments were submitted.

Dr. Hackbart introduced agenda item *Approval of Minutes November 8, 2021*. Mr. O'Mara moved and was seconded by Mr. Cheatham to approve the minutes as presented. The motion passed unanimously.

Dr. Hackbart introduced agenda item *Management Fee Presentation*. Dr. Hackbart stated that Ms. Case and Ms. Young would give the management fee presentation and their observations. Ms. Case introduced herself and informed the Committee that she is the Assistant Director of Accounting, Investment Operations Branch with Kentucky Public Pensions Authority (KPPA). Ms. Case stated that management asked her to give a brief presentation on the reporting and review process of the management fees. Ms. Case stated that she would start by giving a history of how KPPA arrived at where it is today and then she would turn the presentation over to Ms. Young, KPPA's Branch Manager. Ms. Case further stated that Ms. Young would outline KPPA's current processes. Ms. Case stated that during the last eight to ten years the discussion of fees has been a very hot and controversial topic. Ms. Case stated that there has been a lot of discussion around how the fees should be reported and defined and that there is no real uniform guidance. Ms. Case stated that this has left a lot of the decisions on how to report the fees in the hands of the reporting agents, which here is KPPA, and that all of the reporting agents have different opinions on the matter. Ms. Case stated that she was not going to debate that topic, but that she just wanted to give the Committee a history and let them know why different retirement systems are reporting fees in different ways. Ms. Case stated that in 2015 most of the managers she tracked for the systems did not report management and performance fees and the fees were netted and were not reported as a single line item. Ms. Case further stated that the fees were not billed through an invoice and most were not reported on the quarterly reports; however, this was not an uncommon practice. Ms. Case stated for the most part the only managers that billed KPPA via an invoice for their fees, and were captured and reported, were primarily public equity and fixed income managers. Ms. Case stated that prior to 2015 fees were captured, but it was primarily only the managers that were being

invoiced as well as a few managers that voluntarily reported fees. Ms. Case stated that around 2015 the decision was made to request that all managers begin reporting management and performance fees. Ms. Case stated that as a result of this reporting change that the overall investment expenses almost doubled, which created a lot of attention surrounding the fees at that time. Ms. Case stated that for the next three years KPPA took time to ensure that the fees were being captured and reported correctly, because this was a new process not only to KPPA but to the custodial bank and KPPA's account team. Ms. Case stated that we were constantly being questioned about our fees and why they were so much higher than other retirement systems. Ms. Case stated that while this was easily explained it was not visible on our financial statements. Ms. Case stated that in looking at the financial statements all of the fees were reported in a single line and were classified as investment expenses. Ms. Case stated that what used to be just management fees was now both management and performance fees combined. Ms. Case stated that in 2017 the legislature passed Senate Bill 2 (SB2), which required KPPA, Kentucky Teacher's Retirement System, Kentucky Judicial Retirement Plan and the Kentucky Legislators Retirement Plan to include profit sharing, carried interest and partnership expenses in their reporting of investment fees. Ms. Case stated that in 2018 KPPA made the decision to report performance fees as a separate line item. Ms. Case stated that the following year KPPA separated out the overall investment expenses, which included the performance fees. Ms. Case stated that the hope was that this would allow KPPA to continue to be transparent with our fees, but also to have a better comparison when one compares KPPA to other retirement systems which are only reporting management fees. Ms. Case stated that while there is still no real guidance on how fees should be reported she does see a trend towards more plans reporting all of their fees in some manner. Ms. Case stated that some plans report them on the face of their financial statements, like KPPA does, and some report them as supplemental

information to the financial statements. Ms. Case then turned the presentation over to Ms. Young to give some insight on KPPA's review process and what is reported to everyone. Ms. Young introduced herself as the Investment Operations Branch Manager at Kentucky Public Pensions Authority and explained that she is responsible for management and performance fees on a couple of different levels. Ms. Young stated that the management fees are paid in one of two ways. They are either invoiced to KPPA or they are netted by the manager against income for those fees that are invoiced. Ms. Young stated that the Investment Director reviews the invoice to ensure that the fees conform with the manager agreement and that once the Investment Director approves an invoice for payment it is sent to Investment Operations and Investment Operations processes the payment in the BNY Mellon system. Ms. Young further stated that the fees that are netted are reported to KPPA by the manager on their monthly or quarterly statements and then BNY Mellon records the fees in their system. Ms. Young stated that Investment Operations monitors the reporting of the management fees ensuring what the manager reported is the same as what BNY Mellon reported. Ms. Young stated that the manager fees that are netted are also reviewed by staff. While staff do not recalculate the fees, they do review them to ensure that they are at or below the manager's fee schedule and any errors or discrepancies that are found are discussed with the Office of Investments. Ms. Young stated that KPPA would then contact the manager to discuss the discrepancy. Ms. Young stated that, in addition to reviewing the fees, Investment Operations also reports the fees each quarter to the Investment Committees and posts the fees on the KPPA website. Ms. Young reviewed the current reporting process with the Committee members and stated that this report may look familiar because it is part of the standard reports that are given out to the Investment Committees each quarter. Ms. Young stated that the report captures all of the fees that are reported by each asset class and are separated out between manager, performance and

miscellaneous fees. Ms. Young then reviewed the presentation slide titled Current Reporting Process Cont'd and stated that it showed an example of what is reported on the KPPA website. Ms. Young stated that this report showed the manager and performance fees by asset class and it also showed the market value, which allows one to see what the total fees were compared to the market value. Ms. Young stated that this report is required by SB2. Ms. Young thanked the Committee for allowing her to present to them and stated that if there were any further questions that the Committee members may reach out to KPPA staff who would be happy to answer them. Dr. Hackbart asked if anyone had any questions for Ms. Case or Ms. Young. Mr. Cheatham asked if the report on page 18 in Board Books was the report that is published on the KPPA website. Ms. Case replied yes. Mr. Cheatham stated that he thought KPPA was supposed to be reporting the fee as a percentage as well. Ms. Case stated that it is on the bottom of the report at the total level and the document referred to is just a small portion of the report to give the Investment Committee an example of what is on the KPPA website. On the KPPA website is the full report and at the very bottom the total assets under management and the fees and the basis points that are associated with them are found. Mr. Cheatham stated that it is not listed line by line percentage per manager. Ms. Case stated no, but that she could certainly add that additional information if the Committee wanted. Mr. Eager asked if the Committee would like to see that. Dr. Hackbart replied yes that it would certainly be more meaningful, otherwise, the Investment Committee is just looking at numbers. Ms. Case stated that she would get that information added to the report. Dr. Hackbart asked Ms. Case about the earlier observations regarding the higher fees as a result of combining management and performance fees together and asked if that was the correct interpretation. Ms. Case replied that prior to 2018 on the financial statements KPPA had one line item and listed those fees as investment expenses, which included management, performance and any miscellaneous

fees. Ms. Case further stated that when staff added in the performance fees, which is what some retirement systems do not have, it made our fees look much higher. Ms. Case stated that is why KPPA separated out the fees beginning in 2018 to show that KPPA is more in line with other retirement systems. Dr. Hackbart asked if there are standards that KPPA could comply with and follow for comparison of management fees with peer groups for analysis. Ms. Case stated that there has been a lot of discussion regarding that topic and currently ILPA is probably the primary standard, but it is not a requirement. Ms. Case stated that several of the managers do report to KPPA with the ILPA format. ILPA has a very detailed report that is provided, but right now there are no requirements forcing managers to use that format. Ms. Case believed that in the near future there will be more guidance and standards to be followed. Dr. Milkman asked why there wasn't as performance fee listed on the report that she had been referencing. Ms. Case apologized stating that this is just a sample of the full report, but if the Investment Committee members look at the KPPA website they would see the performance fees. Ms. Case stated that what was being shown was public equity and fixed income, which do not have performance fees associated with them. Ms. Case stated that performance fees are primarily associated with limited partnerships, which are shown on the KPPA website. Ms. Case apologized and stated that she should have added the full report in the presentation. Mr. Cheatham suggested that staff put a zero in the performance fee column for transparency purposes. Mr. Eager suggested that staff add not applicable (N/A) in the performance fee column if there are no performance fees associated with it. This item was provided for informational purposes only.

Dr. Hackbart introduced agenda item *Pooling Language – Investment Policy Statement*. Mr. Herbert stated that the major changes to the CERS Investment Policy Statement that were to be

voted on could be found on pages 23 and 24 of Board Books. Mr. Herbert stated that the changes codified the pooling language in this document. Mr. Herbert stated that during the trustee education session on investments he outlined how the custody bank, BNY Mellon, currently and historically had been using the pooling process to account for all of the investments. It basically is an investment pool of all of the strategies and then it is a unitized process within the ownership for each of the plans and the funds. This mainly comes from BNY Mellon's language and the process it uses, which the Board adopted. Dr. Hackbart stated that this is a draft edition of the CERS Investment Policy Statement and that there have been some editorial comments that the Committee might want to add. Dr. Hackbart stated that it would be beneficial and useful to the Committee members to have a training session detailing the pooling and utilization process. Dr. Hackbart further stated that it seems like a topic and process that is not well known. By providing a better understanding of the process it would help the Committee members feel more comfortable that it is accurate and also to tie back into the accounting system in how those records are kept. Dr. Hackbart asked Mr. Herbert if he would conduct this training session. Mr. Herbert stated yes he would do that. Mr. Herbert stated that while this is common among pension plans of this sort and size it is not a well-traveled topic. Dr. Hackbart stated that if anyone else had any additional editorial comments or questions to submit them to CEO Ed Owens within the next several weeks and a training session would be scheduled regarding this topic. Dr. Hackbart asked if there were any additional questions regarding the Investment Policy Statement. Mr. Cheatham stated that he understands the Committee is trying to get CERS' Investment Policy Statement in line with how operations are, but Mr. Cheatham thought everyone needs to understand exactly what House Bill 484 and the CERS partners and beneficiaries expect from a transparency standpoint with regard to the ownership of trust assets. Particularly given what appears to be included in this present

legislative session with the KPPA housecleaning bill and the three year timeline with regard to getting the separation of CERS completed in a timely manner and the costs allocated to that. Mr. Cheatham stated that he thought it was kind of like having a merger in reverse, but at the same time he believed from conversations he had with the partners and beneficiaries of CERS that the main purpose of House Bill 484 was to ensure transparency and accountability with regard to the ownership of these assets. Dr. Hackbart stated that at the present time the ownership is specified as KRS and asked Mr. Herbert if that was correct. Mr. Herbert stated no, not exactly. Mr. Herbert stated in this situation there are two Boards of Trustees overseeing a pool of assets and those assets are owned by the individual plans. Dr. Hackbart stated that he understands that they are owned by the individual plans, but he was referring to the titling of the ownership. Mr. Herbert stated the titling falls under U.S. trust law. Mr. Herbert stated that in terms of pension law the two Boards sit over top of this process and control the assets. With the Board made up of the owners' representatives owners control of the process. Mr. Herbert restated that the ownership of the trust is at the unit level send representation to sit on the Boards that they control; therefore, to say that the ownership is in one certain place is not exactly accurate. The ownership is at both Board levels (CERS and KRS) in the current structure. Dr. Hackbart asked in terms of the legal documents how are the documents named and asked Mr. Herbert to include this topic in the training session as well. Mr. Herbert stated that it was titled KRS trust. Mr. Cheatham stated that the other part of that discussion has to deal with future investments and how the Committee wants to maintain ownership or unwind previous investments. Dr. Hackbart stated that he wants to ensure that everyone has an in depth understanding of the process and how CERS got to where it is now so everyone has confidence in the process as the Board looks at other potential options. Mr. Herbert stated that he would be happy to conduct the training session. Dr. Hackbart stated that the

Investment Policy Statement was a draft and that the Committee would not take a vote on it at this point in time because there are some editorial suggestions. If anyone had other detailed suggestions before the next meeting they were to forward them to CEO Owens or Dr. Hackbart and they would take those into consideration for the final draft.

Dr. Hackbart introduced agenda item *Administrative Investment Policy Statements*. Dr. Hackbart stated that the Committee members initially decided in early 2021 that it might be better to start the approval process of the Administrative Investment Policy Statements at the KPPA level and then KRS and CERS could review and approve the policies. In the meantime, based upon a number of suggestions, the decision was made to reverse that process. What is being presented are the final approved Administrative Investment Policy Statements for the Committee to vote on. The policies would then be forwarded to KPPA for consideration and compliance. Dr. Hackbart asked Mr. Herbert if that was a reasonable summary. Mr. Herbert stated yes, except for the last part. Since these policies fall under the CERS Board of Trustees purview, the CERS Board of Trustees would have to adopt these as its Administrative Investment Policy Statements and the policies would not have to go back to KPPA for approval. Mr. Steven Herbert stated that these are basically what was posted prior to HB 484 with the changes in the name to the CERS Board of Trustees as well as the changes to the legal statute references. Mr. Herbert stated that this needs to be done and needs to be adopted so the Board has these policies in place. There may be some changes to these in the future, but as there are so many policies it was recommended that any changes could be done on a policy per policy basis. After these are adopted by the Board, which is required, there could be a more in depth discussion of each policy individually. For instance, in the real estate policy a few examples of what the Committee might want to look at in the near future were added. The

Committee might want to have some of the expected return numbers reviewed by Investment staff and the Investment consultant to make sure those are in line or if those need to be changed. This was just one example, there are several things in the policy that the Committee might want to address. Mr. Herbert suggested reviewing these policies individually to see if any changes are necessary. Dr. Hackbart stated that this would be an item for approval by this Committee and asked if someone would move to approve these Administrative Investment Policy Statements. Mr. Cheatham moved to adopt these policy statements as presented and Dr. Milkman seconded the motion. The motion passed unanimously.

Dr. Hackbart introduced agenda item *Redemption of Putnam Dynamic Asset Allocation*. Mr. Herbert stated that this is a mandate with Putnam and it is in the real return portfolio. There was a memorandum from Mr. Chiu to the Investment Committee Chairs asking for a liquidation or termination of this mandate and it detailed the reasoning behind that decision. Mr. Chiu had received written approval from both of the Investment Committee Chairs and staff is proceeding with the termination process. There is a thirty day notice process, but there is flexibility around the redemption piece and staff are working through how best to do that. Mr. Herbert then introduced Mr. Chiu to go through some of the details regarding the decision to terminate the Putnam mandate. Mr. Chiu stated that the Putnam investment was made in 2020 and replaced a couple of global technical asset allocation investments, which were previously used to provide some liquid exposure to inflation and/or infrastructure assets. Putnam had some higher fees but they also had some more exposure to those areas. This strategy was mainly a sixty/forty equity fixed income allocation with weights a few percentage points around those benchmarks. It had a very high correlation with the S&P 500, over .95, which is also what has been experienced during our time

having it. Mr. Chiu stated that it was decided to replace Putnam with some real tangible asset exposure, such as asset leasing, infrastructure or some other strategies that are more defensive and less correlated to the rest of our portfolio. Mr. Herbert stated that with these assets staff is conducting a search within the real return space and staff has contacted Wilshire regarding this. Mr. Herbert stated that staff has received a couple of calls from direct managers that are already working with Wilshire so this would be along the lines of diversifying out away from public equity and public bond markets, which is already in the portfolio. Mr. Herbert stated that he would update the Committee on how the search progresses. Dr. Hackbart asked Mr. Herbert about the redemption process and how that would be carried out. Mr. Herbert stated that the initial recommendation was to liquidate these assets to cash. KPPA staff were debating whether to use a transition manager or to let Putnam do that, but no decision has been made. If a transition manager is used everything would be transferred over to that transition manager's account and they would liquidate. The reason to do that would be for better transaction costs, but KPPA staff are not convinced that would be the case. This item was provided for informational purposes only.

Dr. Hackbart introduced agenda item *Investment Compliance Update – KPPA Website*. Mr. Herbert stated that this is the first compliance report since he has been here and it is a very short one. Mr. Herbert stated that he began here without a compliance function in Investments and he was building one. Mr. Crawford is KPPA's compliance officer. Mr. Herbert stated that he first began by reviewing the statutes, then policy and finally the processes. He presented the KPPA Statutory Compliance Checklist which is basically what staff is required to provide for public dissemination onto the KPPA website. The boxes would be checked once the website is reviewed and this report executed. Mr. Herbert stated that Mr. Crawford created the checklist. There are two

identical statutes for KRS and CERS, which are KRS 61.645 and 78.782. Mr. Herbert then introduced Mr. Crawford. Mr. Crawford stated that he is just at the beginning and he has started the process of talking with Communication about how to move forward in revamping the KPPA website because there are a lot of items that are vague or difficult to find. As of today, he said that he checked every box. There was some language in the KPPA Statutory Compliance Checklist for Website Postings that he would like to refer to the Legal Department. It was regarding the third bullet point that refers to “as applicable” and refers to the ILPA, which is an organization that is for people that invest in private equity. When talking about fees this is something that he would like to explore moving forward, but he did not understand what “as applicable” means. Mr. Crawford asked if Ms. Hale was ready to comment on that. Ms. Hale stated that “as applicable” means for those asset classes that KPPA actually has, which are covered by the ILPA standards, KPPA will report the fees for those asset classes and for those managers in the manner recommended by ILPA. For those that are not private equity KPPA is not going to report them in that manner and statutorily it is not required to do so. That is what the “as applicable” means. It is not for every asset class that KPPA has, but KPPA does have some. For those managers, as Ms. Case indicated, these fees are reported and tracked accordingly. Mr. Crawford stated that the checklist can be found on the KPPA website and everyone is welcome to look at it. Mr. Crawford stated that this is a starting point and it is posted so that people see that KPPA is being transparent and is doing its best to make sure that this happens. Mr. Herbert stated that staff are going to double check with ILPA regarding the third check box to make sure that KPPA is following those standards correctly. Regarding the last check box about reporting each manager on the performance report. KPPA does not have a report that shows each manager, but it will. What had been posted on the website, as of the day before, is a quarterly report and the law actually says,

after July 1, 2021, that KPPA has to post on its website a quarterly report for each of the plans separated out by HB 484. Mr. Herbert stated that he posted a September quarterly report that is not perfect, but it gives the top line returns, the asset allocation returns as well as a benchmark. The one thing missing is each manager. KPPA does not have a current report that has each manager listed nor does Wilshire, but KPPA staff are working on that. Staff have to separate out each manager per plan and that has never been done. BNY Mellon does not currently do that either. The December report is not ready from Wilshire or KPPA staff. All of the data that KPPA gets from the ninety to one hundred mandates is still being sorted through in order to split this out per plan. Mr. Herbert stated he was excited at where KPPA is headed, but he is in no way happy with what KPPA has so far. Dr. Hackbart asked Mr. Herbert when he believes that KPPA will be in a position to draw routine quarterly reports. Mr. Herbert stated that it will be at some point this year. Dr. Hackbart stated that KPPA is moving in that direction, but is not there yet. This item was provided for informational purposes only.

There being no further business, Dr. Hackbart asked if there was a motion to adjourn the meeting. Dr. Milkman moved and was seconded by Mr. O'Mara to adjourn the meeting at 2:55 p.m. The next meeting of the County Employees Retirement System Investment Committee is scheduled for 2:00 p.m. on May 25, 2022. Copies of all documents presented are incorporated as part of the minutes of the County Employees Retirement System Investment Committee meeting held February 16, 2022.

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 November 8, 2021 were approved by the County Employees Retirement System Investment Committee on February 16, 2022.


Committee Chair

I have reviewed the Minutes of the County Employees Retirement System Investment Committee Meeting on February 16, 2022 for form, content, and legality.


Office of Legal Services