

**MINUTES OF MEETING
KENTUCKY RETIREMENT SYSTEMS
INVESTMENT COMMITTEE MEETING
FEBRUARY 8, 2022, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the February 8, 2022 Kentucky Retirement Systems' (KRS) Investment Committee Meeting, the following Committee members were present: Prewitt Lane (Chair), Keith Percy, Joseph Grossman, and Lynn Hampton. Also in attendance were KRS' CEO John Chilton and the County Employees Retirement System's (CERS) CEO Ed Owens and KRS Trustee Larry Totten. Staff members present were David Eager, Steven Herbert, Victoria Hale, Ashley Gabbard, Erin Surratt, Ann Case, Natalie Young, Steve Willer, Anthony Chiu, Joseph Gilbert, Jared Crawford, Sherry Rankin and Carol Johnson.

Mr. Lane called the meeting to order and Ms. Johnson called roll.

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

Mr. Lane introduced agenda item *Approval of Minutes November 3, 2021*. Ms. Hampton moved and was seconded by Mr. Percy to approve the minutes as presented. The motion passed unanimously.

Mr. Lane introduced agenda item *Management Fee Presentation*. Mr. Lane stated that Ms. Case was going to review the steps that staff goes through for management fee oversight and

compliance. Ms. Case introduced herself and informed the Committee that she is the Assistant Director of Accounting, Investment Operations Branch with the 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 Natalie Young, KPPA's Branch Manager. Ms. Case stated that Ms. Young would outline the processes that KPPA currently utilizes. Ms. Case stated that during the last 8 to 10 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 in 2015 that most of the managers she tracks 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 there were constant questions about the 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. Ms. Case stated that in looking at the financial statements all of the fees were reported in a single line and just classified as investment expenses. Ms. Case stated that what used to appear as management fees now included both management and performance fees combined. Ms. Case stated that in 2017 the legislature passed Senate Bill 2 (SB2) which required KPPA, the Kentucky Teacher's Retirement System and the Kentucky Judicial Retirement System to include profit sharing, carried interest, and partnership expenses in their reporting of investment fees. Ms. Case stated that following the legislation, KPPA, at a minimum, is required to post the fees on its website, but the fees are also reported in its financial statements. Mr. Grossman asked if Ms. Case was saying the fees looked higher compared to other states' retirement systems or retirement systems within Kentucky? Ms. Case replied both. Mr. Grossman also asked if the fees nearly doubled, or if they nearly double just in the way that they were being accounted for? Ms. Case replied that they nearly doubled because KPPA was now including the performance fees in the fee reporting, and KPPA was not doing that before. Mr. Grossman stated that KRS was not necessarily paying more in fees, but fees were being reported differently. Ms. Case replied that was correct. Ms. Case stated that staff is pulling the netted fee out and putting it as a line item on the statements, which was not being done before. Mr. Grossman also asked if due to SB2 whether other Kentucky retirement systems are now reporting the fees in the same way. Ms. Case stated that other Kentucky retirement systems

are consistent with reporting fees on their websites, but not all Kentucky retirement systems are reporting fees on their financial statements. Mr. Eager added that the Kentucky Teacher's Retirement System also reports the carried interest differently. Mr. Eager stated that carried interest is the amount that KPPA pays the manager as their incentive so they may get twenty percent of the profits above some hurdle and KPPA recognizes that quarter by quarter as it occurs. The Kentucky Teacher's Retirement System defers carried interest until the investment is ultimately liquidated, which might be many years later. Therefore, Mr. Eager stated that when comparing the Kentucky Teacher's Retirement System to KPPA, that KPPA will look like its fees are always higher. Ms. Hampton asked if there has been any movement in pension systems in the United States to change to reporting all of the fees. Ms. Case replied yes. Ms. Case further stated that you see a lot more retirement systems being more transparent with their fees, but that they may be reporting them differently since there is no real guidance out there. Mr. Grossman asked if KPPA discloses how it reports the fees when it publishes its financials so that the reader knows what may be different between KPPA and other retirement systems. Ms. Case replied that in 2018 KPPA created two lines on its financial statements. Ms. Case stated that one line includes investment expenses, which includes management, custodial and consulting fees. Ms. Case stated that the second line includes anything that is classified as performance fees, carried interest, and profit sharing to help clarify that increase in fees. Mr. Grossman asked if KPPA accrues those on a quarterly basis. Ms. Case replied yes the managers now report those on a quarterly basis. Mr. Grossman asked if KPPA pays those fees, when the securities are sold or on an annual basis? Ms. Case replied that some are paid on an annual basis and some are paid when the assets are sold. Ms. Case asked Mr. Herbert if he wanted to make any comment regarding the payment of fees. Mr. Herbert stated that for most private investments that fees are paid at the liquidity event or the sale

of the asset. Mr. Herbert further stated that each deal is negotiated separately, but Ms. Case had stated the general rule. Mr. Chilton asked Ms. Case if KPPA actually writes a check for any of these performance fees or is KPPA's distribution reduced by the amount of the fee. Ms. Case stated that KPPA does not write a check for any of the performance fees and that they are either netted in the sale or sometimes they may do a capital call and the capital call would cover that fee. Ms. Case turned the presentation over to Ms. Young, who explained the current process and reporting of the fees that KPPA does. Mr. Herbert stated that he had one clarification before Ms. Young began her presentation. Mr. Herbert stated that for any of the private investments the fee is netted out of the distribution and therefore no physical check would be written. Mr. Herbert stated that it would be different if we had it in a public equity or public fixed income format. Ms. Young introduced herself as the Investment Operations Branch Manager at KPPA 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 Manager approves an invoice for payment it is sent to Investment Operations and Investment Operations would process 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 either their monthly or quarterly statements, which BNY Mellon records 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 them on the KPPA website. Ms. Young reviewed the current reporting process with the Committee members and stated that the 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 are any further questions that the Committee members may reach out to KPPA staff who would be happy to answer them. Ms. Hampton asked how often errors are found. Ms. Case stated that it is not often and most of the time they are just keying errors. Ms. Hampton asked how often these are reported on the website. Ms. Case replied quarterly. After Ms. Young completed her presentation, Mr. Herbert stated that he had one correction for the minutes. Mr. Herbert stated that there is at least one publicly traded manager where a check would be written for a performance fee. This item was provided for informational purposes only.

Mr. Lane introduced agenda item *Investment Policy Statement additional language*. Mr. Herbert stated that the changes to the Investment Policy Statement (IPS) were a slight language change

and included the next item to be discussed by the Committee, which was the Administrative Investment Policy Statements. The first change to the IPS was the ESG language change on page two of the IPS. Mr. Herbert stated the language is fairly straight forward and there will likely be a process to implement the ESG portion of the policy, but that is still under discussion. Mr. Herbert stated that the next change/addition was on page four of the IPS, which outlines the way that the assets of KRS are invested given the unitization at the ownership or fund level and the pooling at the trust level, with its custodial bank. This addition to the IPS is not a change it is a codification of the current practice. Mr. Herbert stated that beginning on page eighteen of the IPS there was a language change since each Board decided to have their own Administrative Investment Policies. The changes made were just a wording change in the document for that to occur for KRS. Mr. Grossman asked if there is an accounting system in place to support the unitization and pooling. Mr. Herbert stated yes (at BYN Mellon). Mr. Lane asked if there was a motion to approve the amendments to the Investment Policy Statement. Mr. Grossman moved and was seconded by Ms. Hampton to approve the Investment Policy Statement as presented. The motion passed unanimously.

Mr. Lane introduced agenda item *Administrative Investment Policy Statements*. Mr. Herbert stated that these policies are what is currently on the KPPA website. Mr. Herbert stated that the thought process was to take the policies for each of the Boards and present them to the respective Investment Committees, change the names to be reflective of each Plan, make sure the appropriate changes to any legal language and typos that were obvious were updated, and change the name on the top of the policy. Mr. Herbert stated that this would enable all policies to get approved and posted on the website. If there was anything else that needed to be changed with an individual

policy, then the Investment Committee could review each policy one at a time. Mr. Herbert stated that the policies as currently written are acceptable, but some might need a few more changes going forward. Mr. Herbert stated that the policies are all operationally sufficient for KRS to use in their current form with the recommended changes being presented at the meeting. Mr. Herbert stated that the first policy is the exception to what he was requesting. Specifically, Mr. Herbert was referring to the Investment Manager Onboarding Checklist. It is in the format of a policy with a signature at the bottom, however, it is certainly not a policy; it is a process, which is likely to change much more often than the policy itself. Mr. Herbert asked the Committee to approve the Investment Manager Onboarding Checklist being removed as an Administrative Investment Policy, although it would continue to be used as a process. Mr. Herbert stated that the process can be vetted and presented to the Committee at a future meeting since it is just something that is being used internally by KPPA staff. Mr. Herbert then addressed the Real Estate Policy found on page fifty-nine of Board Books and used it as an example of showing what the Committee might do in reviewing each policy, which included comments. Mr. Herbert suggested reviewing this policy with a consultant. Mr. Herbert stated that this was just an example of how the Committee might go through these policies individually. Mr. Lane asked if there was a motion to approve the amendments to the Administrative Investment Policies as presented. Mr. Grossman moved and was seconded by Ms. Hampton. The motion passed unanimously.

Mr. Lane introduced agenda item *Redemption of Putnam Dynamic Asset Allocation*. Mr. Lane stated that staff made a recommendation to terminate Putnam Dynamic Asset Allocation, who had not added value to the asset allocation and was really a balanced manager. Mr. Lane stated that the recommendation to terminate Putnam was presented to the CIO of the Investment Team and

once he approved it he then presented it to the Chairman of the Investment Committee for written approval. Mr. Lane stated that he submitted written approval for the termination of Putnam. Mr. Lane stated that the Investment Committee and Board are now being informed of the termination of Putnam. Mr. Herbert stated that this termination was being made from an allocation perspective and that this manager (Putnam) was in the real return asset portfolio. Mr. Herbert stated that he would take the assets from Putnam and invest them in more targeted real return assets. Mr. Herbert stated Putnam was essentially a sixty percent stock/forty percent bond portfolio which was sitting in the real return portfolio and was the main driver of assessing the appropriateness of this investment. It was an allocation decision, not a performance based decision. Mr. Herbert then introduced Mr. Chiu who wrote the memorandum to the Investment Committee and followed the process as Mr. Lane outlined earlier regarding the termination of Putnam. Mr. Chiu stated that Putnam had been a replacement for a couple of other liquid managers in the real return space, and originally were ideally going to provide some exposure to inflation and/or infrastructure. Mr. Chiu stated the past ten plus years, until recently, has not been favorable for those types of strategies given the lack of inflation. Mr. Chiu stated that his thought was to replace Putnam with a strategy that would be technical and have a high return. Mr. Chiu stated that this strategy has a .95 or higher correlation with the S&P 500 so the returns have been good given that it mostly runs along with that. Mr. Chiu stated that as indicated in the memorandum, Putnam basically tilted one or two percentage points away from the benchmark and their commodity exposure was zero at the end of the year. Mr. Chiu stated that it was basically extra fixed income and equity exposure, but labeled as something different. Mr. Chiu stated that he thinks that KPPA can allocate to something better to provide more of a real return that is correlated with inflation and more diversifying to our portfolio, which was the reason for the recommendation. Mr. Herbert stated that as staff transitions

out of Putnam over the next thirty to ninety days staff will have searches ongoing within the real return space as well as private equity for the cash received from this sale. Mr. Grossman asked if staff currently had a manager in mind. Mr. Chiu replied that staff were looking and talking to different managers and strategies both in infrastructure and agriculture as potential candidates for this area. This item was provided for informational purposes only.

Mr. Lane introduced agenda item *Website Posting Update*. Mr. Herbert stated that he would like to review the KPPA Statutory Compliance Checklist for Website Postings with the Committee. Mr. Herbert stated that when he arrived at KPPA the Investment team did not have a compliance function, but now it does. Mr. Herbert stated that Mr. Crawford was kind enough to join the Investment team and has begun putting together a compliance processes. Mr. Herbert stated that they first began by reviewing the statutes and then reviewed the policies as well as the manager compliance to their guidelines as it related to the Investment Policy Statement. Mr. Herbert stated that this is the statutory portion of the process and KRS 61.645 and 78.782 actually have a requirement to post documentation on the KPPA website and follow the five check points at the bare minimum. Mr. Herbert stated that this is to be done on a quarterly basis and encompasses what Ms. Case presented at the beginning of the meeting. Mr. Herbert also stated that it encompasses what he has been working on, which is quarterly reporting. As of July 1, 2021, under the split, there is to be quarterly reporting on the website for each of the Plans that the respective Boards oversee. Mr. Herbert stated that as it is early in the quarter staff do not have any performance reports, except for a raw performance report, which Mr. Herbert shared was on the next page in Board Books. Mr. Herbert stated that he wanted Mr. Crawford to comment on this first. Mr. Crawford stated that his only comment was on the bullet point related to ILPA and the

reference to the wording “as applicable”. Mr. Crawford stated that he spoke to Ms. Hale, who is KPPA’s legal counsel, regarding his concern over the phrase and stated she can speak to that term. Ms. Hale stated that with regard to the third bullet point the, “as applicable”, KPPA reports each fee or commission by manager or partnership consistent with standards established by the Institutional Limited Partners Association (ILPA). The “as applicable” means “as relevant”. Ms. Hale stated that KPPA does not have to report every single fee of every single manager and only has to report those that are relevant to KRS consistent with the standards established by ILPA. Ms. Hale stated that ILPA has standards and then those standards are applied to the managers that KRS actually has. Mr. Crawford asked Ms. Hale how to navigate that. Ms. Hale said that KPPA would go out to ILPA and review the standards that they have. Ms. Hale stated that statute states that KPPA must be consistent with the standards of ILPA and does not say that KPPA must completely replicate the standards, but KPPA just can’t be out in left field either. Ms. Hale recommended that KPPA uses the standards that ILPA has and then they apply them to the fee or commissions that the managers have and report them in a consistent manner. Ms. Hale stated that ILPA just puts out a reporting mechanism so that is what KPPA should use. Mr. Herbert stated that we will have the ILPA standards in the third bullet point from a process prospective and will ensure that they are being applied. Mr. Steven Herbert stated that KPPA is out of compliance with the last bullet point on the checklist, but will be back in compliance shortly. Mr. Herbert stated that staff will have both the September and December reports back up on the KPPA website shortly. Mr. Herbert stated that the reports are currently being worked on. Mr. Herbert pointed to page seventy-four of Board Books and stated that this was BNY Mellon’s reporting and that staff uses its returns for book of record. Mr. Herbert reviewed the report with the Investment Committee. Mr. Herbert stated that staff are going to comply with statutes KRS 61.645 and 78.782 and break out

everything, including asset class returns and manager returns per plan so that staff can post them to the website. Mr. Herbert stated that this is currently not being done at the BNY Mellon level and staff is pulling that data now and putting all of that together. Mr. Herbert stated that this will be done soon and will be emailing the updated reports to the Committee as well as posting them on the KPPA website per statute. This item was provided for informational purposes only.

There being no further business, Mr. Peercy moved and was seconded by Mr. Grossman to adjourn the meeting at 10:58 a.m. The next meeting of the Kentucky Retirement Systems Investment Committee is scheduled for 10:00 a.m. on May 16, 2022. Copies of all documents presented are incorporated as part of the minutes of the Kentucky Retirement Systems Investment Committee meeting held February 8, 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 Kentucky Retirement Systems Investment Committee of the Board of Trustees of the Kentucky Retirement Systems, do certify that the Minutes of the meeting held on November

3, 2021 were approved by the Kentucky Retirement Systems Investment Committee on February 8, 2022.


Committee Chair

I have reviewed the Minutes of the Kentucky Retirement Systems Investment Committee Meeting on February 8, 2022 for form, content, and legality.


Office of Legal Services