



KENTUCKY RETIREMENT SYSTEMS INVESTMENTS



To: KRS Board of Trustees
From: Richard Robben, Interim Executive Director of Investments
Date: September 14th, 2017
Subject: Summary of Investment Committee Activity

New Members

Over the last quarter we welcomed to new members to our Investment Committee, Mr. Kelly Downard and Mr. Matt Monteiro, CFA. These additions bring the number of appointed trustees with investment experience to 6, bringing the board into compliance with recently passed legislation.

New Investments

At the August 22nd meeting, the following investments were approved by the Investment Committee:

- \$150MM with Benefit Street Partners (Private Credit)
- \$150MM with White Oak (Private Credit)

Because of the illiquid nature of both of these investments, the Investment Committee approved these investment for the *following plans only*:

- KERS Haz
- CERS
- CERS Haz
- All Insurance Plans

Investment Consulting Services RFP

The Investment Committee Chair, Mr. Dave Harris, instructed investment staff members to conduct a RFP process to evaluate investment consultants qualified for the role of overseeing and advising the staff, the Investment Committee and the Board on a wide range of investment issues. In addition to wanting to simplify and broaden our consulting relationships, the Investment Committee wanted to reduce the consulting fees, if possible, while at the same time improve the quality of consulting services.

The scope of activities and responsibilities of the new consultant were outlined in the RFP and, except as it applies to real estate investing, included, but was not limited to:

- Provide general investment consulting services ***in all asset classes except Real Estate.***
- Assist in the ongoing evaluation of all investment managers retained by KRS
- Recommend investment managers the consultant feels KRS should hire
- Offer opinions on managers staff is considering hiring including onsite visits as needed
- Advise on asset allocation issues including doing asset/liability studies as appropriate (additional fees may be warranted)
- Help maintain an appropriate Investment Policy Statement
- Work with staff on risk management practices and policies
- Attend Board and Investment Committee meetings when requested
- Help KRS Investment Operations staff fulfill their responsibility to monitor partnership cash flow and manager fees, including carried interests
- Provide Quarterly and Annual reports containing each manager's performance results and identify any areas where changes should be considered
- Educate staff and Trustees generally and in specific areas where the consultant has conducted research applicable to KRS

The committee identified organizational criteria to help focus on those investment consultants most likely to be able to meet KRS' needs because they have the resources and experience required. Qualifying criteria included having at least \$500 Billion in assets under advisement within the tax exempt public fund category, and have multiple clients with at least \$5 Billion in plan assets. The following nine firms met the criteria:

- Aon Hewitt
- Callan
- Meketa
- NEPC
- PCA (a current consultant)
- Russell
- RVK (a current consultant)
- Verus
- Wilshire

After review of the RFP responses, the Review Committee selected four firms, Aon Hewitt, RVK, Meketa, and Wilshire to come to Frankfort for half day interviews. Each firm brought a presentation that covered their RFP response as well as supplementary material and sample reports (e.g. quarterly performance reports, asset allocation studies, etc.). Meketa, Wilshire and Aon had four firm representatives. RVK had six. In the end, committee members felt that with the benefit of the RFP responses, prior knowledge of and working with some of the consultants, the reference calls, and the onsite interviews, it was prepared to make a recommendation that Wilshire be awarded the contract subject to a final on-site due diligence meeting in Pittsburgh. Key differentiators were:

- ✓ *A compatible investment philosophy focusing on risk controlled returns*
- ✓ *Breadth and depth of their research (over 88 researchers and 300 staff)*
- ✓ *Experience with other underfunded state systems (average 23 years' of experience)*
- ✓ *KRS would be an important client (5.5:1 consultant to client ratio)*
- ✓ *Back office expertise to share with KRS (10 back office professionals)*
- ✓ *Employee-ownership which promotes longevity (average 14 years with Wilshire)*
- ✓ *The firm's long history...45 years of investment consulting experience*
- ✓ *Overseas presence for research (offices in 6 countries)*
- ✓ *Business is focused on institutional asset mgmt. (\$1T under advisement)*
- ✓ *List of common clients with GRS*
- ✓ *Personal chemistry the committee felt toward Wilshire's team*

The table below illustrates how the fee proposed by Wilshire compares to the amounts historically paid by KRS for consulting services:

Consulting Services	FY 2016	FY 2017	FY 2018 e
Albourne*	\$486,902.32	\$240,000.00	\$0.00
ORG	\$305,920.25	\$309,058.92	\$315,000.00
Pension Consulting Alliance	\$389,146.87	\$400,821.26	\$101,000.00
RVK **	\$443,206.38	\$442,958.97	\$115,000.00
Wilshire**	\$0.00	\$0.00	\$992,000.00
Subtotal - Consulting	\$1,625,175.82	\$1,392,839.15	\$1,523,000.00
Burgess Software	\$225,000.00	\$225,000.00	\$0.00
Total	\$1,850,175.82	\$1,617,839.15	\$1,523,000.00

* *Albourne was terminated in January 2017*

** *RVK & Wilshire annual fees prorated from 9/1/17*

Wilshire's proposed fee represents an estimated increase of \$130,160.85 in our total consulting expenses for fiscal year 2018 versus fiscal year 2017. However, it also represents a much higher level of service and support than we have requested of our consultants in the past. Additionally, because Wilshire and KRS both utilize the same software for partnership cash flow monitoring and reporting (Burgess), their proposal will allow KRS to cancel its subscription to the application, saving the \$225,000 annual subscription fee.

The Investment Committee approved the recommendation of the Review Committee (appendix A) to hire Wilshire as the new general investment consultant for KRS. The Investment Committee also reaffirmed that ORG will continue to serve as KRS' real estate consultant with the full confidence of the Committee and the investment staff.

Adoption of Updated Investment Policy Statement

At the July 12th meeting, the Investment Committee approved a series of updates to the Investment Policy Statement. The refresh effort, led by committee member Mr. Bill Cook, was aimed at updating language concerning leverage, and restating return targets in relative terms instead of absolute numbers. This

updated IPS was approved by the Investment Committee and the Board at the special called meeting on July 12th. The new Investment Policy Statement is included here as appendix B.

Adoption of New Asset Allocation & Assumed Rates of Return

After many months of study, the Asset Allocation sub-committee presented their final recommendations for asset allocations for each plan. These new asset allocations were approved by the Board at the July 12th special meeting, while the new assumed rates of return were addressed at 2 different meetings. The rates for KERS and SPRS were approved at the May 18th Board meeting, and the rates for all other plans were approved by the Board at the July 12th special meeting. The new asset allocation for each plan are included here as appendix C.

Investment Procurement Policy Draft Approval

Over the summer, KRS staff worked with the Office of Finance and Administration to develop an Investment Services Procurement Policy as specified by Senate Bill 2. A draft version of that policy was approved by the Investment Committee on July 12th, and has been sent to Finance and Administration for final approval.

Performance

Both Pension and Insurance plans posted strong performance for the most recent fiscal year, with both besting their benchmarks. The strong performance trend has continued with above benchmark performance again in July.

PENSION (Net of Fees)					
	Jul-17	FY2017	1Yr	3Yr	5Yr
Total Pension Fund	1.80%	13.47%	12.51%	5.73%	8.22%
Benchmark	1.74%	13.28%	12.17%	5.92%	8.42%
	0.06%	0.19%	0.34%	-0.19%	-0.20%
KERS	1.61%	12.09%	11.35%	5.24%	7.95%
Benchmark	1.51%	11.92%	11.01%	5.55%	8.19%
	0.10%	0.17%	0.34%	-0.31%	-0.24%
KERS-HAZ	1.83%	13.44%	12.69%	5.78%	8.27%
Benchmark	1.80%	13.58%	12.45%	5.64%	8.32%
	0.03%	-0.14%	0.24%	0.14%	-0.05%
CERS	1.84%	13.81%	12.78%	5.84%	8.28%
Benchmark	1.81%	13.64%	12.47%	5.64%	8.32%
	0.03%	0.17%	0.31%	0.20%	-0.04%
CERS-HAZ	1.83%	13.73%	12.71%	5.88%	8.29%
Benchmark	1.80%	13.61%	12.46%	5.64%	8.32%
	0.03%	0.12%	0.25%	0.24%	-0.03%
SPRS	1.71%	12.50%	11.92%	4.99%	7.79%
Benchmark	1.66%	12.61%	11.56%	5.38%	8.16%
	0.05%	-0.11%	0.36%	-0.39%	-0.37%

INSURANCE (Net of Fees)					
	Jul-17	FY2017	1Yr	3Yr	5Yr
Total Insurance Fund	1.79%	13.72%	12.66%	5.93%	8.06%
Benchmark	1.76%	13.55%	12.39%	6.25%	8.61%
	0.03%	0.17%	0.27%	-0.32%	-0.55%
KERS-INS	1.81%	13.78%	12.56%	5.66%	7.80%
Benchmark	1.86%	13.89%	12.57%	5.85%	8.40%
	-0.05%	-0.11%	-0.01%	-0.19%	-0.60%
KERSH-INS	1.79%	13.76%	12.69%	5.88%	8.07%
Benchmark	1.81%	13.73%	12.48%	5.88%	8.42%
	-0.02%	0.03%	0.21%	0.00%	-0.35%
CERS-INS	1.78%	13.67%	12.65%	5.97%	8.11%
Benchmark	1.78%	13.62%	12.42%	5.91%	8.44%
	0.00%	0.05%	0.23%	0.06%	-0.33%
CERSH-INS	1.78%	13.70%	12.68%	6.03%	8.14%
Benchmark	1.77%	13.62%	12.42%	5.91%	8.45%
	0.01%	0.08%	0.26%	0.12%	-0.31%
SPRS-INS	1.78%	13.70%	12.69%	5.97%	8.11%
Benchmark	1.77%	13.61%	12.42%	5.93%	8.45%
	0.01%	0.09%	0.27%	0.04%	-0.34%

A Year in Review

I was recently asked to put together a list of accomplishments made by the Investment Committee over the last year. I have attached that list as appendix D. As you will see, it has been a very busy and successful 12 months.