MEETING MINUTES
KENTUCKY TEACHERS' RETIREMENT SYSTEM
REGULAR QUARTERLY MEETING OF
THE BOARD OF TRUSTEES
FRANKFORT, KENTUCKY
SEPTEMBER 15, 2008, 9 A.M., ET

Under authority of KRS 161.290(1), the Board of Trustees of the Teachers' Retirement System of the State of Kentucky convened in Regular Session in the Board Room of the Teachers' Retirement System Office, 479 Versailles Road, Frankfort, Kentucky, at 9 A.M., EST, Monday, September 15, 2008.

Item 1 - Board Called to Order

The meeting was called to order by Barbara Sterrett, Chairperson.

Item 2 - Roll Call

Members present were:
Tom Shelton
Laura A. Zimmerman
Barbara G. Sterrett
Ruth Ann Sweazy
Ronald L. Sanders
Robert M. Conley
Dr. Jay Morgan
Todd Hollenbach, State Treasurer
Jill Hunter, Proxy for Dr. Jon Draud

Members absent were:
None

Others present were:
Gary L. Harbin, Kentucky Teachers' Retirement System
C. Joe Hutchison, Kentucky Teachers' Retirement System
Robert B. Barnes, Kentucky Teachers' Retirement System
Paul L. Yancey, Kentucky Teachers' Retirement System
Mary Pat Dobbins, Kentucky Teachers' Retirement System
Sandra Shroat Bush, Kentucky Teachers' Retirement System
Jane C. Gilbert, Kentucky Teachers' Retirement System
Patsy Young, Kentucky Retired Teachers' Association
Fred Hester, Kentucky Education Association-Retired
Erlynne Crowe, Kentucky Education Association-Retired
Nancy Williams, EnnisKnupp & Associates
Ed Macdonald, Cavanaugh Macdonald Consulting, LLC
Ed Koebel, Cavanaugh Macdonald Consulting, LLC

Ms. Hunter was appointed a permanent proxy for Mr. Jon Draud, on August 27, 2008, and the proxy is attached hereto as Exhibit A and made a part hereof.

Proxy for Ms Celletti dated June 12, 2008, representing Mr. Hollenbach, is attached hereto as Exhibit B and made a part hereof.

Chairperson Sterrett welcomed those attending for the first time, especially Ms. Hunter and Mr. Shelton.

Item 3 - Minutes of Last Quarterly Meeting

The Board considered the minutes of the previous meeting held June 16, 2008. Upon motion duly made by Mr. Conley and seconded by Dr. Morgan, the minutes of that meeting were unanimously approved as printed.

Item 4 - Report of the Secretary

Chairperson Sterrett recognized Mr. Harbin for the Report of the Secretary. Mr. Harbin shared a note of appreciation from Ms. Robin Kinney who is no longer the proxy for Dr. Draud because she has taken a new position. Mr. Harbin recognized Mr. Hutchison who presented Items 4(A)-4(D).

Item 4(A) - Applications for Retirement and Annuity

Mr. Hutchison distributed a table (a copy of which is attached hereto as Exhibit C and made a part hereof) showing retirements for the months of June, 2008 (a copy of which is attached hereto as Exhibit D and made a part hereof); July, 2008 (a copy of which is attached hereto as Exhibit E and made a part hereof); and August, 2008 (a copy of which is attached hereto as Exhibit F and made a part hereof). He noted that there were 7 payments for handicapped children; 48 payments for disability retirement; 1,538 payments for service retirement and 4 payments for beneficiaries of members eligible to retire. Initial retirements for the period included 1,597 retirees with monthly payments totaling $5,142,285.01. The Board was asked to approve these initial payments as listed in the detailed monthly reports.

BOARD ACTION:
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Sweazy and seconded by Mr. Sanders, the initial payments to retirees for the months of June, July and August 2008, were unanimously approved as presented.

Item 4(B) - Survivor Benefits

Mr. Hutchison discussed the Survivor Benefits Report (a copy of which is attached hereto as Exhibit G and made a part hereof) which indicates 9 survivor benefits, with a total monthly payment of $3,903.75 during the three-month period of April 1-June 30, 2008. The Board was asked to approve the initial payments of these benefits as listed in the detailed report.

BOARD ACTION:
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Conley and seconded by Ms. Zimmerman, the initial payments for survivor benefits for the months of April, May and June 2008, were unanimously approved as presented.

Item 4(C) - Life Insurance Benefits

Mr. Hutchison presented the life insurance benefits report for the period of April 1-June 30, 2008 (a copy of which is attached hereto as Exhibit H and made a part hereof), which shows 19 payments to beneficiaries of active members and 233 payments to beneficiaries of retired members for a total of 252 payments totaling $1,203,000.00. Totals for the same quarter in 2007 were 233 payments in the amount of $1,132,000.00. The Board was asked to approve the payment of these benefits.

BOARD ACTION:
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Sweazy and seconded by Mr. Sanders, payments for life insurance benefits for the months of April, May and June 2008 were unanimously approved as presented.

Item 4(D) - Refunds

Mr. Hutchison discussed the report of refunds for the quarter ended June 30, 2008 (a copy of which is attached hereto as Exhibit I and made a part hereof), that indicates a total of 240 refunds in the amount of $1,987,137.76. During the same quarter in 2007, there were 242 refunds in the amount of $1,933,163.23. The Board was asked to ratify the actions of the staff in refunding these accounts.

BOARD ACTION:
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Sweazy and seconded by Mr. Conley, the report of refunds for the quarter ending June 30, 2008 was unanimously ratified as presented.

Mr. Harbin shared with the Board that this is Mr. Hutchison's last Board Meeting due to his October 1, 2008 retirement and that KTRS staff and administration will greatly miss Mr. Hutchison. Ms. Sterrett thanked Mr. Hutchison for his service to KTRS. Mr. Hutchison shared that he has enjoyed working with Mr. Harbin, the members of the Board and the KTRS staff.

Item 4(E) - Report of the Investment Committee

Mr. Harbin asked Mr. Yancey to present a report of the activities of the Investment Committee for the quarter ended June 30, 2008 (a copy of which is attached hereto as Exhibit J and made a part hereof).

Mr. Yancey reported that during this quarter, there were 1,424 purchases amounting to $10,558,018,104.40 and 1,681 disposals amounting to $10,514,719,150.20. The disposals represented 603 calls, collections of principal and maturities, and 1,078 sales. While the KTRS Investment Office initiates each of these transactions, the custodian of securities is responsible for handling and securing each stock, bond or other type of investment. At the end of the quarter, the System's invested securities had a book value of $13,848,165,764.28 and a market value of $14,233,535,090.13.

Investment income at the end of the quarter showed an annual rate of 5.2% on fixed dollar assets and 3.2% on total assets. These compare with returns of 4.8% and 3.2% at the end of the previous quarter.

The market value of the System's total assets was $14.2 billion on June 30, 2008 as compared to $15.5 billion as of June 30, 2007.

The System's total assets returned –5.7% for the fiscal year ended June 30, 2008. The long-term return on all KTRS investments over the past twenty years is 8.6%, which is well above the actuarial rate of 7.5%. During the last year, 2007-08, which ended June 30, most financial sectors experienced weakness. Relatively strong returns were earned by bond portfolios. On a relative basis, bonds outperformed stocks over the past year. For the 2007-08 year, the System's domestic stock position outperformed the U.S. stock market, as measured by the S&P 500 Index, by .2%. The index earned -12.7%, while the System's position generated -12.5%. Similarly, for the quarter ended June 30, 2008, the System's domestic stocks, which earned a total return of -0.8%, outperformed the index, which earned a return of -2.0%. The System's international stocks earned a total return of -3.0% for the quarter ended June 30, while the MSCI EAFE Index registered a return of -1.9%. Fortunately, the equity markets have displayed more promise and stability during the first two months of 2008-09.

Mr. Harbin explained that a strong emphasis will continue to be placed on further diversifying the members' assets during the 2008-2009 fiscal year. Cavanaugh Macdonald will be performing an Asset Liability Modeling Study in conjunction with Becker, Burke Associates and EnnisKnupp & Associates. Asset allocation is the determinant of returns for pension plans. KTRS will continue to evaluate all investment opportunities and with the advice of the consultants, will advise and educate the Board in these matters. Mr. Harbin reviewed the history of KTRS investments and the KTRS philosophy of investing, emphasizing that the experienced KTRS investment staff, Board, and consultants are working diligently to ensure that investments are made in the best long-term interest of the KTRS membership.

BOARD ACTION:
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Treasurer Hollenbach and seconded by Mr. Shelton, the report of the Investment Committee was unanimously approved as presented.

BOARD ACTION:
Chairperson Sterrett asked for questions or comments on accepting the Quarterly Report on the work of the Investment Committee. Upon motion duly made by Treasurer Hollenbach and seconded by Mr. Shelton, the Quarterly Report of the Investment Activity was unanimously approved as presented (a copy of which is included in Exhibit J and made a part thereof).

Mr. Harbin explained that "borrowing" money from the Pension Fund to fund the KTRS Health Insurance programs greatly reduces the amount of uncommitted (free cash flow) money that is available to invest. The Board has done an excellent job in handling the risks of assets, health care, and benefits by continuing to provide benefits while maintaining the security of funding for KTRS. In order to continue this in these challenging times, asset allocation becomes more important and KTRS will be looking at future options to maximize investment income. It may be necessary to amend the KTRS investment regulations as part of this process. The continued goal is to provide benefits to KTRS members over a long-term basis and currently KTRS is annually providing $1.3 billion in benefits. The KTRS 20-year investment return continues to out perform the S&P 500, and this reflects the judicious investment policies that withstand the unstable periods in the market. KTRS investment costs are 5 basis points, which is well below the cost of other retirement plans.

Mr. Harbin introduced Nancy Williams of EnnisKnupp & Associates. This firm is under contract to provide an independent study of KTRS investment policies, procedures, governance and administration. Ms. Williams explained that the eight areas of study will include: KTRS investment

objectives, cash flow status, investment policies and comparing these with other agencies' practices, KTRS asset allocation, KTRS investment benchmarks, KTRS cost effectiveness, compliance, and risk control.

At the June 2008 Board meeting, the Board approved the contract for the services of EnnisKnupp & Associates, investment consultants, for an independent review of the investment processes at KTRS. This review will study the retirement system's objectives, cash flow needs, governance and investment policy, asset allocation, benchmarks, cost effectiveness, and compliance and risk control. The firm was chosen because it is uniquely qualified for the project. The firm has vast experience working for public retirement systems that have sophisticated portfolios with members' assets that are managed both internally and externally. The team assembled for the KTRS review consists of senior consultants with backgrounds in institutional investments, law, accounting, management, plan governance, and actuarial matters. They possess the professional judgment and expertise required of the project and are experienced in working with boards of trustees as well as staffs at public retirement systems. They understand the unique nature of public pension plans that must manage both asset risk and liability risk and are routinely called upon to make presentations at major pension conferences across the United States.

The firm serves 162 retainer clients with aggregate assets of over $826 billion with client sizes ranging from $6 million to $219 billion. They also serve many project clients, usually 8 to 10 at any given time. Past and current project clients have assets ranging from $2 billion to $500 billion. Their diverse client base includes many prominent public and corporate retirement funds as well as endowments, foundations, and not-for-profit organizations.

Ms. Williams assured the Board that KTRS would receive the best independent thinking that EnnisKnupp can provide in evaluating KTRS investments and the completion date should be within the next 6 months.

Item 4(F) – Legal Services

Mr. Harbin asked Mr. Barnes to review current needs for legal services. Mr. Barnes discussed securities class action cases and in looking at the current KTRS strategy, it would be helpful to engage a firm that specializes in securities litigation to assess the current KTRS policies and procedures and also to evaluate possible securities litigation cases. This counsel would not engage in litigation, but would provide independent evaluation on the merits of a case. The services provided by an evaluation counsel could be of assistance to KTRS in analyzing any substantial securities losses that it may incur as a result of fraud committed by the officers of publicly traded companies, and in recommending appropriate action, whether that be filing a claim as a member of the class action in the federal courts or opting out and pursuing a claim independently in the state courts. An evaluation counsel could also assist KTRS in other securities litigation matters including its contract negotiations with entities that perform securities fraud monitoring services for KTRS. Kentucky Retirement Systems (KRS) currently engages the services of an evaluation counsel that is assisting KRS in these areas. It is recommended that KTRS, on an interim basis, either enter into a memorandum of agreement with KRS, if KRS is willing, to access the services of the KRS evaluation counsel, or, to contract directly for the services of an evaluation counsel to be used on an as needed basis only. Though it is not possible to know the extent of these services the System may need, it is anticipated the annual cost of this contract will not exceed $30,000. After thoroughly researching firms that specialize in these cases, it is recommended that KTRS contract with Reinhart Boerner Van Deuren, which is the same firm used by KRS, for evaluation of Securities Litigation at a maximum contract not to exceed $30,000.00.

BOARD ACTION

Chairperson Sterrett asked for questions or comments. Board Members asked why this has become an issue. Mr. Barnes explained that KTRS began to consider the possibility of employing an evaluation counsel last year after KTRS filed for lead plaintiff status in the Amgen case and that one of the Governor's Working Groups is currently studying securities litigation strategies of the state retirement systems. Board Members also asked if it would be less expensive to enter into an "MOA" with KRS. Mr. Barnes explained that this would not make any difference in the cost but that the KRS contract would contain the same terms and conditions that KTRS would want. Evaluation counsel would be used on an "as needed" basis. Upon motion duly made by Ms. Hunter and seconded by Mr. Conley, the recommendation was unanimously approved as presented.

Mr. Barnes continued and explained that as KTRS expands its portfolio into Alternative Assets, there is a need for specialized legal counsel. Fort Washington, a fund of funds manager with which KTRS contracts, recommended several law firms that could provide additional legal assistance to KTRS with its alternative asset class investments. KTRS has thoroughly researched these law firms and after much consideration has determined that Schottenstein Zox & Dunn based in Columbus, Ohio has both the experience and competence to provide these services at a cost that is below that of the other law firms that were considered. Ohio's State Teachers' Retirement System contracts with this firm and recommends them very highly. It is therefore recommended that KTRS contract with Schottenstein Zox & Dunn to provide assistance with alternative asset class investments on an as needed basis only at a cost not anticipated to exceed $50,000 annually.

BOARD ACTION

Chairperson Sterrett asked for questions or comments. Upon motion duly made by Dr. Morgan and seconded by Treasurer Hollenbach, the recommendation was unanimously approved as presented

The Board was in recess from 10:30 a.m. until 10:45 a.m.

Item 4(G) – Adjustment to the Actuarial Contract

Mr. Barnes provided background of the existing actuarial contract and for the need to adjust the actuarial contract with Cavanaugh Macdonald Consulting, LLC. During its March 17, 2008 meeting, the Board approved a contract renewal for fiscal year 2008-2009 for the actuarial consulting services of Cavanaugh Macdonald Consulting, LLC (CavMac). This contract set the maximum fee at $340,000. Since the March meeting, KTRS has been giving increasing consideration to having a "compliance review" of the retirement system to ensure that it remains in compliance with the Internal Revenue Code (Code) and maintains its status as a qualified plan under Section 401(a) of the Code. KTRS is prompted to reach this conclusion, in part, as a result of the announcement earlier this year by the Internal Revenue Service (IRS) that it is going to start focusing on Code compliance by public retirement plans since the IRS had been "under-serving" these plans in the past. The IRS has already sent out a lengthy questionnaire to many of the larger public retirement plans and it is not unlikely that its review may eventually include KTRS.

In addition to a compliance review, there is a unique opportunity to file a request with the IRS for a "Cycle C determination letter". Determination letters are issued following a review of a retirement plan by the IRS and provide the IRS's findings whether a plan is in compliance with the Code and, therefore, whether the plan is a qualified plan. KTRS has not obtained a determination letter since

April 25, 1985. There have been many plan amendments since that date through both statutory and regulatory amendments. A Cycle C determination letter filing, KTRS is being informed, will be treated more favorably by the IRS with more leniency for correction of errors. The filing deadline for a Cycle C determination letter filing is January 31, 2009. Cycle C reflects the "cycle concept" that is being developed by the IRS under which retirement plans will be required to file for a new determination letter on a regular basis, probably once every five years.

The status of being a qualified plan under Section 401(a) of the Code is extremely valuable for members as it permits them to make contributions to KTRS on a tax-deferred basis. Given the opportunity under the Cycle C filing schedule, and the importance of ensuring the continuance of the qualified status of KTRS, it is recommended that CavMac be directed to begin a compliance review for KTRS, and to then request a Cycle C determination letter from the IRS. This will require CavMac to engage the services of expert consultants, primarily a law firm that is highly qualified and experienced with Code compliance, and thus would necessitate an increase in the maximum fee cap approved by the Board in March. The compliance review is estimated to cost between $25,000 and $35,000. Additional expert assistance with filing for a determination letter is estimated to cost between $5,000 and $10,000. The IRS filing fee is $1,000. Given the importance of maintaining KTRS's qualified status, it is recommended that KTRS have a compliance review conducted, that it seek a new determination letter from the IRS, and that a fee adjustment to the current contract with CavMac be made by adjusting the maximum fee cap from $340,000 to $386,000. Maintaining the qualified tax-exempt status of the plan is of paramount importance to KTRS members.

BOARD ACTION

Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Shelton and seconded by Dr. Morgan, the recommendation for a fee adjustment to the current contract with Cavanaugh Macdonald Consulting, LLC was unanimously approved as presented.

Item 4(H) – Report of the Insurance Committee

Mr. Harbin explained that the Insurance Committee met on September 4, 2008 (a copy of which is attached hereto as Exhibit K and made a part hereof) and asked Ms. Jane Gilbert to provide background on the KTRS Health Insurance programs as well as information on the 2009-2010 Plan Year. The 2009-10 General Fund Budget, adopted by the Legislature and signed into law by the Governor, directs that the amount needed to fund the medical insurance benefit for the 2008-10 biennium be redirected from state contributions that would otherwise be directed to the retirement fund. The actuary has projected that amount to be $125 million for the

2008-09 fiscal year. In addition, the budget also redirected $14 million for the 2008-09 fiscal year and $9 million for the 2009-10 fiscal year to provide subsidies for parent plus, couple, and family coverage of retirees under age 65.
Ms. Gilbert provided a recap of the benefits provided to retirees through two plans: The Medicare Eligible Health Plan (MEHP) and the Kentucky Employees Health Plan (KEHP).

MEHP for retirees age 65 and above:
The KTRS Medicare Eligible Health Plan is the plan for retirees age 65 and older. This plan provides medical benefits for approximately 20,000 participants. Medical benefits are provided by Humana, primarily using a customized Medicare Advantage Private Fee For Service (PFFS) policy designed to mirror benefits received in 2006. The prescription drug benefit is self-insured using Medco as the Prescription Benefit Manager (PBM).

Savings from the utilization of two federal programs, Medicare Part D and Medicare Advantage PFFS, were used to reduce premiums in 2008 to $278 per participant per month from $283 in 2007. These savings are expected to continue through 2010; however, future savings likely will be reduced since Congress has made changes to the Medicare Advantage PFFS program. The likelihood of this occurring was incorporated in making the change to PFFS, with the contract being drafted to include returning to the self-insured funding of the medical benefit should the federal program cease.

With the current savings from the two federal programs, premiums may be raised slightly to $285 per participant per month for calendar year 2009. KTRS provides a supplement equal to 100% of the cost for retirees with 20 years of service whose entry date was prior to July 1, 2002; approximately 86% of retirees would not have to pay toward their own single coverage. The remaining retirees would experience increases in premiums of $.35 to $6.30 per month. Spouses would remain eligible for the plan at the full participant monthly cost of $285.

The recommendations and considerations of the Insurance Committee are as follows:

Insurance Committee Recommendations – Medicare Eligible Health Plan (retirees age 65 and older or subject to Medicare):

1. That the Board approve a monthly supplement amount of $285 for retired members eligible for the Medicare Eligible Health Plan, with a like premium amount charged for spousal coverage for the 2009 plan year.

2. That the Board approve for KTRS staff to issue a Request for Qualifications (RFQ) for a broker/consultant for a Prescription Drug Plan, known as an Employer Group Waiver Plan under the Medicare Modernization Act, effective January 2010 to determine if an annual savings of $5-$15 million can be achieved with minimal benefit disruption to our membership. Should such a savings be recognized, there would be a significant reduction in the actuarial unfunded OPEB liability as projected by the KTRS actuaries and this would further stabilize member premium costs for the MEHP Plan.

3. That the Board approve for KTRS staff to issue a Request for Qualifications (RFQ) for an auditor to perform a 36-month prescription claims audit, a 36-month Medicare Part D subsidy audit, a

dependent eligibility audit with amnesty period, plus any other health plan audits deemed necessary by KTRS staff. The dependent eligibility audit with amnesty period is to coincide with a permanent spousal election or waiver effective January 2010.

4. That the Board authorize a study be conducted and discussions with constituency groups take place to consider changing the 4% retired member coinsurance for primary care physician services and specialist services to a flat co-payment in the range of $10 to $25 (not subject to the medical deductible, indexed to medical inflation and effective no earlier than January 2010).

BOARD ACTION

Chairperson Sterrett asked for questions or comments. Upon motion duly made by Treasurer Hollenbach and seconded by Ms. Sweazy, the four (4) recommendations of the Insurance Committee for retired members eligible for the Medicare Eligible Health Plan were unanimously approved.

KEHP for retirees under age 65:

The Kentucky Employees Health Plan (KEHP) has operated since 2006 as a self-insured plan. The benefits for Plan Year 2009 have been changed from 2008 and are being finalized.

Humana will continue as the Third Party Administrator (TPA) for the medical benefit and Express Scripts will serve as the pharmacy TPA. The monthly premium for 2008 was set at $484.24, a 5.8% increase above the $457.70 premium for 2007. At the time of preparing this report, the premium amount for 2009 is set at $545.08, a 12.56% increase above the 2008 premium.

The number of retirees living out-of-state without access to network benefits has dropped significantly since changing to the self-insured plan. The few out-of-state retirees that do not have in-network benefits will continue to be eligible for out of state reimbursement through KTRS.

KEHP dependent subsidies

In November 2004, the Legislature met in special session to address issues raised by the Kentucky Education Association (KEA) regarding changes proposed by the state administration to active teachers' health care benefits. The resulting Special Session restored those benefits and improved them by adding a dependent subsidy for coverage beyond single coverage. That same subsidy was secured for retired teachers and retired state/city/county employees. Funding was appropriated by the General Assembly for the subsidy for the remainder of the 2004-05 and 2005-06 biennium. Through fiscal year ending 2009, KTRS has been directed to borrow $14.8 million from pension assets to cover these dependent subsidies. From January 2005 through June 2009, these dependent coverage subsidies will have totaled $32.6 million for KTRS retirees.

Insurance Committee Recommendations – Kentucky Employees Health Plan for retirees under age 65:

1. That the Board approve a 2009 monthly premium equivalent amount of $545.08 as a recommended monthly premium charge for KTRS eligible retirees under age 65 and enrolled in the Kentucky Employees Health Plan, and that the supplement provided for retirees living outside of the KEHP national network, as defined by KTRS, will not exceed a similarly situated retiree living in Kentucky.

2. That the Board approve KTRS staff to encourage the KEHP to explore joining the already established Ohio drug purchasing alliance, as long as the savings proves material and each agency may keep their autonomous plan design and separate pharmaceutical benefits manager contract. Any savings from this action would support funding the medical benefit for retirees.

3. That the Board authorize a study be conducted and discussions with constituency groups take place to consider funding options for retiree health care that would ensure long-term funding of retiree health care and would have as a goal to end the practice of redirecting contributions from the retirement fund to fund retiree medical insurance. Such actions would consider equity for both retirees under age 65 and age 65 and older, active members and employers.

BOARD ACTION
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Conley and seconded by Ms. Zimmerman, the three (3) recommendations of the Insurance Committee for retired members eligible for the Kentucky Eligible Health Plan were unanimously approved.

Clarification of Medical Insurance Supplement Payments

Mr. Barnes presented the need for clarification on existing policy. During its June 17, 2002 meeting, the Board approved a new Schedule of Medical Supplement Payments (Schedule) recommended by Buck Consultants for "all new members hired on or after July 1, 2002." The new Schedule applied to both the under age 65 medical plan and the age 65 and over medical plan. The new supplements started at10% for retirees with at least five years of service and rose incrementally to 100% for those members who retire with at least 27 years.

It was clear at the June 17, 2002 meeting that the new Schedule was intended to apply to all persons who became new members of KTRS on or after July 1, 2002. However, there has been at least one extenuated argument that persons who were employed to provide substitute teaching services prior to July 1, 2002 and who continued to provide those services on or after July 1, 2002, the date when substitute teaching was brought into the KTRS field of membership for the first time, should participate under the old Schedule of Medical Supplement Payments with the higher supplements.

The argument presented is that persons who were providing substitute teaching services prior to July 1, 2002 were "hired" before July 1, 2002 and therefore are eligible for the higher supplements. This argument focuses on the language "hired on or after July 1, 2002" and overlooks the reference to "new members" hired on or after July 1, 2002. Persons who provided substitute teaching services prior to July 1, 2002 were not members of KTRS, had no legal relationship to KTRS, and did not contribute to the KTRS Medical Insurance Fund. Thus, it was clearly the intent of the Board during its June 17, 2002 meeting that the new supplement payments would apply to all persons who were hired into KTRS-covered positions on or after July 1, 2002, thus becoming a new member of KTRS on or after July 1, 2002. Accordingly, persons who provided substitute teaching services prior to July 1, 2002, and who became members of KTRS on or after July 1, 2002, would participate under the Schedule adopted by the Board at its June 17, 2002 meeting.

Under KRS 161.470(2), persons with refunded accounts who later return to employment in a KTRS-covered position enter the retirement system as a new member, except that they may reinstate the refunded account. Accordingly, persons who have a refunded account that was established prior to July 1, 2002 and who returned to a KTRS-covered position on or after July 1, 2002, should be required to reinstate the refunded account in order to participate in the medical insurance supplement payments that existed prior to July 1, 2002.

KTRS recognizes the reciprocity provisions incorporated by statute under KRS 61.680 to acknowledge un-refunded service in Kentucky Retirement Systems for determining eligibility for medical insurance. As such, persons who become active contributing members in a KTRS-covered position on or after July 1, 2002, but who established an un-refunded account in Kentucky Retirement Systems prior to July 1, 2002, are eligible to participate in the medical insurance supplement payments schedule that existed prior to July 1, 2002.

Recommendation

It is recommended that the Board re-emphasize the applicability of the effective date of the Schedule of Medical Supplement Payments (Schedule) recommended by Buck Consultants and adopted by the Board during its June 17, 2002 meeting, and furthermore that it specifically address the issue of refunded accounts, by adopting the language as follows:

The Schedule of Medical Supplement Payments (Schedule) recommended by Buck Consultants and adopted during the June 17, 2002 Board meeting applies to all persons who become new members of KTRS on or after July 1, 2002. Persons who provided substitute teaching services prior to July 1, 2002, or who were not employed in KTRS-covered positions from which they made contributions to KTRS, were not members of KTRS prior to that date and did not contribute to the medical insurance fund and therefore participate under the Schedule adopted at the June 17, 2002 meeting. Persons who have a refunded account that was established prior to July 1, 2002 and who returned to a KTRS-covered position on or after July 1, 2002, must reinstate the refunded account in order to participate in the medical insurance supplement payments schedule that existed prior to July 1, 2002. Persons who become new members in a KTRS-covered position on or after July 1, 2002, but who established an un-refunded or reinstated account in Kentucky Retirement Systems prior to July 1, 2002, are eligible to participate in the medical insurance supplement payments schedule that existed prior to July 1, 2002.

BOARD ACTION

Chairperson Sterrett asked for questions or comments. There was discussion concerning the need to clarify the term “un-refunded”, and it was recommended that adding “or reinstated” language to the sentence would clarify the meaning. Upon motion duly made by Treasurer Hollenbach and seconded by Ms. Hunter, the recommendation to amended language was unanimously approved.

Chairperson Sterrett asked for additional questions or comments. Upon motion duly made by Mr. Sanders and seconded by Treasurer Hollenbach, the recommendation with the amended language was unanimously approved.

Item 4(I) – Report of the Legislative Committee

Mr. Harbin explained that the Legislative Committee met on September 4, 2008 and asked Mr. Barnes to review the proposed legislative changes. Mr. Barnes informed the Board that the majority of the recommended legislative proposals are routine housekeeping items that would only provide greater clarity or would make technical changes to existing statutes. The proposals that have been recommended by the Legislative Committee for approval by the Board are as follow:

1. **<u>KRS 161.155(10)</u>**
   This statute allows local school districts to compensate retirees for their unused sick leave and requires that this compensation be included in calculating retirees' initial retirement allowances. This provision could use some greater clarification to emphasize that sick leave compensation is included for retirement calculation purposes only at the time of a member's initial retirement to avoid any uncertainty that it might also apply to the recalculation of retirement allowances following a second retirement resulting from a member who waived his or her retirement annuity to return to work. This amendment would not change current practice.

2. **<u>KRS 161.220(4)(p)</u>**
   This statutory subsection describes which employees of the Kentucky Department of Education (KDE) participate as members of KTRS. It contains a reference to "serving in a professional position" that should more accurately be written as "serving in a professional job classification". This technical amendment would reflect more precisely how KTRS membership within KDE is determined and would not change current practice.

3. **<u>KRS 161.340(1)</u>**
   This statute provides for the Board to employ an "executive secretary" to serve as the chief administrative officer for the Board. The term "executive secretary" is somewhat archaic and does not accurately reflect the position it describes. During the recent posting for an opening for a "deputy executive secretary", KTRS received many applications from individuals who were seeking a clerical or "secretarial" position. An informal survey of other public pension systems across the nation reveals that the term "Executive Director" is by far the most common and recognized designation for the chief executive officer of a public pension system. All other statutory references to "executive secretary" would be correspondingly amended as well.

4. **<u>KRS 161.430(1)</u>**
   The KTRS investment statute references the "Association for Investment Management and Research" as the organization that promulgates "The Code of Ethics" and "The Standards of Professional Conduct" with which KTRS investment advisors and staff employees must comply. The name of this organization has been changed to the "CFA Institute" and should accordingly be updated in this statute. Also, to be technically precise, the publication is entitled "Code of Ethics and Standards of Professional Conduct."

5. **<u>KRS 161.450(1)(b)</u>**
   This statute establishes the member contribution rates and was amended by House Bill1, enacted during the 2008 Special Session, to increase the contribution rate by one percentage point for persons who become members of KTRS on or after July 1, 2008. This recent amendment references "university faculty". This reference should be broader and read "university employees who participate in the Kentucky Teachers' Retirement System" to accurately reflect the fact that KTRS has both university faculty and staff within its field of membership.

6. **KRS 161.605(6)**
In addition to the standard Daily Wage Threshold (DWT) that is measured as seventy-five percent (75%) or sixty-five percent (65%) of a retiree's last annual compensation prior to retirement, KRS 161.605(6) also provides a minimum, floor DWT that retirees may earn in a KTRS-covered position without impact on their retirement allowance. This minimum, floor DWT was initially provided to assist those retirees whose last annual compensation in a KTRS-covered position was earned so long ago that the standard DWT allowed them to earn only very limited compensation, in some of the rarer cases $30 a day or less. To avoid these situations, the minimum, floor DWT was established and is currently set at the base contract salary for a beginning teacher at Rank III on the salary schedule of the district for which they are returning to work. A problem has developed, however, with this minimum, floor DWT in that KTRS does not receive salary schedules from school districts until after the start of the school year and, accordingly, cannot provide its retirees with their minimum, floor DWT until after the school year has started. A minimum, floor DWT set at a single amount for the entire state that could be amended from time to time by the Board with cost of living adjustments, as opposed to a minimum floor DWT that varies from district to district dependent upon each district's salary schedule, would eliminate the problem.

7. **KRS 161.605(8)(b)**
KRS 161.605(8) establishes the critical shortage program under which retired members of KTRS may return to work and earn any amount of compensation without impact on their retirement allowances. This statutory subsection was amended at the request of KDE during the 2008 Regular Session of the General Assembly by creating critical shortage positions for individuals who serve on Scholastic Audit Teams as had been discussed by KTRS and KDE. There was additional language, however, that also included positions providing "technical assistance to schools and districts required under federal law". This reference is vague, open-ended and difficult to administer with any certainty. Furthermore, it is a superfluous reference as the Scholastic Audit Team members, which were the original target for the additional critical shortage positions, is already covered. The critical shortage statute was created with the sole intent of permitting school districts the ability to recruit retired teachers into hard-to-fill teaching positions such as math, foreign languages or special education. For these reasons, it is offered for consideration that the reference to positions required under federal law be deleted.

8. **KRS 161.620**
This statute was amended by the Special Session's House Bill 1 to establish new service retirement factors (a/k/a multipliers) for persons who become members of KTRS on or after July 1, 2008. This legislation did not contain the provision that applies to all persons who became members prior to July 1, 2008 that makes the 3% factor available only under conditions set forth in administrative regulations promulgated by the Board. It is recommended for consideration that this same provision be added for persons who become members on or after July 1, 2008.

9. **KRS 161.630**
This statute describes the standard life annuity with refundable balance retirement plan that is available to retirees. It also permits the Board to adopt additional retirement options. To be technically precise, the word "option" should be deleted from the phrase "life annuity with refundable balance option" found in subsection (3) of this statute. This technical amendment would not change current practice.

BOARD ACTION
Chairperson Sterrett asked for questions or comments. Discussion clarified that the change to KRS 161.220(4)(p) does not affect the classified personnel in the local school districts. Upon motion duly made by Dr. Morgan and seconded by Treasurer Hollenbach, the nine (9) recommendations of the Legislative Committee were unanimously approved

Legislative Update

Mr. Barnes provided an overview of the recent legislative changes that impact KTRS and the Board of Trustees. The General Assembly enacted the Governor's public pension legislation designated as House Bill 1 during the recent Special Session of the General Assembly. This bill changes the retirement benefit structure of both KTRS and Kentucky Retirement Systems. The changes apply primarily to persons who become members on or after July 1, 2008 and include such measures as requiring a minimum of fifteen years of service for vesting in medical insurance and excluding the use of lump sum paid compensatory and annual leave from the calculation of retirement allowances. This bill offers a new tier of retirement factors (a/k/a multipliers) for new members with five different factors for non-university members and four different factors for university members. House Bill 1 also increases new members' employee contribution rate by one percentage point to be used toward

funding medical insurance. These new provisions will also apply to the second accounts of retirees who have returned to work in a KTRS-covered position on after July 1, 2008. Finally, Board members would be limited to serving three consecutive four-year terms, but could serve a fourth four-year term after an absence of four years. This provision would apply only to terms of office beginning after July 1, 2008.

Item 4(J) – Update on Kentucky Public Pension Working Group

Mr. Harbin and Mr. Barnes also provided a progress report on the Kentucky Public Pension Working Group (Working Group) established by the Governor on May 29, 2008, and the six smaller sub-groups into which it has been subdivided, that have continued to meet since the last Board meeting. Mr. Harbin explained that these sub-groups utilize a large amount of KTRS staff time in providing requested information/statistics in addition to time involved in attending the meetings and providing presentations to the Working Group and sub-groups. The Working Group is to present its report to the Governor by November 1, 2008.

Jane Gilbert left at 11:45 a.m. to attend another meeting.

Item 4(K) – Report of the Actuary

Mr. Harbin introduced Ed Macdonald and Ed Koebel of Cavanaugh and Macdonald, LLC., actuaries who provided information on the retirement option factors as well as Market Value Liability and an Asset Liability Modeling Study.

Modification to Retirement Options
Mr. Macdonald and Mr. Koebel reviewed the process by which the firm determined the changes in the retirement factors that are needed. Consideration was given to the age of the retirees, the age of the beneficiaries, and the cost of living increases in the recent 5-year Experience Study that was performed for KTRS. Per KRS 161.400(2), the retirement option factors in use by the System shall be determined by the actuary of the retirement system and approved by the board of trustees by resolution and implemented without the necessity of an administrative regulation. In July 2008, the actuary presented to the System recommended modifications to retirement option factors as a result of changes in assumptions resulting from the most recent experience study conducted by the actuary. The new retirement option factor modifications based on the changing mortality rates were presented to the Board with an effective date of January 1, 2009.

BOARD ACTION
Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Conley and seconded by Treasurer Hollenbach, the resolution to adopt the modified option factors with an effective date of January 1, 2009, was unanimously approved (a copy of which is attached hereto as Exhibit L and made a part hereof).

Mr. Macdonald provided information on Market Valued Liability and how this can impact public pension systems so that the Board is aware of this new liability measurement that is being advocated by private sector actuaries.

Mr. Koebel provided information on the Asset Liability Modeling Study that will cover a 30-year projection. This will consider funding ratios and cash contributions as well as other factors.

Item 4(L) – Executive Secretary's Observations and Comments

Certificate of Achievement for Excellence in Financial Reporting
For the 20th consecutive year, KTRS has received an Award for Financial Reporting Achievement for its Comprehensive Annual Financial Report (CAFR). This award, presented by the Government Finance Officers Association of the United States and Canada, is given to those governmental units and retirement systems that achieve the highest standards in government accounting and finance reporting (a copy of which is attached hereto as Exhibit M and made a part hereof).

Mr. Harbin explained that due to the demands posed by the Working Groups and the new retirement legislation effective July 1, 2008 under HB 1, the Personnel Committee of the Board has not been able to meet to complete the evaluation of the Executive Secretary. This evaluation should be completed by the December Board Meeting.

Mr. Harbin expressed his personal gratitude and the gratitude of the agency to Mr. Hutchison for his expertise, dedication and leadership during his 8 years as KTRS Deputy Executive Secretary and offered good wishes for his up-coming retirement.

. **Item 5 – General Discussion**

Members of the Board asked that KTRS staff explore the instances in which surviving spouses who are participating in KTRS Health Insurance and paying the full cost, lose access to KTRS Health Insurance if they remarry. Is there a possibility that these individuals can continue to participate in KTRS Health Insurance if the remarry if they pay the full cost? Mr. Harbin stated that KTRS staff will look into the issue and respond.

Ms. Sterrett stated that every Board member should attend an Investment Committee meeting to experience the depth of study, amount of work, and volumes of information processed by the Investment Committee members and KTRS staff.

Members of the Board requested a continuing budgeting baseline to reflect how approving expenditures throughout the year impact the agency budget. Mr. Harbin responded that this would be provided and the KTRS operating budget continues to be well below that of comparable agencies.

Item 6 – Adjournment

There being no further business to come before the Board of Trustees, and upon motion duly made by Treasurer Hollenbach and seconded by Mr. Sanders, Chairperson Sterrett declared the meeting adjourned at 12:30 p.m.

Respectfully submitted,

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Mary Pat Dobbins
Secretary