

MEETING MINUTES
KENTUCKY TEACHERS' RETIREMENT SYSTEM
REGULAR QUARTERLY MEETING OF THE BOARD OF TRUSTEES
FRANKFORT, KENTUCKY
JUNE 16, 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., ET, Monday, June 16, 2008.

Item 1 - Board Called to Order

Barbara G. Sterrett, Vice-Chairperson, called the meeting to order.

Item 2 - Roll Call

Members present were:

Robert M. Conley

Laura A. Zimmerman

Dr. Jay Morgan

Barbara G. Sterrett

Ruth Ann Sweazy

Ronald L. Sanders

Todd Hollenbach, State Treasurer, joined the meeting at 9:20 a.m.

Robin Kinney, Proxy for Jon Draud, Commissioner of Education, joined the meeting at 9:55 a.m.

Members absent were:

Dr. Zella F. Wells

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

Sandra K. Parker, Kentucky Teachers' Retirement System

Mark E. Whelan, Kentucky Teachers' Retirement System

Cebert Gilbert, Kentucky Retired Teachers' Association

Fred Hester, Kentucky Education Association-Retired

Erlayne Crowe, Kentucky Education Association-Retired

Ms. Kinney was appointed a permanent proxy on December 14, 2007.

Item 3 (A) - Minutes of Last Quarterly Meeting

The Board considered the minutes of the previous meeting held March 17, 2008. Upon motion duly made by Ms. Zimmerman and seconded by Mr. Conley, the minutes of that meeting were unanimously approved as printed.

Item 3 (B) - Report of Results of Trustee Election

Mr. Harbin reported the results of the election for the position on the Board of Trustees that will become vacant on June 30, 2008, due to the expiring term of Dr. Zella F. Wells, active teacher trustee, who declined to run for reelection.

The election was held in May and Kevin Noland, of the Department of Education, certified the results on June 3, 2008. (A copy of the letter certifying the results is attached hereto as Exhibit A and made a part hereof).

In the election for the active teacher trustee, Tom Shelton, superintendent of the Daviess County Public Schools, was the successful candidate. Mr. Shelton's term of office is July 1, 2008-June 30, 2012.

Mr. Harbin acknowledged the service of Dr. Zella F. Wells on the Board of Trustees and displayed a resolution expressing the Board's appreciation that will be presented to her at a later date. The resolution reads as follows:

RESOLUTION

WHEREAS, Zella F. Wells served with distinction as a member of the Board of Trustees of the Teachers' Retirement System of the State of Kentucky from July 1, 2004 until June 30, 2008; and

WHEREAS, during Zella F. Wells' tenure on the Board of Trustees, policies were adopted that, without shifting costs to KTRS members, resulted in more than \$30 million in savings within the KTRS Medical Insurance Fund; a commitment was secured from the executive and legislative branches of state government to fund medical insurance benefits for retired Kentucky educators; policy was adopted that raised the earnings income exclusion for those KTRS members who must retire for reason of disability; KTRS office hours were expanded in order to better serve members; and

WHEREAS, during Zella F. Wells' tenure on the Board of Trustees, the annual distribution of retirement and medical benefits to KTRS members increased from \$1.004 billion to \$1.350 billion; and

WHEREAS, during Zella F. Wells' tenure on the Board of Trustees, the Teachers' Retirement System of the State of Kentucky operated on a sound financial basis; and

WHEREAS, Zella F. Wells' thoughtful and insightful contributions were invaluable to the deliberations of the Board of Trustees; and

WHEREAS, Zella F. Wells will be sorely missed by members of the Board of Trustees and staff of the Teachers' Retirement System of the State of Kentucky.

NOW, THEREFORE, BE IT RESOLVED, that the members of the Board of Trustees wish to thank Zella F. Wells for her numerous contributions to the successful operation of the Teachers' Retirement System of the State of Kentucky and express appreciation for her service on behalf of the public school teachers of the Commonwealth of Kentucky; and

BE IT FURTHER RESOLVED, that a copy of this Resolution be made a part of the official minutes of the Board of Trustees, and that a copy thereof be presented to Zella F. Wells.

Adopted this 16th day June 2008.

Barbara G. Sterrett
Vice-Chairperson

Gary L. Harbin
Executive Secretary

Item 4 - Report of the Secretary

Vice-Chairperson Sterrett recognized Mr. Harbin for the Report of the Secretary. Mr. Harbin recognized Mr. Hutchison who presented Items 4(A)-4(E).

Item 4 (A) - Applications for Retirement and Annuity

Mr. Hutchison distributed a table (a copy of which is attached hereto as Exhibit B and made a part hereof) showing retirements for the months of March, 2008 (a copy of which is attached hereto as Exhibit C and made a part hereof); April, 2008 (a copy of which is attached hereto as Exhibit D and made a part hereof); and May, 2008 (a copy of which is attached hereto as Exhibit E and made a part hereof). He noted that there was 1 payment for handicapped children; 34 payments for disability retirement; 81 payments for service retirement and 6 payments for beneficiaries of members eligible to retire. Initial retirements for the period included 122 retirees with monthly payments totaling \$239,037.21. The Board was asked to approve these initial payments as listed in the detailed monthly reports.

BOARD ACTION:

Vice-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 March, April and May 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 F and made a part hereof) which indicates 10 survivor benefits, with a total monthly payment of \$1,920.00 during the three-month period of January 1-March 31, 2008. The Board was asked to approve the initial payments of these benefits as listed in the detailed report.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Sanders and seconded by Dr. Morgan, the initial payments for survivor benefits for the months of January, February and March 2008, were unanimously approved as presented.

Item 4 (C) - Life Insurance Benefits

Mr. Hutchison presented the life insurance benefits report for the period of January 1-March 31, 2008 (a copy of which is attached hereto as Exhibit G and made a part hereof), which shows 7 payments to beneficiaries of active members and 193 payments to beneficiaries of retired members for a total of 200 payments totaling \$979,000.00. Totals for the same quarter in 2007 were 251 payments in the amount of \$1,215,000.00. The Board was asked to approve the payment of these benefits.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Conley and seconded by Mr. Sanders, payments for life insurance benefits for the months of January, February and March 2008 were unanimously approved as presented.

Item 4 (D) - Refunds

Mr. Hutchison discussed the report of refunds for the quarter ended March 31, 2008 (a copy of which is attached hereto as Exhibit H and made a part hereof) that indicates a total of 518 refunds in the amount of \$3,637,484.56. During the same quarter in 2007, there were 422 refunds in the amount of \$2,878,846.65. The Board was asked to ratify the actions of the staff in refunding these accounts.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Sweazy and seconded by Ms. Zimmerman, the report of refunds for the quarter ending March 31, 2008 was unanimously ratified as presented.

Item 4 (E) - Interim Financial Statements

The Interim Financial Statements for the quarter ended March 31, 2008 (a copy of which is attached hereto as Exhibit I and made a part hereof) are submitted for informational purposes only and require no action of the Board of Trustees.

Item 4 (F) - Report of the Investment Committee

Mr. Harbin recognized Mr. Yancey for the Investment Committee report (a copy of which is attached hereto as Exhibit J and made a part hereof).

The Report of the Investment Committee for the quarter ended March 31, 2008, was presented for review and approval. During this quarter, there were 1,467 purchases amounting to \$10,241,946,894.97 and 1,667 disposals amounting to \$10,195,503,123.12. The disposals represented 81 short-term (repo, discount notes); 34 fixed income securities; 492 principal pay-downs; 33 redemptions/maturities, and 1,027 equity securities. 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 \$13,804,866,810.08, and a market value of \$14,487,896,992.07.

Investment income at the end of the quarter showed an annual rate of 4.8% on fixed dollar assets and 3.2% on total assets. These compare with returns of 5.3% and 3.4% at the end of the previous quarter.

Committee Report:

The U.S. economy continues to react to the combined effects of the sharp downturn in the housing market and rising energy costs. Consumer spending is slowing, along with corporate profits, as consumers are forced to spend more of their discretionary income on higher gas prices. The retail and auto sectors have been hit especially hard by the pullback in spending. Some economists are forecasting that economic growth may slow to recessionary levels.

With the downturn in the financial markets, the System generated a total return of -0.8% for the year ended March 31, 2008. Although the current investment environment remains challenging, the System's long-term returns remain strong with the entire fund earning fifteen and twenty-year annualized returns of 7.8% and 8.8%, respectively. The stock portfolio earned a one-year return of -5.7%, while the bond position earned a positive return of 7.9% over the period. Over longer time-periods, the stock portfolio has earned a fifteen-year annualized return of 9.8% and a twenty-year annualized return of 11.6%, while the bond portfolio has earned fifteen and twenty-year annualized returns of 6.5% and 7.6%.

The U.S. stock market declined for the second consecutive quarter, with the broad market S&P 1500 Stock Index posting a return of -9.3% for the quarter ended March 31, 2008. International markets are also struggling with the general slowdown in global economic growth with international stocks, as measured by the MSCI EAFE Stock Index, returning -8.8% during the quarter. The Federal Reserve continues to lower interest rates in its efforts to stimulate the economy and provide liquidity to the credit markets. The Fed lowered the benchmark Fed Funds rate by 25 b.p. to 2% on April 30, for a cumulative lowering of the rate by 325 b.p. since the financial crisis first took hold last summer.

One result of the current downturn in the financial markets has been a return to investors focusing on high-quality investments. After a period of time in which investors were rewarded for carrying higher-risk investments such as sub-prime mortgages, it now appears that conservative investment strategies, such as those used by KTRS, will take the forefront.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Zimmerman and seconded by Mr. Sanders, the investment report for the quarter ending March 31, 2008 was unanimously approved as presented.

Further Developments

The System continues to make strides toward further diversifying the investment portfolio, and recently hired two international stock managers, Baring Asset Management and Baillie Gifford, along with a core real estate manager, Prudential Real Estate Investors. In late April, Baring Asset Management and Baillie Gifford were each allotted \$150 million to invest, bringing the System's total allocation to international stocks to 9.4%. The long-term goal is a 15% allocation to international equities. In July, the System will begin funding Prudential Real Estate Investors' mandate to manage \$200 million in real estate investments, and anticipates that this \$200 million allotment will be funded gradually over a one-two year time-period.

At the March 17, 2008 Board meeting, it was reported that the contracts for the new managers were currently being negotiated and were not available for presentation to the Board at that meeting. It was recommended that the Investment Committee be authorized to approve the contracts at its April 25 meeting, and for those contracts to then be presented to the Board at the June meeting for ratification. Accordingly, the Investment Committee approved the contracts at its April 25 meeting and presented the following information for the Board's ratification:

Baillie Gifford is an independently owned, Edinburgh, Scotland, based investment firm, with approximately \$110.1 billion assets under management. Baillie Gifford uses a bottom-up team based approach to portfolio construction. They select stocks that can sustain above average growth in earnings and cash flow while employing geographic and sector teams to conduct fundamental research. The firm's largest international large-cap growth clients include The Vanguard Group, EDS Retirement Plan, and New York City Police Fund.

The investment with Baillie Gifford is in a co-mingled fund (The EAFE Fund). The initial investment is \$150 million, an amount that classifies KTRS as a Class 3 investor in the Fund. As such, the annual management fee will fluctuate from quarter to quarter, but based on the amount of the initial investment, is expected to be approximately \$930,000 annually.

RECOMMENDATION:

The Investment Committee recommended the ratification of the contract with Baillie Gifford as an international stock manager according to the fee structure stated above.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. The Board voted unanimously to adopt the recommendation of the Investment Committee to ratify the contract with Baillie Gifford, as an international stock manager, at the fee structure as presented.

Baring Asset Management is a subsidiary of Massachusetts Mutual Life Insurance Company with the international equity team located in London, England. Baring has approximately \$53.2 billion assets under management. The firm uses a growth at a reasonable price strategy that focuses on countries, sectors, and stocks with the potential for the greatest earnings growth. Baring employs 42 stock analysts, with final portfolio construction being the responsibility of a seven-member Global Equity Group. International large-cap growth clients include Denver Public Schools, New Mexico Educational Retirement Board, and MassMutual.

The investment with Baring Asset Management is in a co-mingled fund (The Baring Focused International Equity Fund). The initial investment is \$150 million. The annual management fee is scaled based primarily on the value of the fund. Therefore, the amount of the fee will vary each quarter. Based on the amount of the initial investment, the management fee is expected to be approximately \$750,000 annually.

RECOMMENDATION:

The Investment Committee recommended the ratification of the contract with Baring Asset Management as an international stock manager according to the fee structure stated above.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. The Board voted unanimously to adopt the recommendation of the Investment Committee to ratify the contract with Baring Asset Management, as an international stock manager, at the fee structure as presented.

Prudential Real Estate Investors (PREI) is a part of Prudential Financial, Inc. PREI has approximately \$28.8 billion assets under management, and is headquartered in Parsippany, New Jersey. The firm invests primarily in existing income-producing properties with strong cash flow and the potential for capital appreciation. Examples include office, retail, industrial, apartment, self-storage and hotel properties. Public pension fund clients include Indiana State Teachers' Retirement System, Public School Retirement Systems of Missouri, Teachers' Retirement of Louisiana, and New York State Teachers' Retirement System.

The investment with Prudential Real Estate Investors (PREI) is in a co-mingled fund (PRISA Account). KTRS has made an initial commitment of \$200 million to the fund. \$50 million will be invested in July. Fees are based on property costs, operating cash flow, and the level of cash in the portfolio. Each of these components will fluctuate from quarter to quarter, as will the fee.

RECOMMENDATION:

The Investment Committee recommended the ratification of the contract with Prudential Real Estate Investors (PREI) as a core real estate manager according to the fee structure stated above.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. The Board voted unanimously to adopt the recommendation of the Investment Committee to ratify the contract with Prudential Real Estate Investors (PREI), as a core real estate manager, at the fee structure as presented.

Molpus Woodlands Group. Another recent development was the System's initial investment in the timberland asset class. KTRS has an initial commitment to Molpus of \$100 million. In April, the System completed the purchase of 68,392 acres of timberland located in the upper peninsula of Michigan. This property, purchased for \$74.5 million, will be managed by the Molpus Woodlands Group.

The management fees are scaled, based on the value of the timberland under management. In addition, there is a performance incentive fee for returns above stated benchmark real returns.

RECOMMENDATION:

The Investment Committee recommended the ratification of the contract with Molpus Woodlands Group as a timberland investment manager according to the fee structure stated above.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. The Board voted unanimously to adopt the recommendation of the Investment Committee to ratify the contract with Molpus Woodlands Group, as a timberland investment manager, at the fee structure as presented.

Hancock Timber Resource Group. KTRS' initial commitment is \$100 million to this manager; no funds have been invested at this date.

The management fees are scaled, based on the value of the timberland under management. In addition, there is a performance incentive fee for returns above stated benchmark real Internal Rates of Return (IRR).

RECOMMENDATION:

The Investment Committee recommended the ratification of the contract with Hancock Timber Resource Group as a timberland investment manager according to the fee structure stated above.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. The Board voted unanimously to adopt the recommendation of the Investment Committee to ratify the contract with Hancock Timber Resource Group, as a timberland investment manager, at the fee structure as presented.

Results of RFP for Investment Advisor Review

Mr. Harbin explained that per KRS 161.430, "the Board of Trustees shall employ experienced competent investment counselors to advise it on all matters relating to investment." At the December Board meeting, the Board approved the recommendation by the Investment Committee to issue an RFP to select an independent investment counselor to review the investment process, governance, and the recommended allocation of assets. The System's current investment counselor, Becker Burke and Associates has been the independent investment advisor to the System since 1990. An outside review will be beneficial in that a fresh look will be taken of the investment processes, governance, and the recommended allocations of the assets. In ways, this is similar to the actuarial audit conducted a few years ago when KTRS had an independent actuary review the current actuary's assumptions and processes. Four strong candidates responded to the RFP. After a thorough review of the responses, and interviews with public pension plans that used the services of the finalists to the RFP response, staff recommends the services of EnnisKnupp, with Nancy Williams, Principal, as project leader. The amount of the contract is \$230,000, with travel and expenses billed separately. This fee does not include appearing before the Legislature and/or the Governor. If these services are required, they will charge their standard hourly rates, not to exceed \$5,000 per day. The next best response had a fee range between \$315,000 and \$350,000 with appearances before legislative committees to be \$5,000 per day, plus expenses. The projected timeframe for delivery of the final report will be seven to eight months.

RECOMMENDATION:

The Executive Secretary recommended executing a contract with EnnisKnupp to provide services relating to the operational and governance review of investments for the System at a fee not to exceed \$230,000, with travel and expenses billed separately. Fees for any necessary appearances before the Legislature and/or Governor will be billed separately at standard hourly rates not to exceed \$5,000 per day.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Hollenbach and seconded by Dr. Morgan, the Board voted unanimously to execute a contract with EnnisKnupp to provide services relating to the operational and governance review of investments for the System at a fee not to exceed \$230,000, with travel and expenses billed separately. Fees for appearances before the Legislature and/or Governor will also be billed separately at standard hourly rates, not to exceed \$5,000 per day.

Item 4 (G) – Transfer of Interest

Mr. Harbin explained that KRS 161.440 requires that a transfer of interest be made from the Guarantee Fund to other funds, except the Administrative Expense Fund and Medical Insurance Fund, and requested authority from the Board to make the transfer of funds as of July 1, 2008. (A copy of the Directive authorizing the transfer is attached hereto as Exhibit K and made a part hereof).

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Conley and seconded by Mr. Hollenbach, authorization was unanimously granted to the Executive Secretary to transfer interest from the Guarantee Fund to other funds, except the Administrative Expense Fund and Medical Insurance Fund, on July 1, 2008, as required by KRS 161.440.

Item 4 (H) – Transfer of Reserve Funds

Mr. Harbin explained that each year, KTRS is required by KRS 161.420 to transfer an amount equal to the accounts of members retiring on July 1, along with an equal amount from the State Accumulation Fund, to the Allowance Reserve Fund. In addition, sufficient sums must be transferred during the year at the time of retirement of individual teachers. He requested authority from the Board to make the transfer of funds on July 1, and further requested that the authorization cover the transfer of accounts of teachers who will retire during the 2008-2009 fiscal year. (A copy of the Directive authorizing the transfer is attached hereto as Exhibit L and made a part hereof).

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Sanders and seconded by Ms. Sweazy, authorization was unanimously granted to the Executive Secretary to transfer an amount equal to the accounts of members retiring on July 1, along with an equal amount from the State Accumulation Fund, to the Allowance Reserve Fund, as required by KRS 161.420. Authorization was also unanimously granted to the Executive Secretary to transfer an amount equal to the accounts of members retiring during fiscal 2008-2009, along with an equal amount from the State Accumulation Fund, to the Allowance Reserve Fund, as required by KRS 161.420.

The Board recessed at 10:20 a.m., and resumed at 10:35 a.m.

Item 4 (I) - Resolutions Authorizing Disposal of Securities

Mr. Harbin explained that, in order to complete transactions disposing of securities, a Resolution is required to (a) authorize the signatures used in investment transactions; and, (b) authorize lease agreements on real estate properties owned by the Teachers' Retirement System. Further, a Resolution is required that will specifically cover securities issued by the Government National Mortgage Association (GNMA). (Copies of these Resolutions are attached hereto as Exhibit M and Exhibit N, respectively, and made a part hereof).

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Conley and seconded by Mr. Sanders, signature authorization for use in investment transactions, and signature authorization for use in lease agreements on real estate properties owned by the Teachers' Retirement System, was unanimously granted to the Executive Secretary and the Chief Investment Officer, jointly and severally. Further, specific signature authorization for use in securities issued by the Government National Mortgage Association (GNMA) was also unanimously granted to the Executive Secretary and the Chief Investment Officer, jointly and severally.

Item 4 (J) – Corporate Resolution

Mr. Harbin explained that, in order to complete transactions transferring securities, a Corporate Resolution must be re-adopted each year. (A copy of the Resolution is attached hereto as Exhibit O and made a part hereof).

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Zimmerman and seconded by Mr. Hollenbach, a Resolution was unanimously adopted granting authority to any one of the following officers, namely, the Chairman of the Board of Trustees, the Executive Secretary, or the Chief Investment Officer, to sell and assign securities of the Teachers' Retirement System of the State of Kentucky.

Item 4 (K) - Election of Investment Committee and Authorization for Investment

Mr. Harbin explained that KRS 161.430 provides that the Board may appoint an Investment Committee consisting of the Executive Secretary and two Trustees to act for the Board in all matters of investment, subject to the approval of the Board of Trustees. Following the Board's appointments, the Board must approve a resolution that authorizes the Investment Committee to act in behalf of the Teachers' Retirement System during fiscal year 2008-2009. (A copy of the Resolution is attached hereto as Exhibit P and made a part hereof).

BOARD ACTION:

Vice-Chairperson Sterrett asked for nominations for the two trustee positions on the Investment Committee. Dr. Morgan made a motion that Robert M. Conley continue as Chairman of the Investment Committee and Ronald L. Sanders continue as a member of the Investment Committee. Ms. Zimmerman seconded the motion. Vice-Chairperson Sterrett called for further nominations. There being none, Robert M. Conley was elected chairman of the

Investment Committee and Ronald L. Sanders was elected a member of the Investment Committee by unanimous consent.

Vice-Chairperson Sterrett asked for questions or comments regarding the investment resolution. Upon motion duly made by Dr. Morgan and seconded by Mr. Hollenbach, the resolution was unanimously adopted that authorizes the Investment Committee to act for the Board in all matters of investment, subject to the approval of the Board, during fiscal 2008-2009.

Item 4 (L) – 2007-2008 Administrative Expense Fund Budget

Mr. Harbin explained that the state budget makes no appropriation to the Teachers' Retirement System for administrative expenses; however, the biennial Budget Act does set amounts that the System may expend for administration during a two-year period. The allowable budget submitted to the Legislature for fiscal year 2008-2009 is \$10,102,600, an increase of 5.85% percent above the current year. (A copy of the Administrative Expense Fund Budget for 2008-2009 compared to 2007-2008 is attached hereto as Exhibit Q and made a part hereof).

Mr. Whelan distributed a schedule comparing KTRS expenses with expenses of other public pension systems, and explained that KTRS administrative expenses remain low when compared to other systems of similar size. For the fiscal year ended June 30, 2007, KTRS administrative expenses were \$7.3 million, which approximates to 4.75 basis points. The fiscal year 2008-2009 budget increase above fiscal year 2007-2008 totals \$559,100. The major portion of the increase is attributable to personnel costs that occur from the application of normal salary increments for employees during the year. In addition, as in prior years, the budget contains sufficient funding to provide for additional staff, should they be needed, to properly handle an increase in the number of retirements.

Additional increases are also anticipated in postage expense, printing expense and replacement of computers.

Mr. Hollenbach questioned what percentage of the annual budget is attributable to personnel costs.

Mr. Whelan responded that approximately 70% of the budget is attributable to personnel costs. Mr. Hollenbach questioned if the number of personnel at KTRS is similar to pension plans in other states.

Mr. Whelan cited one state whose personnel costs are lower, but contracted costs are much higher. Mr. Whelan reminded the Board that all unspent funds are returned to the KTRS Investment Department for reinvestment. Mr. Hollenbach questioned if most of the increase in personnel costs is attributable to new hires or to increases in salaries for current employees. Mr. Whelan stated that most is for anticipated new hires who may be needed if member retirements rise.

Mr. Hollenbach stated that he is concerned with the KTRS budget that increases expenses when most of the departments within state government are cutting their budgets. However, he expressed his faith in KTRS management and its intent to closely monitor the budget.

Ms. Sterrett questioned if the administrative budget contains costs for the Pathway Project. Mr. Harbin responded that those costs are a part of the Capital Projects budget.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Sanders and seconded by Ms. Zimmerman, the Administrative Expense Fund Budget for fiscal 2008-2009 was unanimously adopted as presented.

Item 4 (M) - IRC Section 415b Limit

Mr. Harbin explained that KRS 161.611 requires that the Board of Trustees provide a supplemental retirement benefit plan for the sole purpose of enabling KTRS to apply the same formula for determining benefits payable to all members of the retirement system whose benefits under the retirement system are limited by Section 415 of the Internal Revenue Code. This plan requires annual transfers from employer contributions to fund the limited benefit. The Executive Secretary requests authorization to make necessary transfers from employer contributions sufficient to provide these benefits for fiscal year 2008-2009.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Hollenbach and seconded by Dr. Morgan, authorization was unanimously granted to the Executive Secretary to make transfers from employer contributions to the supplemental retirement benefit plan in an amount sufficient to provide benefits to members whose benefits under the retirement system are limited by Section 415 of the Internal Revenue Code, as required by KRS 161.611.

Item 4(N) - Personnel Matters

Mr. Harbin explained that the Teachers' Retirement System's Employee Compensation Plan provides that all employees eligible for annual salary increments shall receive increments equal to the percent funding available for state employees that is provided in the budget approved by the General Assembly. The 2008 Session of the General Assembly adopted a budget that provides funding for salary increments for state employees amounting to an annualized value of the employee's base salary on their anniversary date according to the following formula:

An increment of one percent is provided in fiscal year 2008-2009 on base salary or wages. In addition to this salary increase, a one percent annual salary increase shall be provided under the Executive Budget Contingency Plan should the surplus funds be sufficient to pay 100 percent of the General Fund cost of the salary and associated fringe benefits. In addition to the prior two salary increases, a one percent annual salary increase shall be provided under the Executive Budget Contingency Plan should the surplus funds be sufficient to pay 100 percent of the General Fund cost of the salary and associated fringe benefits.

The Executive Secretary requested authorization from the Board of Trustees to approve normal salary advancements that will maintain equity in salary increments for KTRS employees equal to that received by state employees, as provided by the System's Employee Compensation Plan, during fiscal year 2008-2009. Sufficient funds for this expenditure are included in the System's 2008-2009 Administrative Expense Fund Budget.

All eligible KTRS employees are included in this authorization except for the Executive Secretary. Personnel Committee members will conduct the annual performance evaluation of the Executive Secretary at a meeting to be scheduled by the chair of the Personnel Committee. The Committee will report its recommendations to the trustees at the Board meeting most closely following the evaluation. If the Board of Trustees chooses to provide an increment for the Executive Secretary, the Board must determine the increase and authorize the Chair to implement the increment.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Mr. Hollenbach and seconded by Dr. Morgan, authorization was unanimously granted to the Executive Secretary to approve annual increments, according to the formula adopted during the 2008 Session of the General Assembly, for each eligible KTRS employee in fiscal 2008-2009.

Ms. Zimmerman, chair of the Personnel Committee, reported that the Committee will meet to conduct the annual performance evaluation of the Executive Secretary prior to the September 15, 2008 Board meeting, and will report its recommendations to the full Board at the September Board meeting.

Item 4 (O) - Election of 2008-2009 Chairperson and Vice-Chairperson

Mr. Harbin explained that KRS 161.340 provides that the Board of Trustees shall elect from its membership a chairperson and a vice-chairperson on an annual basis.

BOARD ACTION:

Vice-Chairperson Sterrett asked for nominations for the position of Chairperson of the Board of Trustees for fiscal year 2008-2009. Ms. Zimmerman nominated Barbara G. Sterrett, seconded by Mr. Hollenbach. Vice-Chairperson Sterrett called for further nominations. Upon motion duly made by Ms. Kinney and seconded by Mr. Conley, unanimous consent was given that nominations cease. Upon motion duly made by Mr. Hollenbach and seconded by Mr. Conley, Barbara G. Sterrett was elected to the position of Chair of the Board of Trustees, for fiscal year 2008-2009, by unanimous consent, except for Ms. Sterrett, who abstained from voting.

Vice-Chairperson Sterrett asked for nominations for the position of Vice-Chairperson of the Board of Trustees for fiscal year 2008-2009. Mr. Conley nominated Jay Morgan, seconded by Mr. Hollenbach. Vice-Chairperson Sterrett called for further nominations. Upon motion duly made by Mr. Hollenbach and seconded by Ms. Zimmerman, unanimous consent was given that nominations cease. Upon motion duly made by Mr. Hollenbach and seconded by Mr. Conley, Jay Morgan was elected to the position of Vice-Chairperson of the Board of Trustees, for fiscal year 2008-2009, by unanimous consent, except for Dr. Morgan, who abstained from voting.

Item 4 (P) - Committee Appointments

The Chairperson will identify standing committees that are to report and make recommendations to the full Board, and will also appoint members of the Board to the committees for terms that correspond to the term of the Chairperson. Vice-Chairperson Sterrett requested that Board members contact the Board Secretary with their preference for committee service. The Chairperson will make committee appointments for the coming year and will notify those appointed.

Item 4 (Q) – Legislative Update

At its December 2007 meeting, the Board approved a package of legislative proposals that were mostly housekeeping in nature and that did not change the current practice of the retirement system, but that did contain the substantive provisions of allowing un-purchased out-of-state K-12 public school service to count toward the thirty years of service required to return to work at 75% of last annual compensation and establishing a minimum Daily Wage Threshold.

These legislative proposals were introduced to the General Assembly as HB 470 and passed unanimously out of both the House of Representatives and the Senate. The Governor signed HB 470 on April 11, and its provisions will become effective on July 1, 2008.

Among other items of legislation introduced during the 2008 Session was Senate Bill 65 that contained the same provisions for the universities that participate in KTRS as the provisions that were approved by the Board in December. These provisions would allow university employees, who are otherwise eligible for membership in KTRS, a one-time opportunity to switch to KTRS and purchase prior years service during which they participated in the optional retirement plan. These provisions would also establish an alternate payment schedule for the universities to pay their share of the unfunded liability that would not otherwise have been paid with the establishment of the optional retirement plan. Since these provisions for the universities were proposed in Senate Bill 65, the Legislature chose not to include them in HB 470.

SB 65 passed unanimously out of both the House and the Senate. It was signed by the Governor on April 7, and became effective as law on that same date, except that the opportunity for optional retirement plan participants to switch to KTRS and purchase prior service is not available until July 1, 2008, according to the language of this legislation.

The House and the Senate approved different versions of an executive branch budget bill, which was identified as HB 406 during the Session. As a result, HB 406 was sent to Conference Committee (comprised of both House and Senate members) and then to a Free Conference Committee. Ultimately, the House and Senate were able to reach consensus on the budget bill and both chambers approved this version by vote on April 2. The Governor exercised ten line-item vetoes, none of which affected the budgetary provisions for KTRS. The final version of HB 406 does not contain funding for ad hoc cost of living adjustments as requested by KTRS, it continues the practice of borrowing from employer contributions to pay for current medical costs (including the spousal subsidy), and it does not provide a supplemental employer match for the pension fund that is needed to ensure that the retirement system can pay off its unfunded liability over a thirty-year period.

The House and Senate passed out different versions of the Governor's pension reform bill, HB 600, and ultimately were unable to reach a consensus, with the result that the 2008 Regular Session ended without pension reform legislation. The House version closely resembled the version presented by the Governor. The Senate version, while containing many identical provisions to the House version, also contained some significant differences largely in the portion of the bill that addressed Kentucky Retirement Systems (KRS). Among those differences was the implementation of a partial defined contribution individual savings account for new members of KRS and the establishment of a cost of living allowance (COLA) window that would expire in 2018 for current and future employees.

The two versions of the pension bill also contained one important difference that applied to KTRS. The House version would have required the Legislative Research Commission to conduct a study to determine the feasibility of transferring the classified school employees, currently participating in the County Employees Retirement System (CERS) under KRS, to KTRS. The Senate version would have kept the classified staff under the KRS umbrella, but taken them out of CERS and placed them in the Kentucky Employees Retirement System. The remaining county and municipal employees who now participate in CERS would have been transferred to a newly created retirement system, the Local Government Employees Retirement System, but would also have remained under the KRS umbrella.

Both versions of the bill had numerous other provisions that applied to KTRS. The changes to the actual KTRS benefit structure would have applied only to persons who became members on or after July 1, 2008, and included 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. HB 600 would also have provided an employee contribution increase of one percentage point for new members that would be used to help fund medical insurance. Board members would have been 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 have applied only to terms of office beginning after July 1, 2008.

The provision of most concern with both versions of HB 600 was one that would have created a new tier of retirement factors for new members with five different factors for non-university members and four different factors for university members. New factors of 1.7% for the first ten years for new hires, then 2.0% for all years once ten, but no more than twenty, are achieved, appear to be unnecessarily severe especially in consideration of the fact that individuals who retire with less than twenty years are likely to have Social Security earnings and therefore be subject to the Windfall Elimination Provision and the Government Pension Offset, all in addition to paying one percentage point more in employee retirement contributions. Furthermore, the savings achieved with this provision are not significant.

The Governor has presented to House and Senate leadership a new draft bill containing the portions of HB 600 upon which both chambers of the General Assembly agreed during the Regular Session and has asked leadership to agree to enact this legislation. If the two chambers can reach consensus, the Governor will convene a Special Session on June 23, so that the legislation can be effective by the start of the new fiscal year beginning July 1, 2008.

Finally, bills that would have extended the retirement window offered by KRS, that would have required the state to fund medical insurance for KTRS retirees, and that would have added a supplemental floating employer contribution rate did not pass.

Mr. Harbin distributed copies of legislation proposed for consideration during the Special Session, and explained that retiree medical will not be addressed except for the recommendation to increase the amount of service required for new hires to be eligible for insurance coverage upon retirement.

Item 4 (R) - Executive Secretary's Observations and Comments

Numbers of Retirements

The number of retirements has risen this year, but not at the level that might be expected given the retirement window that will expire in January 2009 at Kentucky Retirement Systems (KRS). The retirement window impacts KTRS members who also have service credit with KRS. However, KRS reports that they are not experiencing the number of retirements that had been expected to occur with the expiration of the retirement window. The chart written below indicates the number of retirements during June/July over the past twelve years.

<u>School Year Ended</u>	<u>Number of Retirees</u>
2008	1,353 (as of 6/9/08)
2007	979
2006	1,098
2005	1,100
2004	1,363
2003	1,022
2002	1,478
2001	1,301
2000	1,405
1999	1,347
1998	1,324
1997	1,832

A number of factors contribute to this trend, including:

1. Continued pattern following Board directed changes to plan in 2002
2. Successfully getting message to prospective retirees through mid-career and pre-retirement workshops
3. Medical Insurance not being fully funded gives teachers pause and contributes to them working longer

Board Members Attend Training at Southern Conference on Teacher Retirement

Board members Barbara Sterrett and Laura Zimmerman, along with Executive Secretary, Gary Harbin, attended the 64th annual Southern Conference on Teacher Retirement in Oklahoma City, Oklahoma, in April 2008. This conference provides valuable current information on the operation of public teacher retirement systems, along with the opportunity to network with other retirement professionals to keep KTRS attuned to best practices in System administration.

Pathway Project Contract

During its March 17, 2008 meeting, the Board approved the issuance of a Request for Proposal for computer system development and programming support services to be used in the implementation of the Pathway Project. A Request for Proposal was developed specifying the work to be performed, and was advertised in April in the Lexington Herald-Leader and the Courier Journal.

Three firms submitted a written proposal in response to the RFP. Their proposals were evaluated in the following four major categories:

- Understanding the Project
- Methodology Used for the Project
- Experience and Qualifications
- Hourly Fees for Programming, Design and Analysis, and Project Management

In addition to proposing hourly fees, firms were required to furnish the proportionate amount of time they historically bill to a project for each function listed (Programming, Design and Analysis, and Project Management). The combination of hourly fees and historical billing percentages were used to determine a composite hourly rate. Greater weighting was given to technical qualifications than was given to proposed fee. Composite hourly rates ranged from \$93.50 per hour to \$149.00 per hour.

After evaluating the three proposals, it was determined that Rippe & Kingston Systems, Inc. submitted the best overall proposal. Their proposed hourly rates are \$120.00 for Management, \$105.00 for Design and Analysis, and \$100.00 for Programming. Travel expenses are to be billed in addition to hourly fees.

RECOMMENDATION:

The Executive Secretary recommends executing a contract with Rippe & Kingston Systems, Inc. to provide system development and programming support services for the Pathway Project at an annual fee for fiscal year 2008-2009, not to exceed \$800,000.00.

BOARD ACTION:

Vice-Chairperson Sterrett asked for questions or comments. Upon motion duly made by Ms. Zimmerman and seconded by Ms. Kinney, authorization was unanimously granted to the Executive Secretary to execute a contract with Rippe & Kingston Systems, Inc., to provide system development and programming support services for the Pathway Project at an annual fee for fiscal year 2008-2009, not to exceed \$800,000.00.

Governor's Public Pension Working Group

Mr. Harbin stated that on May 29, 2008, Governor Beshear announced the creation of the Governor's Public Pension Working Group. The Working Group, which is to report its findings to the governor by November 1, 2008, will recommend ways to improve investment returns and meet funding obligations to the pension systems.

Mr. Harbin also discussed a report issued by the Legislative Research Commission (LRC) that was developed in response to a request last year that the investments of both the Kentucky Teachers' Retirement System and the Kentucky Employees Retirement System be reviewed. The report was presented at a June 12 meeting with the LRC, and KTRS responded to the review findings at that meeting. The report made three recommendations: (1) report specific investment goals and measurable investment objectives; (2) report overall fund benchmark with a description of how the benchmark is calculated; (3) report separate U.S. and international stocks investment return benchmarks. KTRS concurs with each of these three recommendations.

Mr. Barnes reported that the Governor's Public Pension Working Group will look at five areas and divided participants into five sub-groups. The areas that will be reviewed are: (1) defined contribution plan; (2) classified school employees at CERS; (3) investments of both systems, policies, strategies and governance; (4) securities litigation policies; and (5) long-term funding strategy for pension plans. Three KTRS staff members are participating. Mr. Harbin was appointed to the Defined Contribution sub-group; Mr. Yancey was appointed to the investments sub-group and Mr. Barnes was appointed to the securities litigation sub-group.

Item 4 (S) – General Discussion

Vice-Chairperson Sterrett suggested that the Board of Trustees conduct a one-day training session during the coming months. Mr. Harbin responded that a date after October 1 would work well.

Treasurer Hollenbach requested that in upcoming Board meetings, a representative from one of each of the investment management firms attend the Board meeting to present information regarding their firm's investment strategies.

Item 4 (T) - Adjournment

There being no further business to come before the Board of Trustees, and upon motion duly made by Mr. Hollenbach and seconded by Ms. Zimmerman, meeting adjournment was unanimously approved. Vice-Chairperson Sterrett declared the meeting adjourned at 12:15 p.m.

Respectfully submitted,



Sandra K. Parker

Secretary