

## JLARC Meeting – Minutes

July 10, 2017

AttendingJLARC Members:

Delegate Robert Orrock, Chairman; Delegate Betsy B. Carr; Delegate M. Kirkland Cox, Senator Emmett Hanger, Senator Janet Howell, Delegate Chris Jones, Delegate R. Steven Landes, Delegate James P. Massie, Senator Ryan McDougle, Senator Thomas K. Norment, Delegate John M. O'Bannon, Delegate Kenneth Plum, Senator Frank Ruff, Ms. Martha Mavredes, Ex Officio.

JLARC Staff:

Hal Greer, Director; Justin Brown, Senior Associate Director; Tracey Smith, Associate Director; Kimberly Sarte, Associate Director; Kate Agnelli; Lauren Axselle, Erik Beecroft, Sarah Berday-Sacks, Jamie Bitz, Danielle Childress, Drew Dickinson, Kathy DuVall, Nick Galvin, Maria Garnett, Mark Gribbin, Paula Lambert, Jeff Lunardi, Liana Major, Bridget Marcek, Joe McMahon, Ellen Miller, Jordan Paschal, Ellie Rigsby, Nathan Skreslet, Nichelle Williams, Christine Wolfe.

Others:

Mitchell Nason, Patricia Bishop, Ronald Schmitz, Jeanne Chenault, Rory Badura, Curt Mattson, Cindy Wilkinson, Michael Cooper, J.T. Grier (Virginia Retirement System); Mary Morris, Gary Ometer, Vivian Shields, Chris McGee, Michael Swink, Jordan Forbes (Virginia529); Lance Weiss, Amy Williams (GRS); John Watkins (retired Senator of Virginia); Senator Sturtevant; Nathalie Molliet-Ribet, Deputy Secretary of Education; Joe Flores (Deputy Secretary of Health and Human Resources); David Von Moll (Comptroller, Department of Accounts); Dan Wolfe (VITA); Doug Gray (Virginia Association of Health Plans); Art Lipscomb (Lobbyist for Virginia Professional Fire Fighters); Michael Jay (House Appropriations Committee); Sarah Herzog and Adam Rosatelli (Senate Finance Committee). Mike Woods (Troutman Saunders); Brittany West, Myles Louria (Hunton and Williams); Michael Martz (Richmond Times-Dispatch); Saraya Wintersmith (Virginia Public Radio); Heidi Abbott (Hunton & Williams);

The meeting was called to order at 10:00 a.m. by Delegate Orrock, Chairman. Delegate Orrock recognized Hal Greer, JLARC staff Director, who introduced two new staff members, Danielle Childress and Ellie Rigsby, to the Commission and provided the Commission with a brief overview of the meeting agenda. Mr. Greer then introduced Justin Brown, Senior Associate Director, who summarized the study topic selection subcommittee meeting held prior to the full Commission meeting. Senator Norment, as chair of the study

selection subcommittee, provided some brief context about the subcommittee's deliberations. Mr. Brown indicated that the subcommittee approved two study resolutions: Department of Professional and Occupational Regulation, and Department of Elections. A motion was made and seconded, per Delegate Orrock's request, to authorize JLARC staff to conduct work under the two study resolutions. The subcommittee requested that staff develop three additional draft study resolutions: Rising inmate healthcare costs; foster care, adoption, and CSA; and the Workers Compensation Commission. The subcommittee further requested that staff proceed with background research about potential studies of four agencies: Department of Game and Inland Fisheries, Virginia Employment Commission, Office of the Attorney General, and Office of the State Inspector General. The additional study resolutions and background information about potential studies will be presented to the study topic selection subcommittee at its next meeting prior to the full Commission meeting the morning of Monday, September 11.

Mr. Greer then provided a brief overview of the request from Senator Wagner, Chairman of the Joint Commission on Administrative Rules, for JLARC staff to conduct a fiscal impact review on state government and a broader review of the fiscal impact of Executive Directive 11 (2017). Delegate Orrock commented that the broader review is more than usual for JLARC. Mr. Greer explained that JLARC staff is under an obligation to perform a fiscal impact review on state government of the Executive Directive so the staff should move forward with the review. There being no objections from the Commission, Delegate Orrock stated that the staff may move forward with the fiscal impact review on state government of Executive Directive 11. The Commission was silent on the broader review of the fiscal impact.

Subsequently, Kimberly Sarte, Associate Director for Ongoing Oversight and Fiscal Analysis, presented a brief overview of the remaining agenda items then introduced Joe McMahon who presented the Commission with a briefing of the *Prepaid529 Investment Management* report. At the conclusion of Mr. McMahon's presentation, Delegate Massie asked if JLARC staff consulted with VRS on this study and Mr. McMahon confirmed that they did. Delegate Massie then asked who sets the investment benchmarks. Mr. McMahon explained that a consultant works to determine the benchmarks, which are then presented to the Investment Advisory Committee and ultimately approved by the Virginia529 board. Delegate Massie then asked what percentage of investments are in core versus non-core fixed income and the duration of the fixed income assets. Mr. McMahon stated that page 3 of the report includes a figure with the asset allocations of the Prepaid529. He further explained that the duration of the entire portfolio is seven to eight years, but asked VA529 staff to comment on the duration of the core versus non-core investment portfolios. Mary Morris, CEO of VA529, stated that the core fixed income portfolio has a duration of 9.23 years compared to 5.27 years for non-core fixed income. Delegate O'Bannon asked how big the Prepaid529 portfolio is compared to other states. Mr. McMahon stated that the Prepaid529 portfolio is the second largest in the nation. Senator Norment stated that he is willing to make a motion the endorse removing the CFO from the Investment Advisory Committee. Delegate Massie asked if the current consultant is determining whether current benchmarks are the appropriate indicators to measure performance of the Prepaid529 fund. Mr. McMahon stated that the current consultant has been doing this on an ongoing basis.

Delegate Orrock then stated that the Commission will approve the *Prepaid529 Investment Management* report by general consensus. There being no objections, the report was approved unanimously by the Commission.

Ms. Sarte then introduced Mr. Lance Weiss and Ms. Amy Williams, consultants with Gabriel, Roeder, Smith and Company who provided the Commission with a brief presentation of the *2017 Quadrennial Actuarial Audit of the Virginia529 Prepaid Program*. Delegate Jones asked how the load on tuition pricing compares to other states. Mr. Weiss explained that this depends on the funded status but that 11 percent is somewhat conservative. Delegate Massie asked who hired and pays GRS for their consulting services. Mr. Weiss stated that JLARC staff hired and pays GRS. Delegate Massie then asked if GRS reviews alternative investments. Mr. Weiss said that they do not review the valuation of assets because they are not qualified to do so. Ms. Mavredes explained that this is done as a part of the APA's annual financial audit. Delegate Massie asked if the APA has qualified staff to do this. Ms. Mavredes said that she will follow up to determine exactly what her staff does in these audits. She also explained that they have hired a firm that will be providing training later this month to APA and VRS staff on auditing and evaluating the valuation of portfolios.

At the conclusion of the presentation by GRS staff, Delegate Orrock stated this presentation was for information purposes only and that no action was required by the Commission.

Mr. McMahon then provided the Commission with a brief presentation in response to GRS's comments and options regarding the surplus funded status of the Prepaid529 fund. At the conclusion of this presentation, Mr. McMahon stated that JLARC staff suggest a motion to direct the Virginia529 board to develop a policy to address the funding status surplus of Prepaid529. The motion directs the Virginia529 board to develop a detailed written policy by May 15, 2018 that sets forth the actions that will be taken to address the Prepaid529 fund surplus. The motion further states that in developing the policy, the board should consider, but not be limited to, the following options: (1) reduce the pricing load on future Prepaid contracts and (2) provide rebates or dividends to account holders. Delegate O'Bannon asked if this type of motion has been made by JLARC in the past. Delegate Orrock said that he does not recall making this type of motion during his tenure on JLARC. Delegate Landes asked if a letter could be written by the JLARC Chairman directing the Virginia529 board to develop a policy to address the funding status surplus of Prepaid529. Mr. Greer said that this could be done. Kimberly Sarte explained that JLARC has ongoing oversight responsibilities of Virginia529. The options for addressing issues with agencies for which JLARC has oversight may be different than those under a typical JLARC report. Delegate Orrock asked if Virginia529 could report to JLARC at the November Commission meeting about plans regarding the funded status. Delegate Landes said that the Commission may want to consider whether it is appropriate to have a motion for this. Delegate Orrock stated that this is something that could be addressed in the next legislative session. Mr. Greer said that Virginia529 could present to JLARC on their approach for how they plan to address the funding status surplus of the Prepaid529. Delegate Orrock said that he would

prefer that the Commission not change its prior practices. Delegate Orrock then stated that, there being no objections from the Commission, Virginia529 will be included as a part of the November 13, 2017 JLARC meeting. Del. O'Bannon stated that there may be a need to discuss how the Commission approaches ongoing oversight in the future.

Subsequently, Mr. McMahon introduced Mary Morris, CEO for Virginia529, who provided the Commission with an overview of Virginia529, growth of its programs, the Prepaid529 investment management report and contract pricing, and the 2017 quadrennial audit of the Prepaid529 program. Delegate Massie asked if Ms. Morris will provide JLARC staff with Virginia529's most recent income statement and balance of cash flows. At the conclusion of Ms. Morris' presentation, Delegate Orrock stated this presentation was for information purposes only and that no action was required by the Commission.

Ms. Sarte then provided the Commission with a presentation on the Virginia Retirement System (VRS) oversight report. Delegate Landes asked whether other states use an absolute return adjustment for investment staff compensation and benchmark against private sector peers. Ms. Sarte said that she did not have that information with her, but that she would follow-up with him on this issue. Delegate Landes proceeded to ask Ms. Sarte to confirm that the VRS board took the JLARC recommendations, chose not to make any changes to the incentive pay plan, and instead added language to more clearly articulate their current practices. Ms. Sarte explained that this was correct. Delegate Landes then asked what the return on investment is of the overall incentive plan and whether Virginia is outperforming other states. Ms. Sarte explained that information was included in the December report showing that VRS was in the top group of plans in terms of performance. Delegate Massie asked who the compensation consultant currently is. Ms. Sarte indicated that McLagan is the current compensation consultant.

Delegate Orrock then stated that the Commission will approve the VRS oversight report by general consensus. There being no objections, the report was approved unanimously by the Commission.

Subsequently, Delegate Orrock welcomed Mr. Mitchell Nason, Chairman of the VRS Board of Trustees, who provided the Commission with an overview of VRS. Delegate Landes expressed concerns about the incentive pay that the investment officers have received and asked how the board justifies ignoring JLARC's recommendations regarding VRS's incentive pay plan for investment staff. Mr. Nason said that the board had seriously discussed JLARC's recommendations, but that the board supported the current pay plan and the rationale behind it. The absolute return adjustment, in particular, was adopted in response to the recession. Delegate Landes said that Virginia is one of a few states that has an incentive pay plan for investment staff, which makes it difficult to justify having one, even though the investment staff have exceeded investment benchmarks. He further stated that he hopes the board will consider this in the future. Mr. Nason stated that this will be in board discussions going forward.

Following Mr. Nason's remarks, Mr. Ronald Schmitz, VRS Chief Investment Officer, presented an overview of VRS' investments. At the conclusion of Mr. Schmitz's

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presentation, Ms. Patricia Bishop, VRS' Director, provided the Commission with an overview of VRS membership, the impact of pension reform efforts in Virginia, funded status, contribution rates, hybrid retirement plan status (including voluntary contributions), benchmarking, and VRS's Line of Duty Act administrative roles.

At the conclusion of Ms. Bishop's remarks, Delegate Orrock stated this presentation was for information purposes only and that no action was required by the Commission. Del. Massie stated that despite the optimistic tone of the presentation, the retirement plan is still under-funded by more than \$20 billion.

Lastly, Mr. Greer announced that the next Commission meeting is scheduled for September 11, 2017, which will include a presentation on the findings and recommendations from the VCCS report, as well presentations on VITA oversight and the biannual Report to the General Assembly.

There being no further business, the Commission rose at 12:35 p.m.

Approved by: Hal E. Greer  
Hal E. Greer, Director

Date: 7/18/17

Prepared by: Paula C. Lambert  
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