



VRS Overview

for the Joint Legislative Audit and Review Commission

Presenters:

Robert L. Greene, Vice Chairman, VRS Board of Trustees

Ronald D. Schmitz, Chief Investment Officer

Robert P. Schultze, VRS Director

July 14, 2014

VRS Overview

- **Robert L. Greene**
Vice Chairman, VRS Board of Trustees

Investments Overview

- **Ronald D. Schmitz**
Chief Investment Officer

Administration Overview

- **Robert P. Schultze**
Director



Remarks

Robert L. Greene
VRS Board Vice Chairman

Board Members



Diana F. Cantor, *Chairman*

Robert L. Greene, *Vice Chairman*

A. Marshall Acuff, Jr.

Joseph W. Montgomery*

Wallace G. "Bo" Harris, Ph.D.

Mitchell L. Nason

W. Brett Hayes

Troilen Gainey Seward, Ed.S.

William H. Leighty*

* Indicates recent appointments to the VRS Board.

- Fiscal year end returns and fund amount
- Status of the Strategic Projects Committee and Project Frontier
- Successful implementation of the Hybrid Retirement Plan
- Support of Pension Reform Funding Plan



Investments

Ronald D. Schmitz
Chief Investment Officer

VRS Investment Presentation Outline



- Total fund performance ending 3/31/14
- Returns through 5/31/14
- Fiscal year returns for the past 20 years, compared to the actuarially assumed return
- Asset allocation overview
- Update on the phase-in of the new asset allocation policy
- Overview of internally managed assets
- Economic/market outlook

Total Fund Performance as of March 31, 2014



PERFORMANCE SUMMARY
Rolling Periods Ending
March 31, 2014

TOTAL FUND PERFORMANCE

	10 Yr	5 Yr	3 Yr	1 Yr	Market Value (\$MM)
Total Public Equity	7.2	18.3	9.7	16.8	27,991
<i>Benchmark</i>	6.8	17.4	9.0	16.1	
Total Investment-Grade Fixed Income	5.1	6.8	4.1	0.1	11,313
<i>Benchmark</i>	4.6	4.6	3.9	-0.1	
Total Credit Strategies	n/a	14.1	6.9	8.5	11,401
<i>Benchmark</i>	n/a	11.8	6.3	6.5	
Total Real Assets	9.3	11.0	12.2	12.4	6,558
<i>Benchmark</i>	9.0	8.9	11.5	10.9	
Total Private Equity	14.7	14.0	15.1	22.2	5,068
<i>Benchmark</i>	10.0	20.3	17.3	31.1	
Total Strategic Opportunities Portfolio	n/a	n/a	n/a	3.1	379
<i>Benchmark</i>	n/a	n/a	n/a	1.7	
Total Fund	7.0	13.7	8.6	11.7	63,918
<i>VRS Custom Benchmark</i>	6.4	12.9	8.2	11.6	

- Total Plan returns exceeded the benchmark returns over the past one, three, five and ten years.
- Outperformance versus benchmark over the past ten years across all programs.
- Cumulative dollar value-added above the benchmark over past 10 years approximates \$2.8 billion.

Total Fund Performance as of May 31, 2014

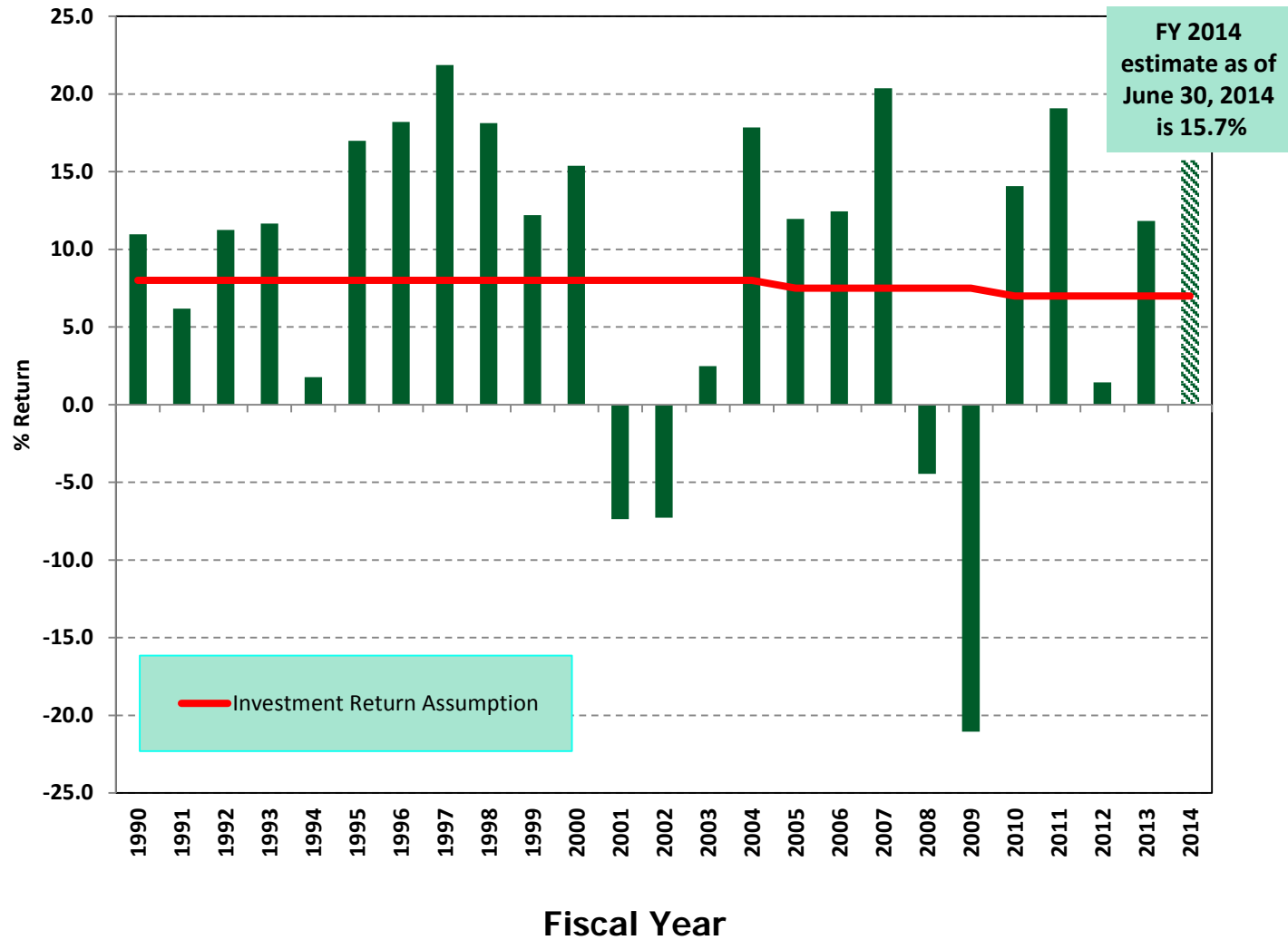


PERFORMANCE SUMMARY
Rolling Periods Ending
May 31, 2014

TOTAL FUND PERFORMANCE

	10 Yr	5 Yr	3 Yr	1 Yr	Fiscal YTD	Market Value (\$MM)
Total Public Equity	7.7	14.6	10.0	16.5	19.4	28,367
<i>Benchmark</i>	7.2	13.6	9.4	15.7	18.9	
Total Investment-Grade Fixed Income	5.6	6.7	3.9	3.0	4.7	11,555
<i>Benchmark</i>	5.1	4.9	3.7	2.7	4.3	
Total Credit Strategies	n/a	12.1	7.1	9.0	10.7	11,823
<i>Benchmark</i>	n/a	9.9	6.5	7.5	9.9	
Total Real Assets	9.7	9.6	12.1	13.4	11.5	6,714
<i>Benchmark</i>	9.3	9.4	11.1	11.7	11.2	
Total Private Equity	14.6	14.0	15.0	22.2	17.6	5,003
<i>Benchmark</i>	9.8	25.3	15.4	23.9	19.1	
Total Strategic Opportunities Portfolio	n/a	n/a	n/a	2.4	2.1	391
<i>Benchmark</i>	n/a	n/a	n/a	1.9	2.2	
Total Fund	7.4	11.7	8.7	12.4	13.7	64,750
<i>VRS Custom Benchmark</i>	6.8	11.6	8.2	11.7	13.5	

VRS Fiscal Year Returns

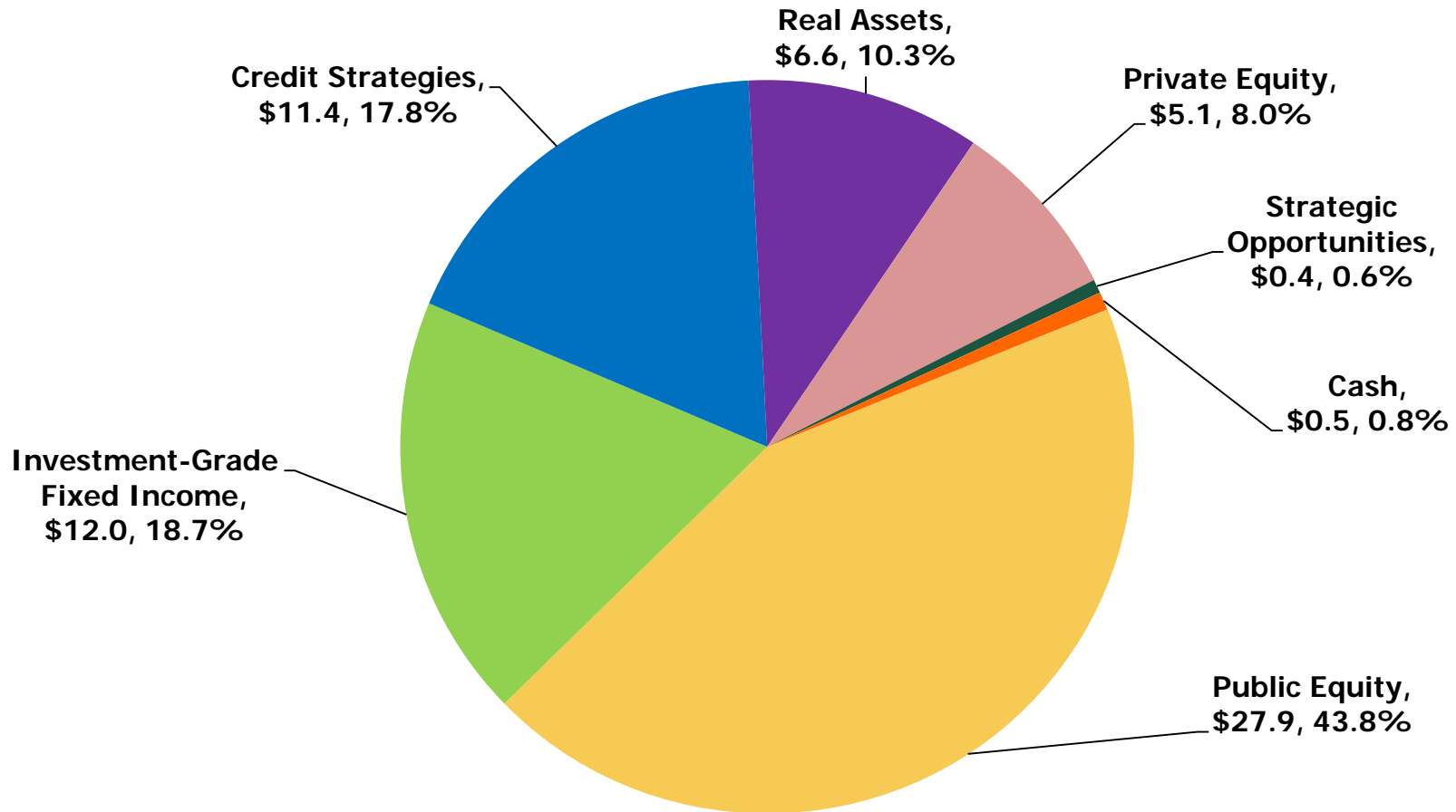


	VRS Return (As of March 31, 2014)
3-year	8.6%
5-year	13.7%
10-year	7.0%
15-year	6.3%
20-year	8.6%
25-year	8.9%

VRS Asset Allocation as of March 31, 2014



Total Fund market value = \$63.9 billion



(Dollar Amounts in Billions/Percent of Total Fund)

Year 2 of the Asset Allocation Phase-In



	<u>Original Plan</u> <u>7/14</u>	<u>Proposed Plan</u> <u>7/14</u>	<u>7/17 Target</u>
Public Equity	42.0%	42.0%	42.0%
Fixed Income	18.0%	18.5%	15.0%
Credit Strategies	18.0%	19.0%	15.0%
Real Assets	11.5%	11.5%	15.0%
Private Equity	9.5%	8.0%	12.0%
Strategic Opportunity Portfolio	0.0%	0.0%	0.0%
Cash	1.0%	1.0%	1.0%

Internal Asset Management (IAM)

Mandates as of March 31, 2014



Asset Class	Objective	Assets (MM)
Equity	Passive U.S. Large Cap (Madison)	\$328
	Passive Non-U.S. Large Cap (Dogwood)	\$706
	Active U.S. Large (Potomac)	\$3,388
	Active Non-U.S. Large (Matoaka)	\$1,918
	Active U.S. Small (Afton)	\$357
	Active U.S. Small Synthetic	\$156
	Active U.S. REIT (Monroe)	\$81
	Active U.S. Large Cap Low Volatility (Mobjack)	\$792
	Active Non-U.S. Large Low Volatility (Piedmont)	\$1,808
	Subtotal	\$9,534
Fixed Income	Collateralized	\$3,306
	Credit	\$3,635
	Government Related	\$4,356
	Rebalancing Account	\$670
	Subtotal	\$11,967
Total		\$21,501

IAM Track Record

as of March 31, 2014



		1 year	3 years	5 years	10 years	Inception*
Equity	Return	19.50	14.11	22.13	7.89	6.10
	Benchmark	18.20	11.61	20.13	6.95	5.21
	Excess	1.30	2.50	2.00	0.93	0.89
	Risk (TE)	1.25	1.33	1.30	1.06	1.05
	Info Ratio	1.04	1.89	1.54	0.88	0.85
Fixed Income	Return	0.07	4.10	5.10	5.36	6.31
	Benchmark	(0.07)	3.76	4.55	5.04	6.01
	Excess	0.14	0.33	0.55	0.32	0.30
	Risk (TE)	0.22	0.37	0.48	0.43	0.34
	Info Ratio	0.65	0.91	1.15	0.74	0.88

**Equity Inception April 2001, Fixed Income Inception August 1995.
These inception dates represents the current team's tenure.*

- The pace of growth is expected to exceed 3% in the final three quarters of the year.
- Inflation, at 2.1%, remains within the Fed's target range.
- The "quickenening" economy and better-than-estimated corporate earnings have pushed U.S. stocks to new highs.
- Some measures of employment show continued weakness and labor force participation is the lowest it has been since 1978.
- Geo-political risks in Ukraine, the Middle East and Asia (China's Pacific islands dispute with its neighbors) dominate global risks.
- It is likely that the European Central Bank will adopt a quantitative easing program of their own in 2015 and, along with Japan, will assure that developed economy interest rates remain near zero for some time to come.



Administration

Robert P. Schultze
Director



VRS Membership Overview

VRS Total Membership



	Plan 1	Plan 2	Hybrid	Total
Teachers	101,776	43,684	948	146,408
Political Subdivisions	67,515	36,122	1,918	105,555
State Employees	53,613	23,782	1,477	78,872
State Police Officers' Retirement System (SPORS)	1,533	496	0	2,029
Virginia Law Officers' Retirement System (VaLORS)	5,646	3,725	0	9,371
Judicial Retirement System (JRS)	318	69	0	387
Total Active Members	230,401	107,878	4,343	342,622

Total Active Members	Retirees/ Beneficiaries	Inactive/ Deferred Members	VRS Total Population
342,622	176,694	125,142	644,458

As of May 31, 2014

Benefit Comparison



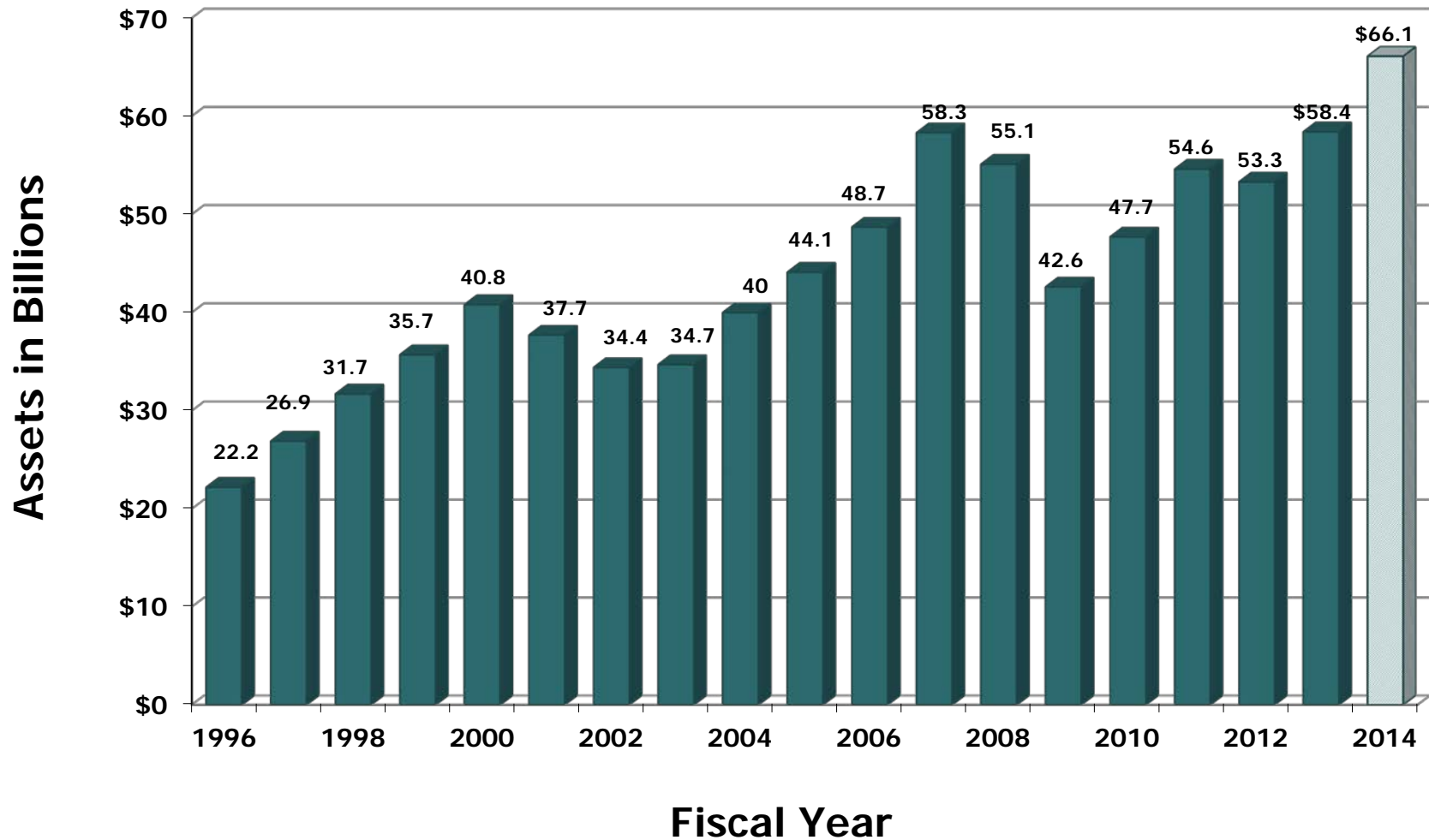
	State	Teachers	Local
Actives:			
Average Age	48.3	45.2	46.3
Average Service	12.8	11.9	11.1
Average Salary	\$48,972	\$48,994	\$41,287
Retirees: (in FY 2013)			
Avg. Age @ Retirement	63.0	61.8	62.1
Avg. Service @ Retirement	22.6	23.3	19.9
Avg. Benefit @ Retirement	38.4%	39.6%	34.7%
Avg. Annual Benefit	\$20,441	\$23,116	\$15,367
Avg. Social Security Benefit at Age 62	\$18,252	\$17,640	\$14,640

Information above obtained from the June 30, 2013, Actuarial Valuation.

Net Assets Available for Benefits



Estimate as of
June 30, 2014



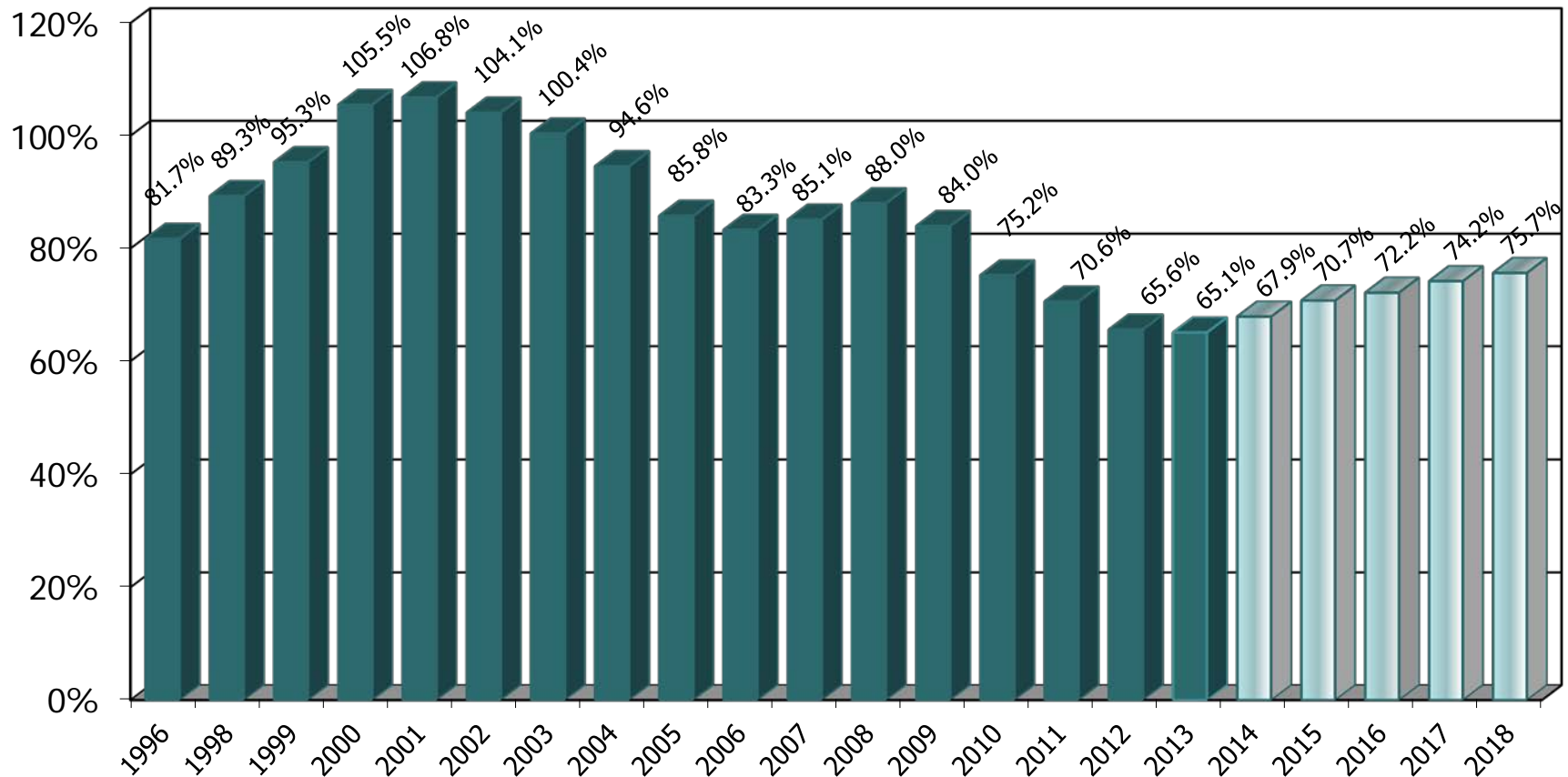
For the Fiscal Year Ended June 30, 2014

(Dollars Expressed in Billions)

Beginning Balance – July 1, 2013	\$58.4
Contributions	\$3.1
Net Investment Income	9.0
Total Additions	\$12.1
Total Deductions	4.4
Net Additions	\$7.7
Ending Balance – July 1, 2014	\$66.1
Cash Flow <i>(Contributions minus Deductions)</i>	\$(1.3)

The information in schedule is based on data from the VRS General Ledger as of June 30, 2014 before the final closing and does not reflect the reversal of June 30, 2013 accruals or the recognition of the June 30, 2014 accruals and adjustments.

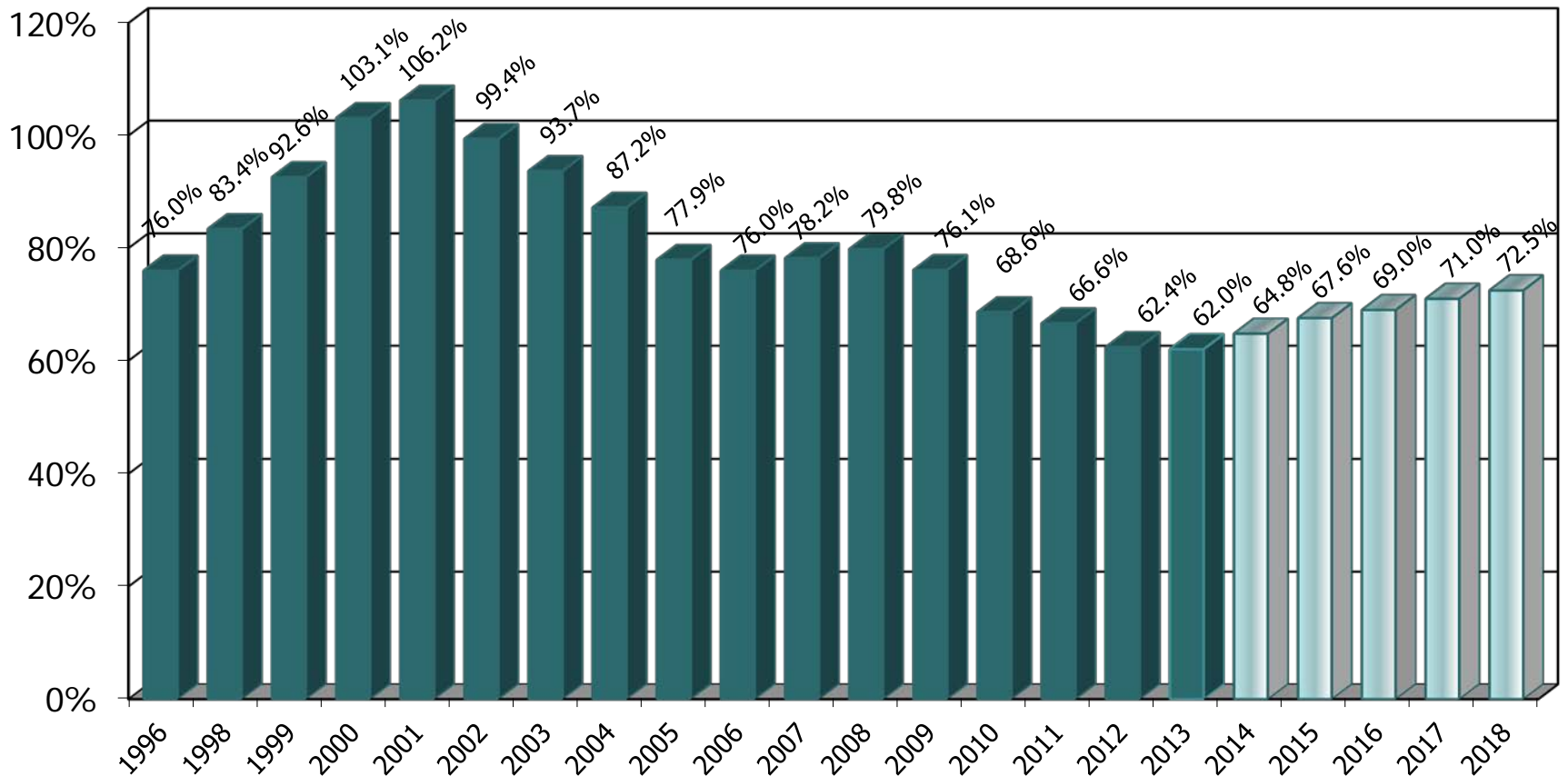
Funded Status: State Employees



Assumptions:

- Fiscal Year 2014 investment return estimated at 15.0%.
- Other projected years' investment returns assume 7.0% with 2.5% inflation rate.
- Assets estimated at actuarial value of assets (five-year smoothing).

Funded Status: Teachers



Assumptions:

- Fiscal Year 2014 investment return estimated at 15.0%.
- Other projected years' investment returns assume 7.0% with 2.5% inflation rate.
- Assets estimated at actuarial value of assets (five-year smoothing).

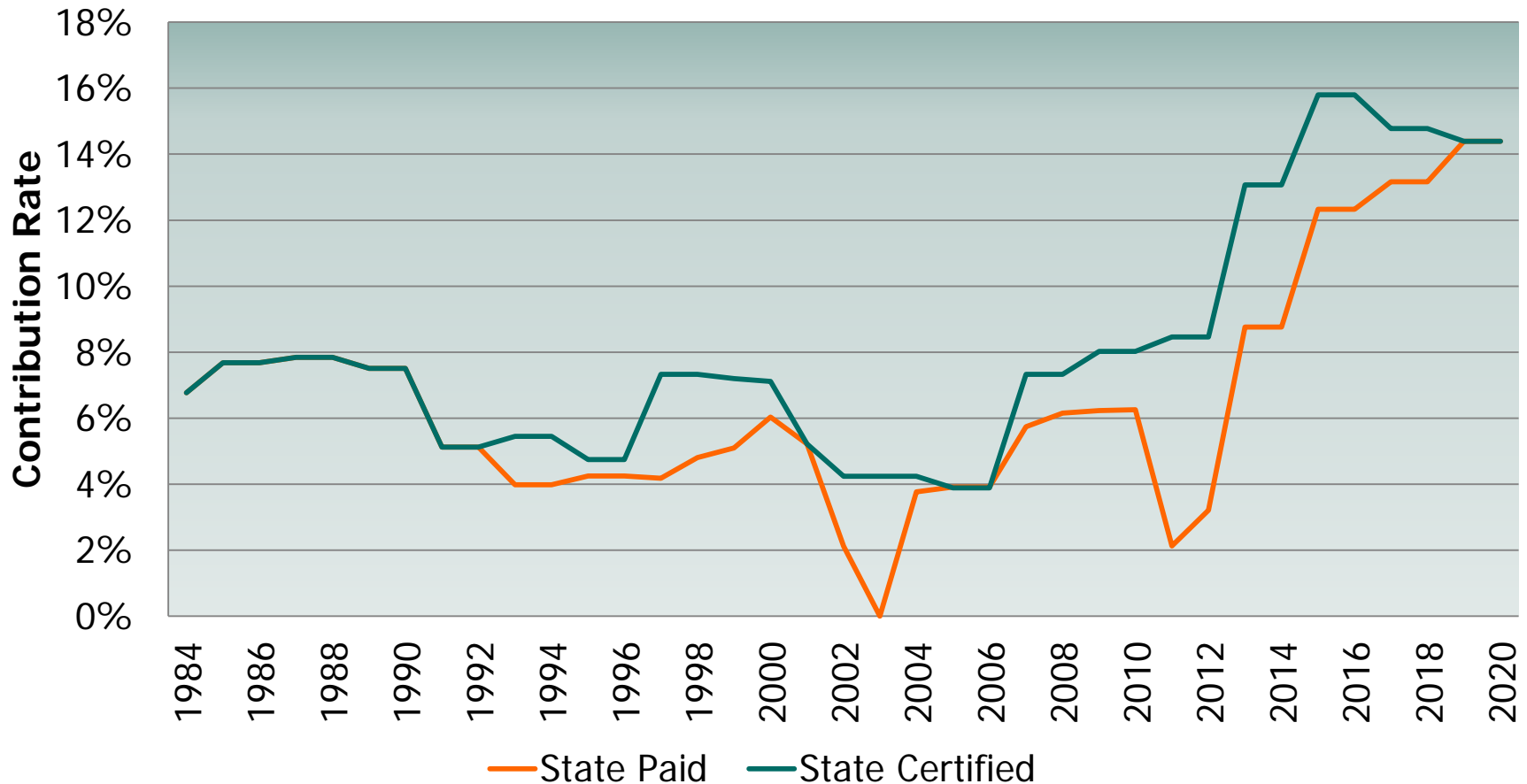


VRS Employer Rate Information

State Employer Contribution Rates



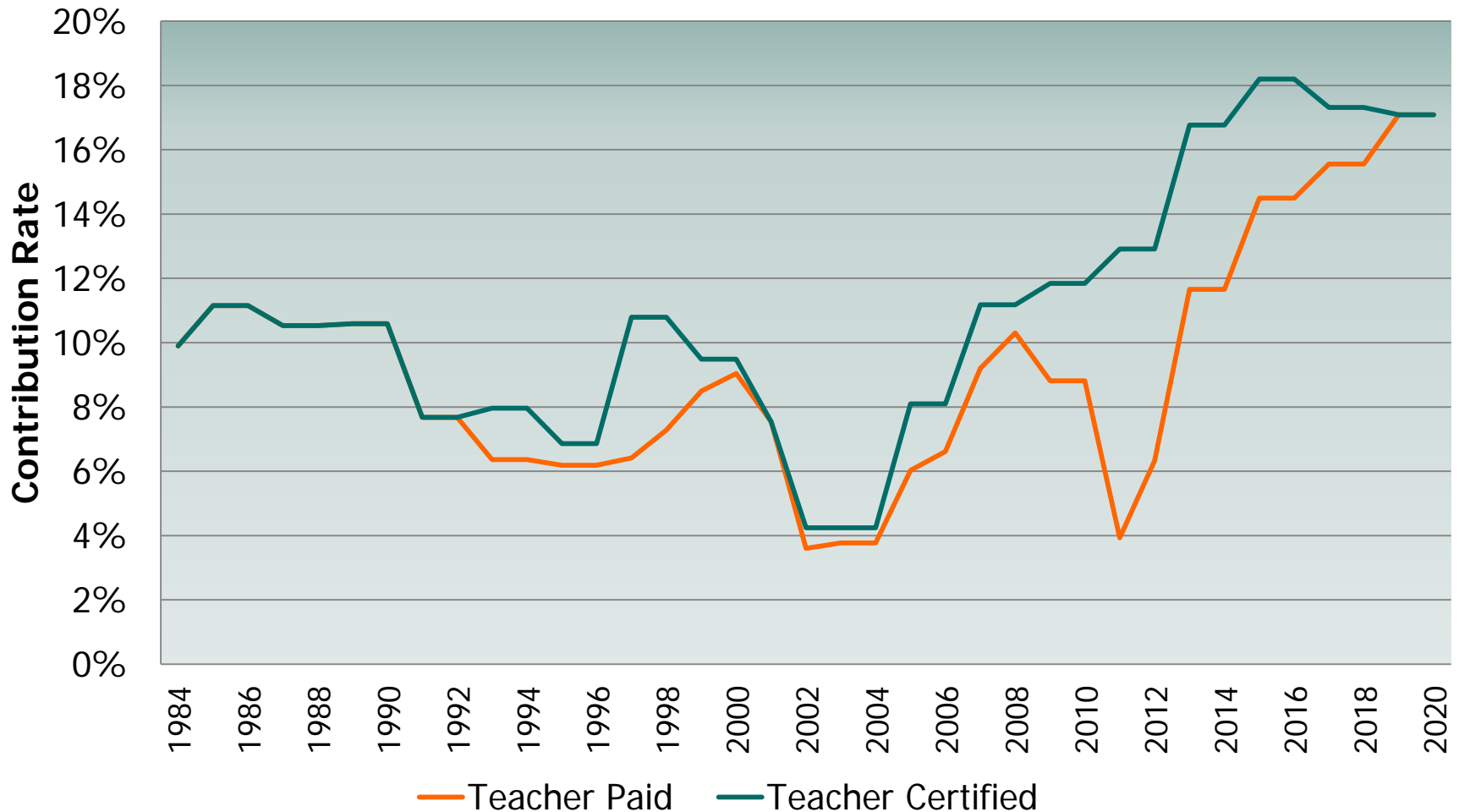
State Employer Contribution Rates FY 1984 - 2020



Teacher Employer Contribution Rates



Teacher Employer Contribution Rates FY 1984 - 2020



Estimated VRS Employer Contribution Rates



General Assembly committed to phase-in contribution rates for the teacher and state plans to the VRS board-certified rates as follows:

	July 1, 2012	July 1, 2014	July 1, 2016	July 1, 2018
State	67.02%	78.02%	89.01%	100%
Teachers	69.53%	79.69%	89.84%	100%

Estimated Contribution Rates by Fiscal Year

	2013-14	2015 & 2016	2017 & 2018	2019 & 2020
State	8.76%	12.33%	13.16%	14.39%
Teachers	11.66%	14.50%	15.56%	17.09%

Added cost to achieve the 2015/2016 contribution rate increases is approximately \$315 million for the biennium in General Funds.

Above contribution rates are net of employee contributions.

Funded Status and Contributions Summary



- Pension Reform Plan requires increased employer contribution rates over the next two biennia.
- Recent budget enacted by the General Assembly stays on track with the funding plan.
- Bond-rating agencies consider the Pension Reform Plan to be credit positive.

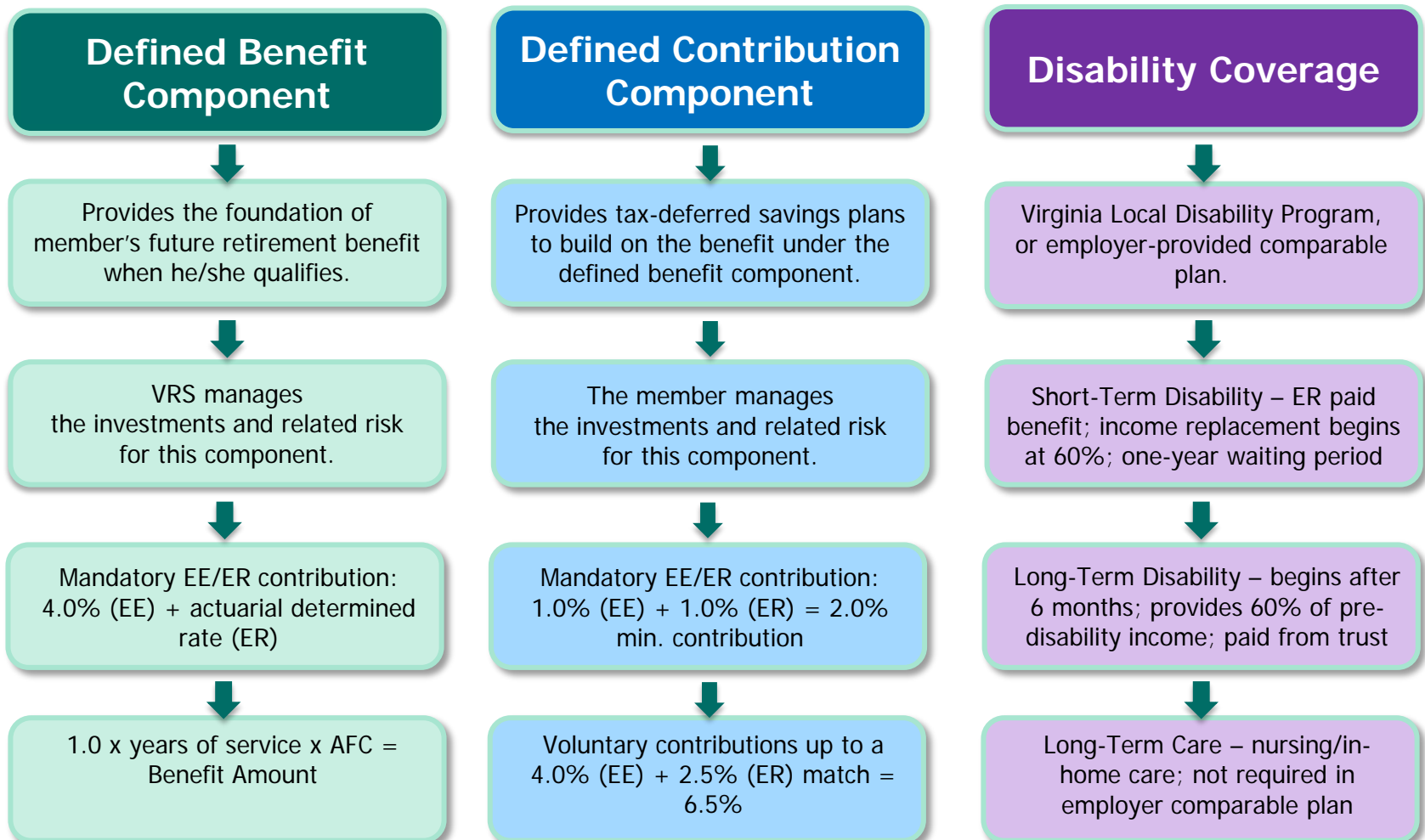


Pension Reform

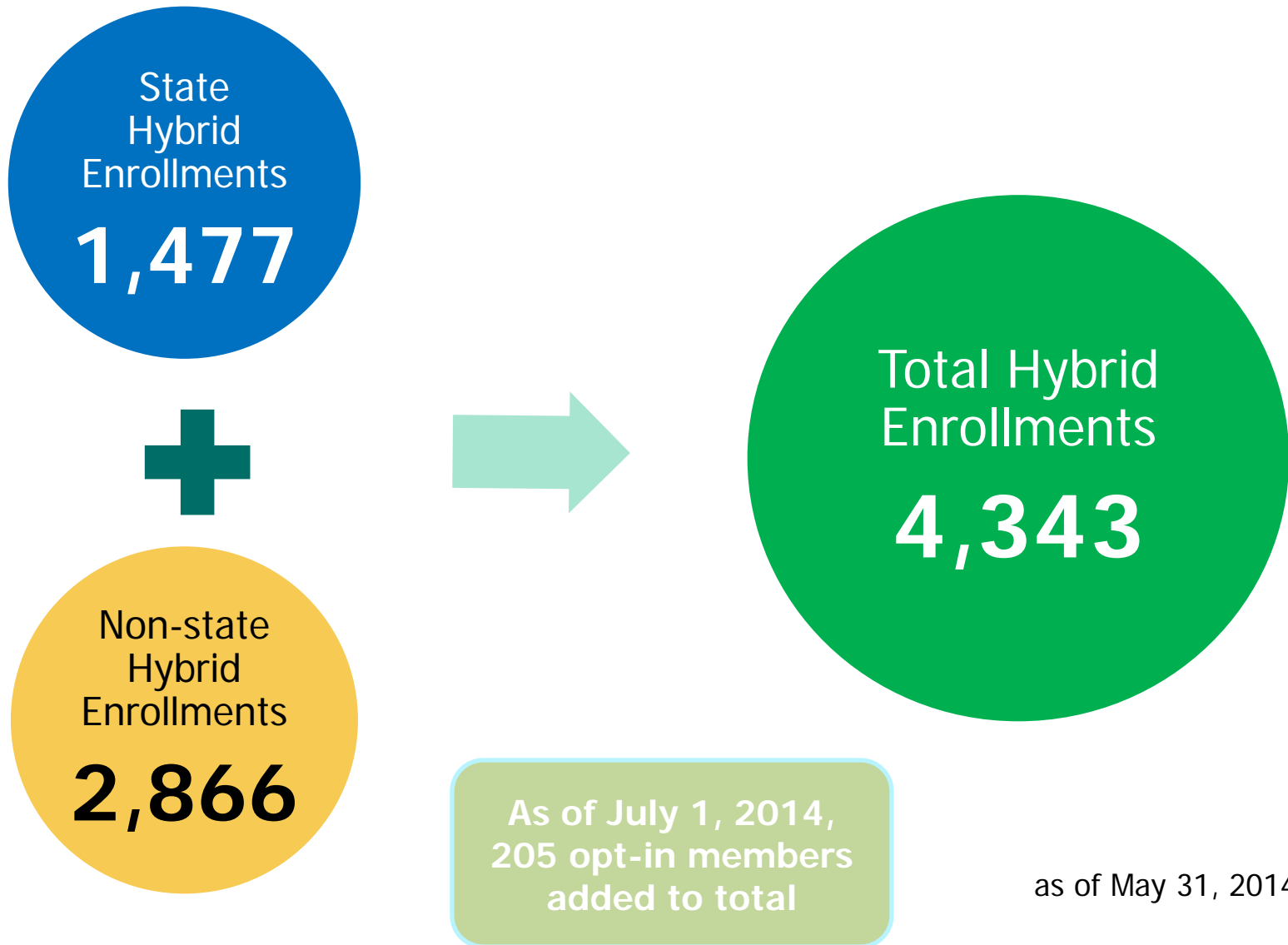
What Is a Hybrid Retirement Plan?



A defined benefit plan and a defined contribution plan form the components of the VRS Hybrid Retirement Plan:



Hybrid Plan Enrollments





New Pension Accounting Rules

New GASB Accounting Rules for Public Pension Plans



Fiscal Year 2014

- VRS must report unfunded liabilities on the face of financial statements.
- VRS will value assets on mark-to-market basis, which will increase volatility.

Fiscal Year 2015

- Employers will report under new rules.
- Employer will receive apportioned share of the teacher cost-sharing plan.
- State and local employers will be subject to new auditing standards and testing requirements.

New GASB Accounting Rules for Other Post Employment Benefits (proposed)



Fiscal Year 2017

- VRS also will follow new accounting rules for Other Post Employment Benefits (OPEBs): Group Life Insurance, VSDP/VLDP, HIC, LODA, Pre-Medicare retiree health insurance.*
- OPEB rules will be a mirror image of the pension rules.

Fiscal Year 2018

- New OPEB accounting rules apply to state and local employers.
- State and local employers will receive apportioned share of OPEB costs.

* Pre-Medicare health insurance administration by DHRM subject to new accounting rules.



Addendum:

- **2014 Legislation**
- **Funded Status of Other Programs**
- **Modernization Update**

VRS Legislative Summary



VRS-Requested Legislation/PASSED

Bill Number	Patron	Description
SB 87	Sen. Watkins	Makes technical amendments to the programs administered by VRS. Signed by Governor, effective July 1, 2014.

Legislation Affecting VRS: Judicial Retirement/PASSED

Bill Number	Patron	Description
HB 10	Del. Jones	Provides that the annual retirement allowance of any person who has served as a judge but retires under a different defined benefit retirement plan shall not exceed 78% of the person's average final compensation, unless such person after ceasing to be a judge performs five or more years of creditable service under such other defined benefit retirement plan. Only those persons who retired as a judge or justice may serve as a senior jurist on the Supreme Court or the Court of Appeals. Contains an emergency clause. Governor signed and struck language making bill retroactive to July 1, 2013.

VRS Legislative Summary



Legislation Affecting VRS: Defined Contribution Plans/PASSED

Bill Number	Patron	Description
HB 147 and SB 412	Del. O'Bannon Sen. Hanger	Authorizes the VRS Board of Trustees to develop policies and procedures to allow certain independent contractors performing services for the Commonwealth's Medicaid program to participate in the deferred compensation plan for employees of the Commonwealth. Authorizes the Director of the Department of Medical Assistance Services to provide payments or transfers to and to participate in any deferred compensation plan for independent contractors providing services for the Commonwealth's Medicaid program established by the Board. The substitute limits the participants to dentists and has an expiration date of January 1, 2020. Signed by Governor, effective January 1, 2015.

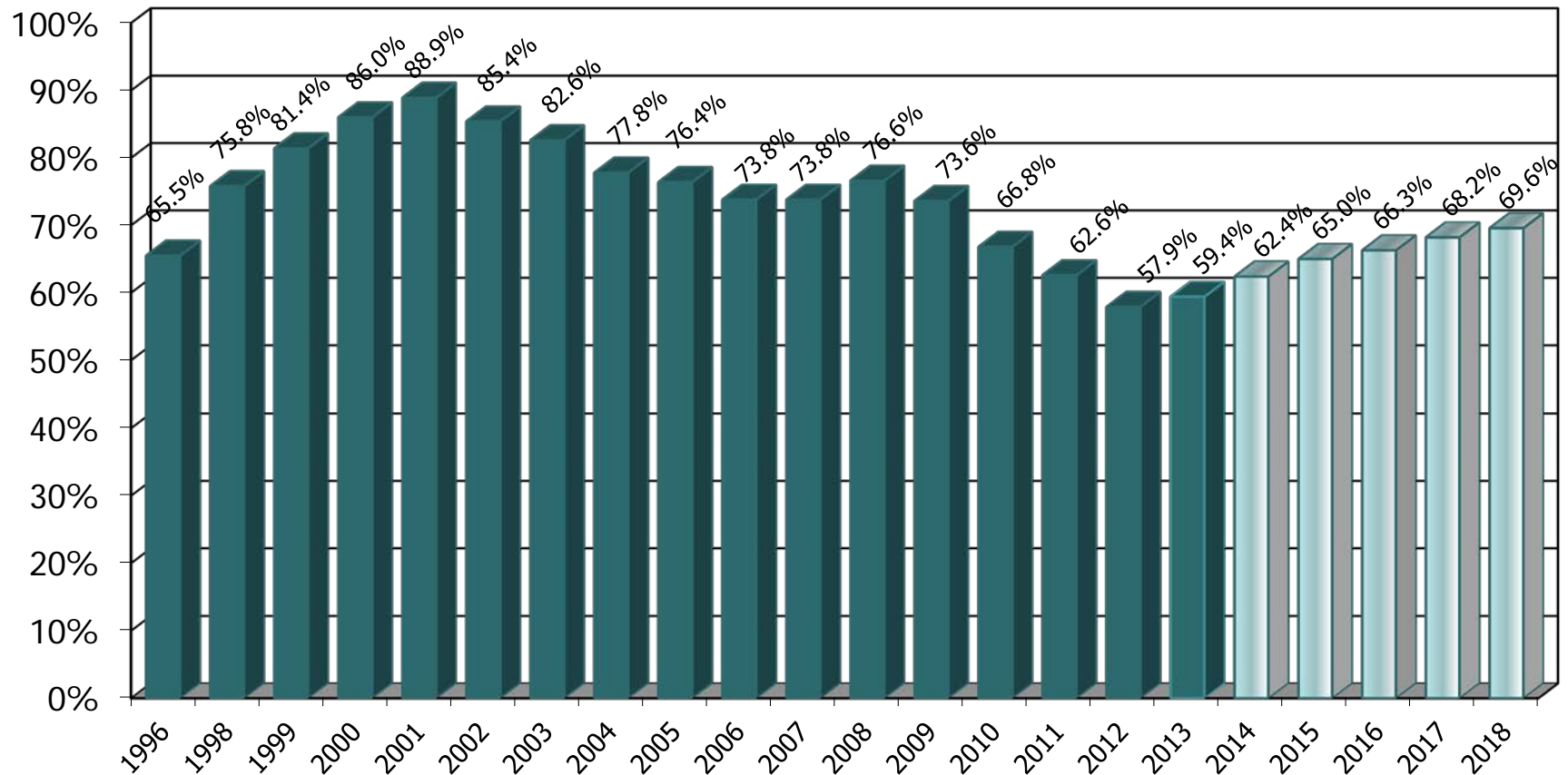
VRS Legislative Summary



Legislation Affecting VRS: Defined Contribution Plans/PASSED

Bill Number	Patron	Description
HB 700 and SB 79	Del. Ingram Sen. Ruff	Allows the governing board of an institution of higher education that has established its own optional retirement plan to establish a policy regarding the number of years of service that an employee must perform before being entitled to receive all contributions made by the institution on his behalf to the plan. Would only apply to employees hired on or after July 1, 2014, who are not in continuous service at the time of hiring. Signed by Governor, effective July 1, 2014.
SB 188	Sen. McDougle	Authorizes the inclusion of a Roth option in deferred compensation retirement plans for state and local government employees. Signed by Governor, effective July 1, 2015.

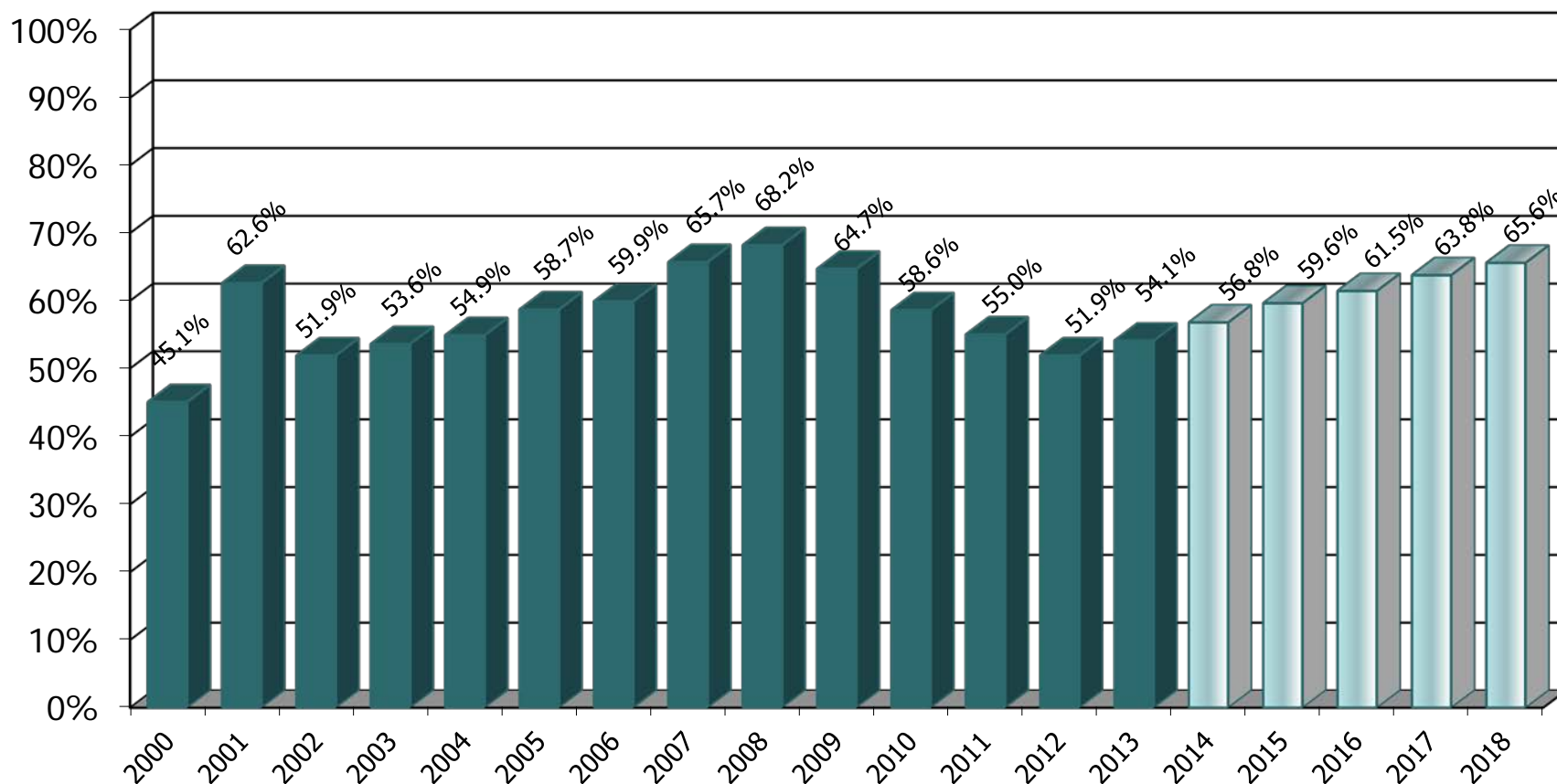
Funded Status: SPORS



Assumptions:

- Fiscal Year 2014 investment return estimated at 15.0%.
- Other projected years' investment returns assume 7.0% with 2.5% inflation rate.
- Assets estimated at actuarial value of assets (five-year smoothing).

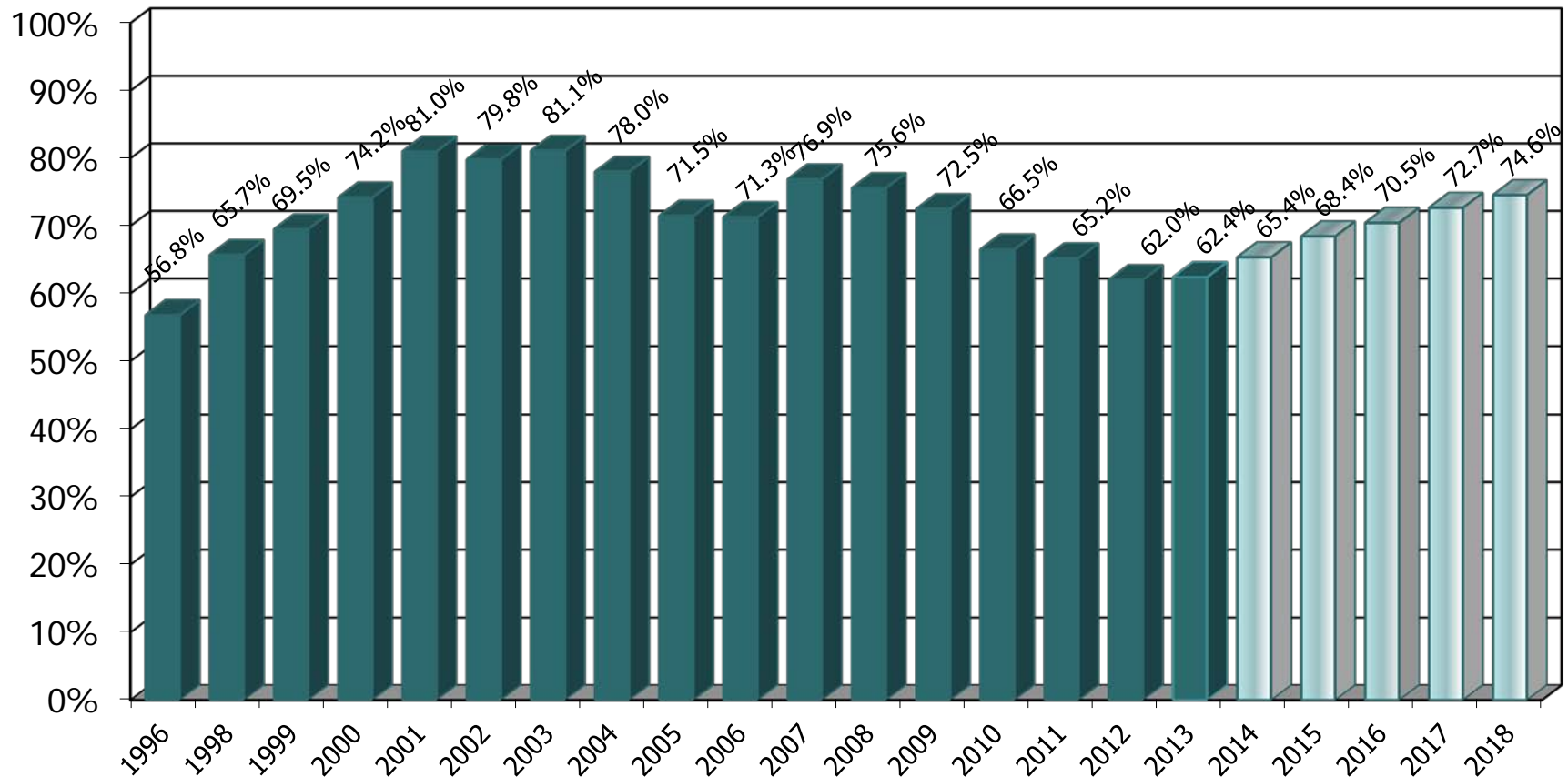
Funded Status: VaLORS



Assumptions:

- Fiscal Year 2014 investment return estimated at 15.0%.
- Other projected years' investment returns assume 7.0% with 2.5% inflation rate.
- Assets estimated at actuarial value of assets (five-year smoothing).

Funded Status: JRS



Assumptions:

- Fiscal Year 2014 investment return estimated at 15.0%.
- Other projected years' investment returns assume 7.0% with 2.5% inflation rate.
- Assets estimated at actuarial value of assets (five-year smoothing).

Fiscal Year 2012

- Implemented Phase 3 November 5, 2012.
- Provided improved employer functionality.
- Replaced employer contribution system used by about 1,000 reporting entities and submission of \$3 billion annually in contributions.

Fiscal Years 2013 - 2014

- Focused on supporting the new system and implementing complex changes for pension reform.
- Prepared to restart Modernization (Phase 4).

Fiscal Year 2015

- Will deliver member and retiree functionality required to decommission the legacy mainframe system.
- Analysis and design work on first two initiatives for Modernization began July 1.

Thank You