

OVERSIGHT VRS Report

JOINT LEGISLATIVE AUDIT & REVIEW COMMISSION OF THE VIRGINIA GENERAL ASSEMBLY

Semi-Annual VRS Investment Report: July 1998

The investment return of the Virginia Retirement System (VRS) has exceeded the benchmark established to evaluate the performance of the total fund over short to intermediate time periods. VRS investment performance has yet to match the returns of its long-term benchmark. However, unlike the intermediate-term benchmark, the long-term benchmark is not reflective of the actual VRS asset allocation. Furthermore, the current VRS asset allocation has been in effect only since 1995, and therefore strict comparisons of VRS investment return with the long-term benchmark may be premature at this time.

VRS is continuing its efforts to manage its investment operations in the most cost-effective manner possible. In June 1998, a VRS consultant reported that while VRS investment returns were in the top quartile of U.S. pension funds, its investment costs were also higher than those of similarly-sized funds. Specifically, VRS calendar year 1997 investment costs of 35 basis points were higher than a computed average benchmark cost of 26 basis points for U.S. funds of similar size and asset allocation. The consultant stated that the reason for this is that VRS external management fees were generally higher than those of its peers.

VRS has made greater use of internal asset management a priority in order to enhance the cost effectiveness of its investment program. For example, VRS investment staff are developing a proposal to internally manage a portion of the \$4.5 billion international equity portfolio. In addition, VRS would like to manage a greater percentage of its fixed income program internally. Currently, only 17 percent of the \$7.7 billion fixed income portfolio is managed internally.

On the other hand, VRS is also working to identify alternative types of investments within all of its asset classes -- including those which are potentially more expensive to administer than internally managed, passive investment accounts. For example, VRS is continuing to research the desirability of adding high-yield bonds, emerging market debt, and arbitrage strategies to its fixed income program. In addition, VRS continues to explore the feasibility of making private equity investments in foreign countries, such as those in Asia and Latin America. While possibly more expensive to manage, these types of alternative investments also provide potential investment performance benefits to VRS.

Profile: Virginia Retirement System Investments

Market Value of Assets: \$31.5 billion
 Number of External Managers: 74
 Number of External Investment Accounts,
 Direct Investments, and Partnerships: 160
 Estimated FY 1998 Investment
 Expenses: \$91 million (28.9 basis points)
 Number of VRS Investment Staff:
 24 positions (1 vacancy)

Total Return on Investments¹

10 years	5 years	3 years	1 year
13.5%	15.7%	21.4%	27.8%
(Intermediate Benchmarks:)			
na ²	15.6%	20.8%	27.6%
(Long-Term Benchmarks:)			
na ²	17.4%	23.8%	32.3%

¹ Time periods ending 4/30/98

² Not computed by VRS.

Investment Policy Indicators (as of April 30, 1998)

Asset Class	Asset Allocation (% of Total Assets or \$ Amount)		Where Invested (% of Asset Class)		Type of Management (% of Asset Class)	
	Target	Actual	Domestic	International	Active	Passive
Public Equity	66%	65.6%	79%	21%	46%	54%
Fixed Income	25%	25.6%	97%	3%	57%	43%
Private Equity	\$1.5 billion	\$1.35 billion	91%	9%	100%	0%
Real Estate	\$1.4 billion	\$1.08 billion	98%	2%	0%	100%