OVERSIGHT VRS Report

JOINT LEGISLATIVE AUDIT & REVIEW COMMISSION
OF THE VIRGINIA GENERAL ASSEMBLY

Semi-Annual VRS Investment Report
December 2000

As of September 30, 2000, the market value of the VRS pension fund was $40.8 billion. For the one-, three-, and five-year periods, the fund's investment performance exceeded established benchmarks for the period ending September 30, 2000. The VRS' investment returns for all time periods measured exceeded the actuarial assumed investment return of eight percent.

The public equity program is VRS' largest asset class comprising almost $24.7 billion. The domestic public equity program, continued to lag established performance benchmarks for the one-, three-, and five-year periods (see Table 1 on page 2). However, the domestic equity program in the second and third quarter of calendar year 2000 outperformed the program's Russell 3000 benchmark. Within the domestic equity program, both the active and passive domestic equity programs exceeded established performance benchmarks for the third quarter of calendar year 2000.

However, the investment performance of the non-U.S. public equity program in the third quarter of calendar year 2000 was negatively impacted by higher oil prices and slowing consumer spending in the United States. The fixed income program's performance was consistent with its benchmark, returning almost seven percent for the one-year period. Real estate, although not meeting its performance benchmark, returned 12 percent for the one-year period ending September 30, 2000. Finally,

Profile: Virginia Retirement System Investments

Market Value of Assets: $40.8 billion

Number of External Managers:
Public Equity – 21 Fixed Income – 4

Number of External Investment Accounts:
Public Equity – 31 Fixed Income – 7

FY 2000 Investment Expenses:
$116.4 million (28.5 basis points)

FY 2000 Investment Department Operating Expenses:
$5.2 million (1.3 basis points)

Number of VRS Investment Department Staff: 34 positions (3 vacant)

Total Return on Investments

	10 years	5 years	3 years	1 year
	14.3%	15.9%	13.0%	17.8%
Performance/Intermediate Benchmarks (Time Periods Ending 9/30/00)		14.7%	12.0%	13.9%

Investment Policy Indicators (as of September 30, 2000)

	Asset Allocation (% of Total Assets or $ Amount)		*Asset Allocation* (% of Asset Class)		*Type of Management* (% of Asset Class)	
Asset Class	Target	Actual	Domestic	International	External	VRS
Public Equity	61.4%	60.4%	76.6%	23.4%	86%	14%
Fixed Income	25%	25.6%	99%	1%	66%	34%
Private Equity	$3.5 billion	$3.5 billion	95.3%	4.7%	100%	0%
Real Estate	$1.5 billion	$1.5 billion	94%	6%	100%	0%
Treasury Inflation Protection Securities	$539 million	$539 billion	100%	0%	0%	100%

Table 1

VRS Investment Performance for Periods Ending September 30, 2000

Program/ *Performance Objective*	Fiscal Year to Date	Prior 1 Year	Prior 3 Years	Prior 5 Years
Total Fund	0.6%	17.8%	13.0%	15.9%
VRS Performance Benchmark	*0.5%*	*13.9%*	*12.0%*	*14.7%*
Domestic Equity	1.2%	15.4%	13.9%	19.5%
Russell 3000	*0.7%*	*18.2%*	*16.0%*	*20.9%*
International Equity	(7.0)%	8.7%	5.0%	7.5%
Salomon BMI Global ex U.S.	*(6.5)%*	*6.7%*	*4.2%*	*5.8%*
Fixed Income	3.0%	7.0%	5.9%	6.5%
Lehman VRS Custom	*3.0%*	*7.0%*	*5.9%*	*6.1%*
Private Equity	2.6%	110.4%	53.3%	47.3%
Russell 3000 plus 250 Basis Points	*3.2%*	*20.7%*	*18.5%*	*23.4%*
Real Estate	3.7%	12.0%	8.0%	10.0%
Blend of NCREIF and NAREIT Indexes	*4.6%*	*14.9%*	*12.1%*	*12.2%*
Treasury Inflation Protection Securities (TIPS)	2.5%	N/A	N/A	N/A
Actual TIPS Account Return	*2.5%*	*N/A*	*N/A*	*N/A*

Source: JLARC staff analysis of VRS data.

the private equity program continued to outperform its benchmarks for all time periods reported.

The impact of VRS' private equity program on the total fund's performance has been substantial. VRS invests in private equity to accomplish two primary objectives – to diversify the overall retirement fund and to provide enhanced returns relative to the public equity program. While private equity can provide higher returns, it also has higher risks, is less liquid than public equity, and the fees are typically higher than fees on other asset classes. As a result, VRS views private equity as an opportunistic asset class and has not established a strategic asset allocation target for the program. Since April 1989 when the program was implemented, the program's annual return has averaged 32.6 percent, well above its performance benchmark's annual return of 21.8 percent.

Finally, VRS investment staff, the Investment Advisory Committee, and the Board of Trustees continue the process of revising the fund's asset allocation policy through the asset/liability study. The asset/liability study recognizes the impact liabilities have in selecting an asset allocation policy. The asset/liability study will cover a 20-year period from June 30, 2000, focusing on five-year, 10-year, and 20-year time periods. A number of portfolios will be modeled with the approved asset allocation policy linking the fund's investments to the system's funding and benefit policies.

VRS OVERSIGHT Report

VRS Oversight Report is published periodically by the Joint Legislative Audit and Review Commission (JLARC) in fulfillment of Section 30-78 _et seq._ of the _Code of Virginia_. This statue requires JLARC to provide the General Assembly with oversight capability concerning the Virginia Retirement System (VRS), and to regularly update the Legislature on oversight findings.

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