



Review of VRS and Virginia529 Investment Benchmarks

JLARC review of VRS and Virginia529 benchmarks

- Code directs JLARC oversight of VRS and Virginia529, including investment practices, policies, and performance
- Investment benchmark review examined
 - purpose of investment benchmarks
 - processes VRS and Virginia529 use to determine benchmarks
 - investment performance compared with benchmarks
 - performance compared with other public pension and defined benefit college savings plans

In this presentation

Background

VRS and Virginia529 benchmark processes

VRS investment benchmarks and performance

Virginia529 investment benchmarks and performance

Benchmarks are used to measure funds' investment performance

- Provides information about how a fund's earnings compare to if it had been invested like the benchmark
 - **Actively managed funds:** whether active management (e.g., investment strategies, individual managers) generates additional returns
 - **Passively managed funds:** whether fees paid for passive management are competitive
- Over- or underperformance relative to benchmark equates to fund value gained or lost

Strong benchmarks have several key characteristics

- A strong benchmark should
 - be used to hold investment staff and other fiduciaries accountable for performance
 - be specified before the evaluation period
 - clearly indicate the names and weights of securities
 - reflect the investment mandate and strategy used
 - contain securities that can be purchased
 - consist of holdings that are like fund being measured

Benchmarks are used to track fund performance at all levels of investment portfolio

- **Total fund level:** information about how differences between the target and actual asset allocations affect performance
- **Asset class level:** information about how mix of investment strategies affects performance
- **Investment manager level:** information about how individual manager decisions affect performance

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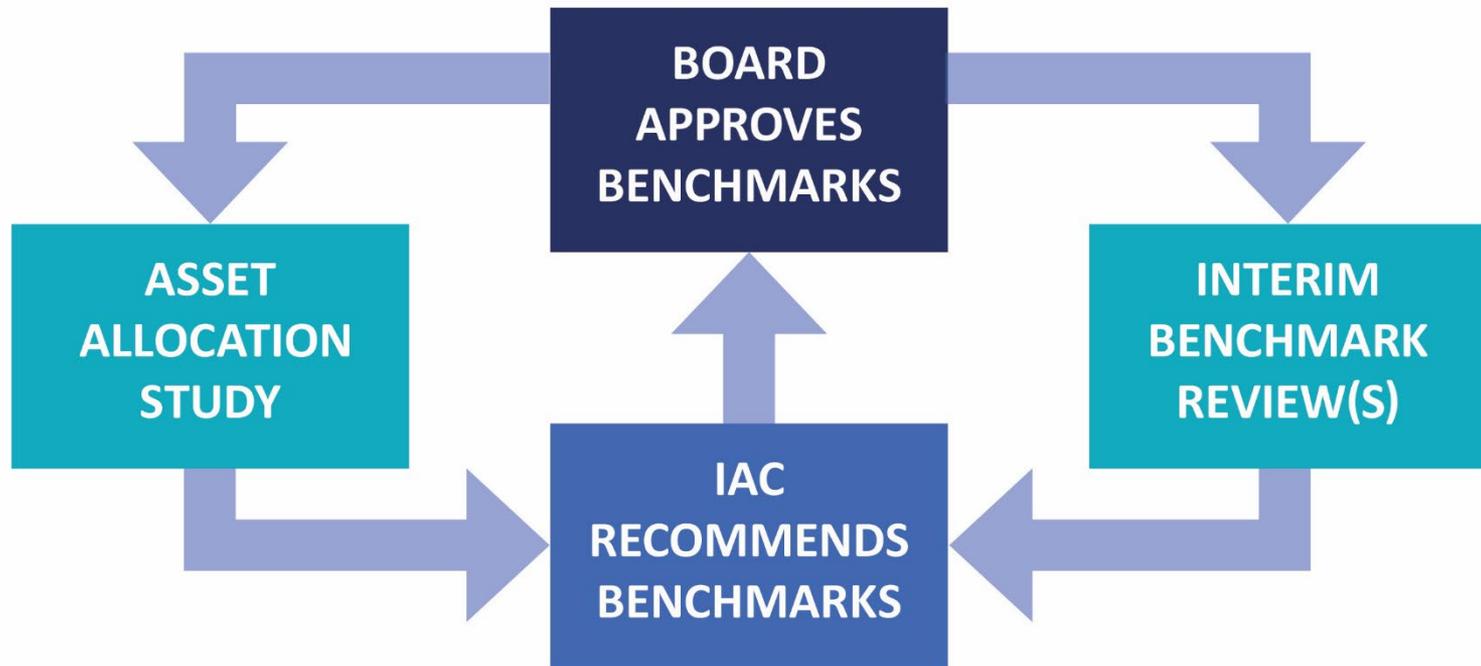
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VRS and Virginia529 set benchmarks with asset allocation studies and interim reviews



IAC: Investment Advisory Committee. Asset allocation studies review not only a fund's asset allocation but also recommend appropriate benchmarks for primary asset classes.

VRS and Virginia529 use custom benchmarks for their total funds

- Custom total fund benchmarks blend the benchmarks for each asset class at their target asset allocation percentage
 - Provides information about how deviations from target allocation result in over- or underperformance
- Custom benchmarks are widely used at total fund level by other public pension and defined benefit college savings plans

VRS and Virginia529 use widely recognized benchmarks for most asset classes

- Common market indexes
 - Example: VRS and Virginia529 use the MSCI All Country World Index (ACWI) as all or part of their public equity benchmarks
 - MSCI ACWI captures large, medium, and small companies in developed & emerging market countries
- Custom asset class benchmarks that blend 2 or more market indexes

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VRS uses external consultants to conduct asset allocation studies and interim benchmark reviews

- VRS conducts asset allocation studies and interim reviews about every 3 years
 - Most recent asset allocation study in spring 2023
 - Most recent interim benchmark review in spring 2024
- VRS investment staff review benchmarks on ad hoc basis

VRS board approved several significant changes to benchmarks in recent years

- Approved changes to 7 benchmarks in 2023 based on asset allocation study and staff reviews
 - Example: added the MSCI World Minimum Volatility Index to public equity benchmark to reflect its strategy favoring low-volatility stocks
- In 2020, lowered private equity benchmark by 2.5% (removed 250-basis point spread), which makes benchmark easier to meet or exceed
 - Virginia529 and some other public pension plans add spreads to their private equity benchmarks

VRS trust fund overperformed every benchmark for longer-term periods (March 31, 2024)

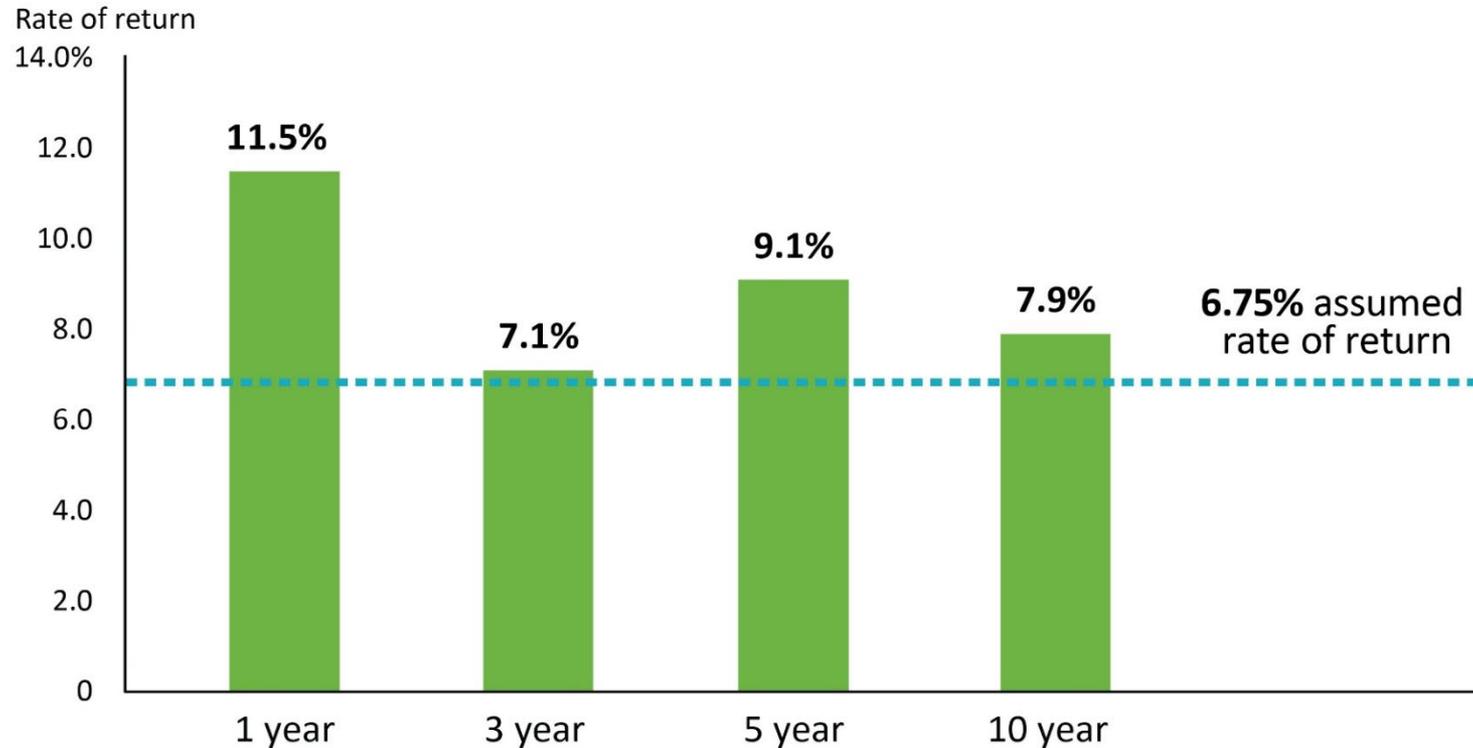
(Updated from report with more recent data)

| Asset class | Assets (billions) | 1-year | 3-year | 5-year | 10-year |
|---------------------------------|-------------------|----------|----------|----------|----------|
| Public equity | \$38.3 | ✓ | ✓ | ✓ | ✓ |
| Private equity | 19.4 | ✗ | ✓ | ✓ | ✓ |
| Credit strategies | 16.2 | ✓ | ✓ | ✓ | ✓ |
| Fixed income | 16.0 | ✓ | ✓ | ✓ | ✓ |
| Real assets | 14.1 | ✓ | ✓ | ✓ | ✓ |
| Multi-asset public strategies | 3.5 | ✓ | ✓ | ✓ | N/A |
| Private investment partnerships | 2.4 | ✗ | ✓ | ✓ | N/A |
| Total Fund | \$113.0 | ✗ | ✓ | ✓ | ✓ |

✓ = Return met or exceeded benchmark ✗ = Return below benchmark

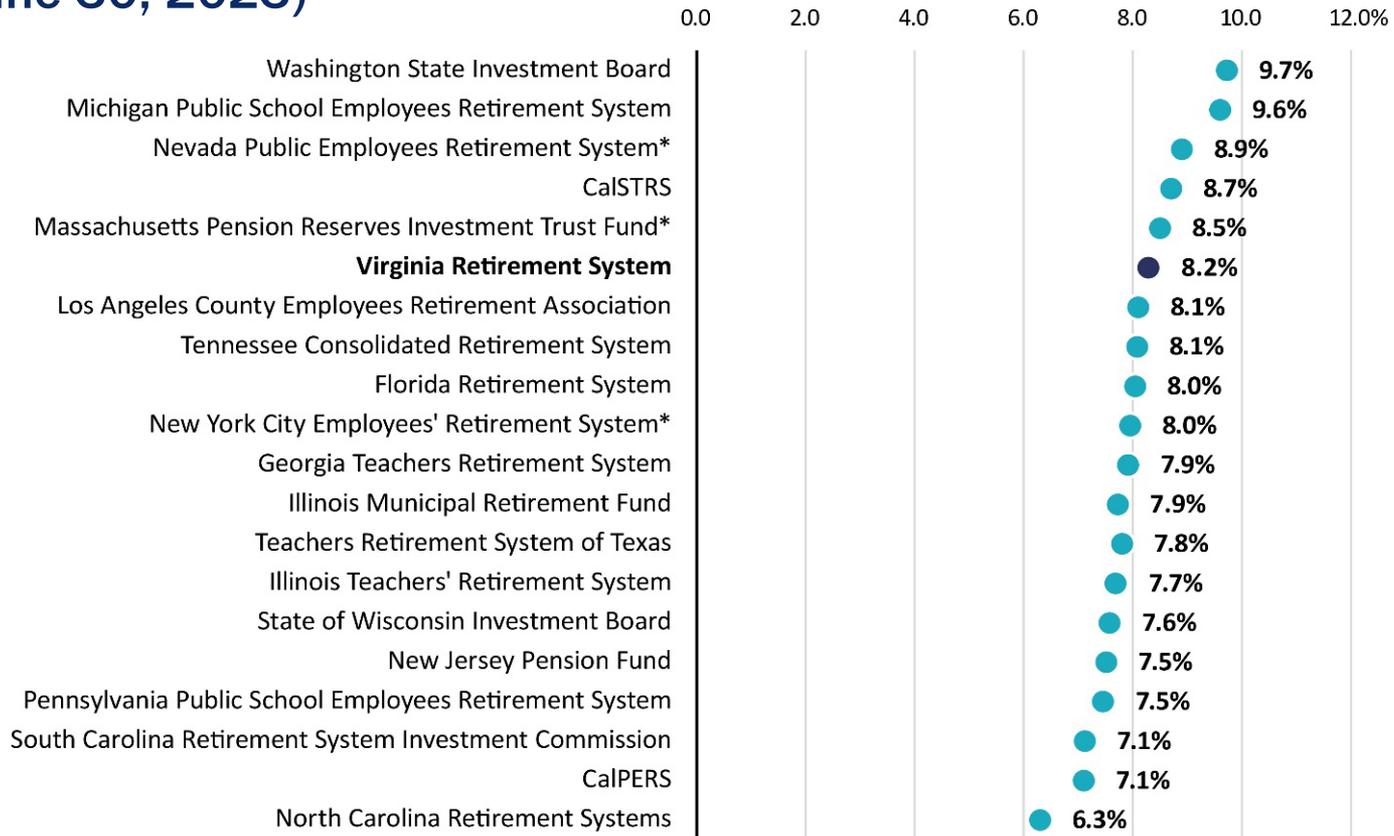
VRS trust fund returns were above long-term assumed rate of return

(March 31, 2024)



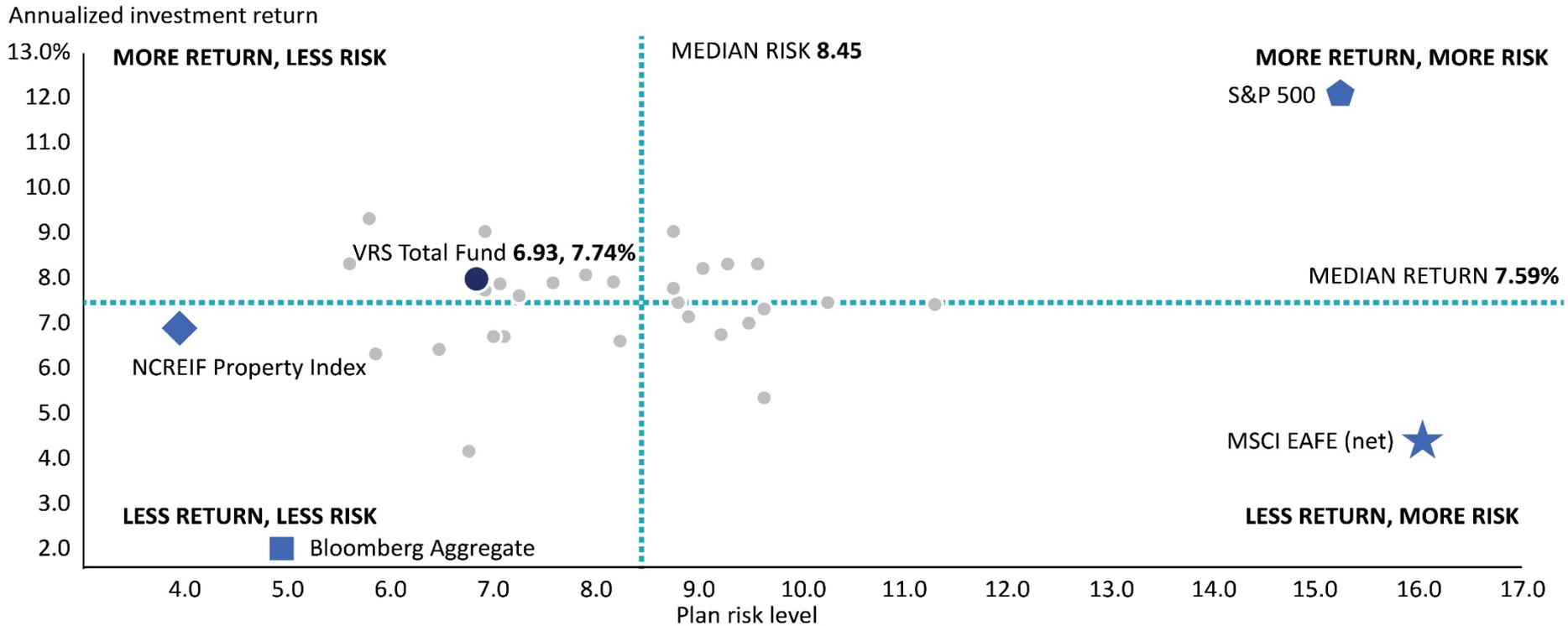
Updated from report with more recent data.

10-year absolute return for VRS total fund higher than majority of other large public pension plans (June 30, 2023)



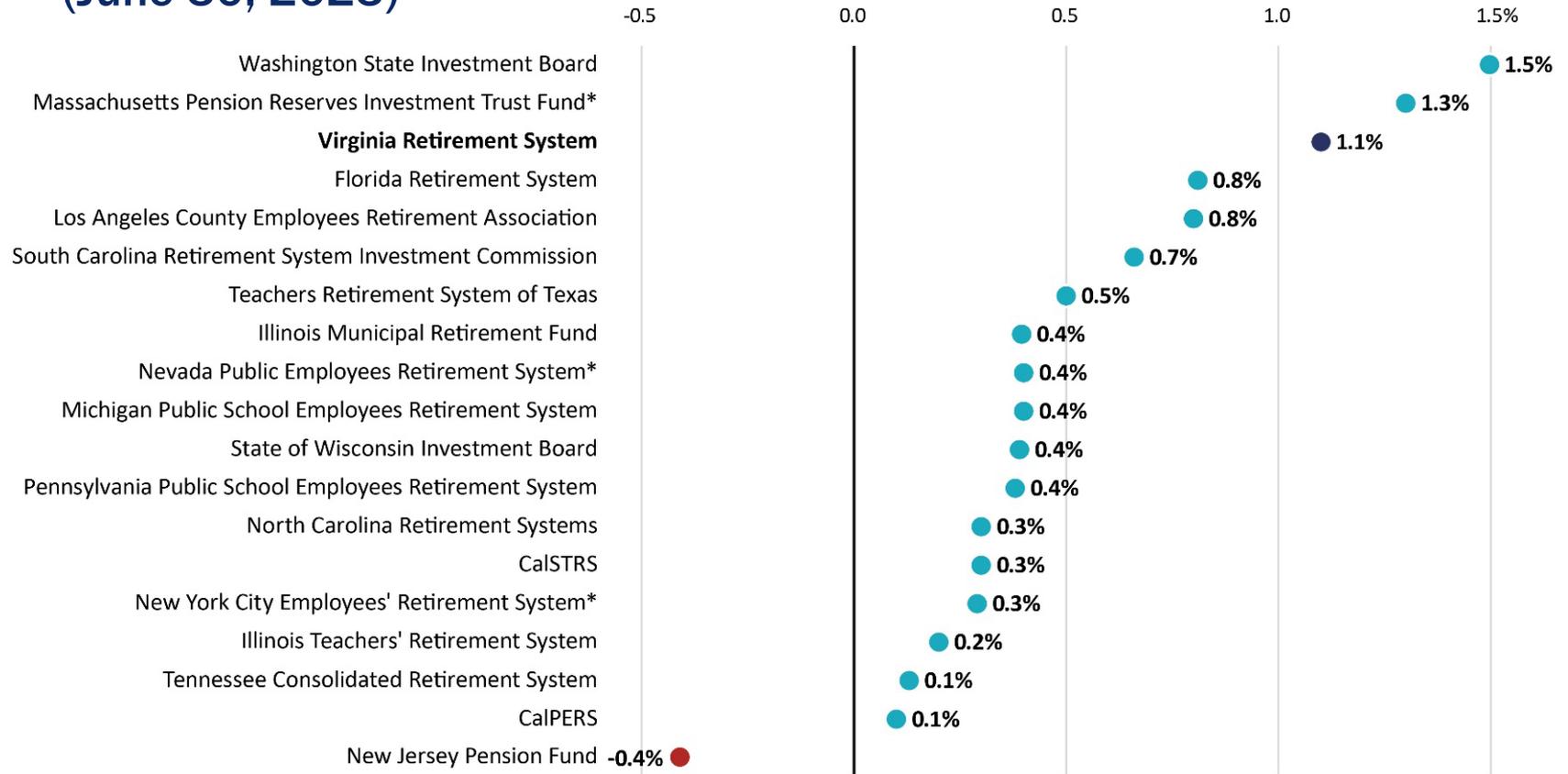
* Returns are gross of fees.

VRS is considered a higher-return, lower-risk plan compared with other large public pension plans (December 31, 2023)



SOURCE: Wilshire Trust Universe Comparison Service.

VRS exceeded 10-year total fund benchmark by more than most other large public pension plans (June 30, 2023)



* Returns are gross of fees.

JLARC review of VRS benchmarks could be considered

- Recent changes to VRS benchmarks, including removing spread for the private equity benchmark
- JLARC review could broadly assess VRS benchmarks or focus on the private equity benchmark
- Review could be undertaken with assistance from an investment consultant

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Virginia529 reviews benchmarks in collaboration with its investment consultant

- Virginia529 contracts on an ongoing basis with a consultant to assist the IAC, board, and staff with managing DB529 funds
- Consultant conducts asset allocation studies and recommends appropriate benchmarks
- Consultant assists investment staff with ad hoc reviews of benchmarks

Virginia529 board approved changes to some benchmarks in 2021

- Some changes designed to simplify benchmarks
 - Benchmarks still largely based on 2018 JLARC review undertaken with an independent investment consultant
- Other changes reflect restructuring of the investment portfolio
 - e.g., Domestic equity change from active management to passively managed index fund

DB529 fund underperformed most benchmarks

(March 31, 2024)

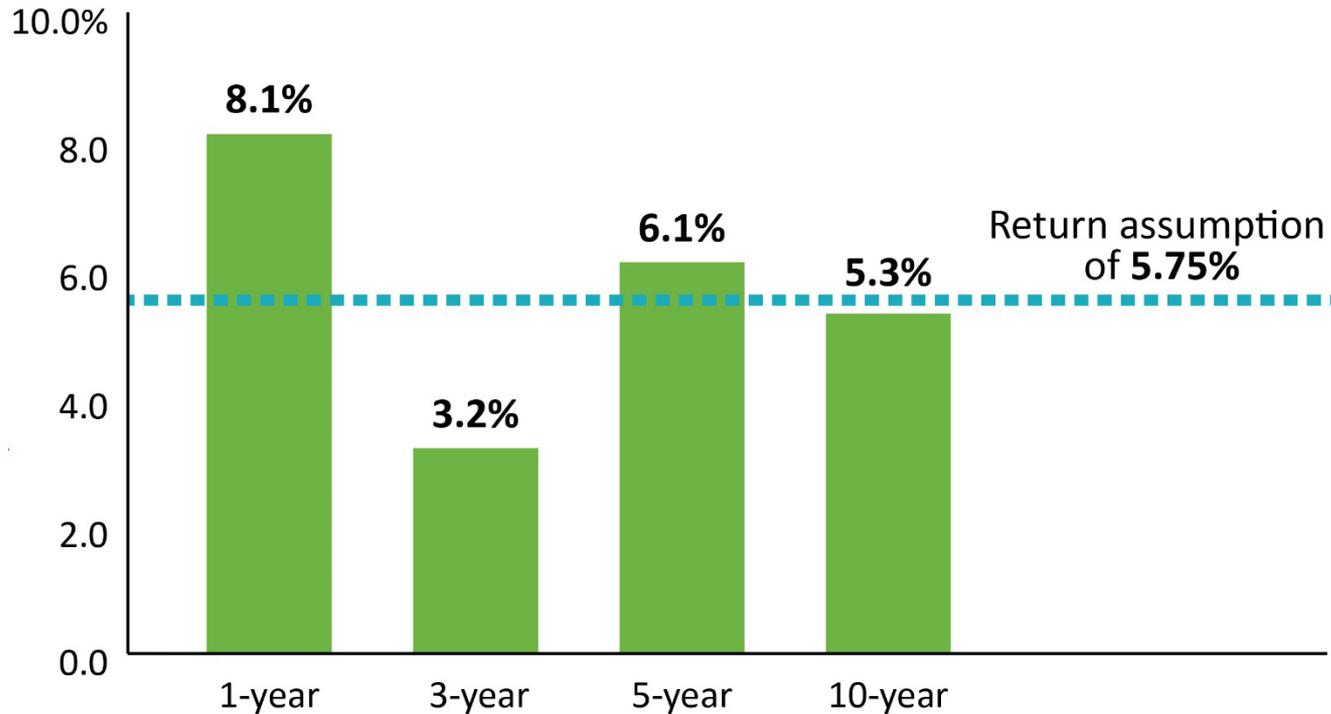
| Asset class | Assets (millions) | 1-year | 3-year | 5-year | 10-year |
|-------------------|-------------------|--------|--------|--------|---------|
| Fixed income | \$1,632 | ✓ | ✓ | ✗ | ✗ |
| Alternatives | 724 | ✗ | ✓ | ✓ | ✓ |
| Public equity | 611 | ✓ | ✗ | ✗ | ✗ |
| Total Fund | \$2,967 | ✗ | ✗ | ✗ | ✗ |

✓ = Return met or exceeded benchmark ✗ = Return below benchmark

Updated from report with more recent data.

DB529 fund returns were mixed compared with long-term assumed rate of return

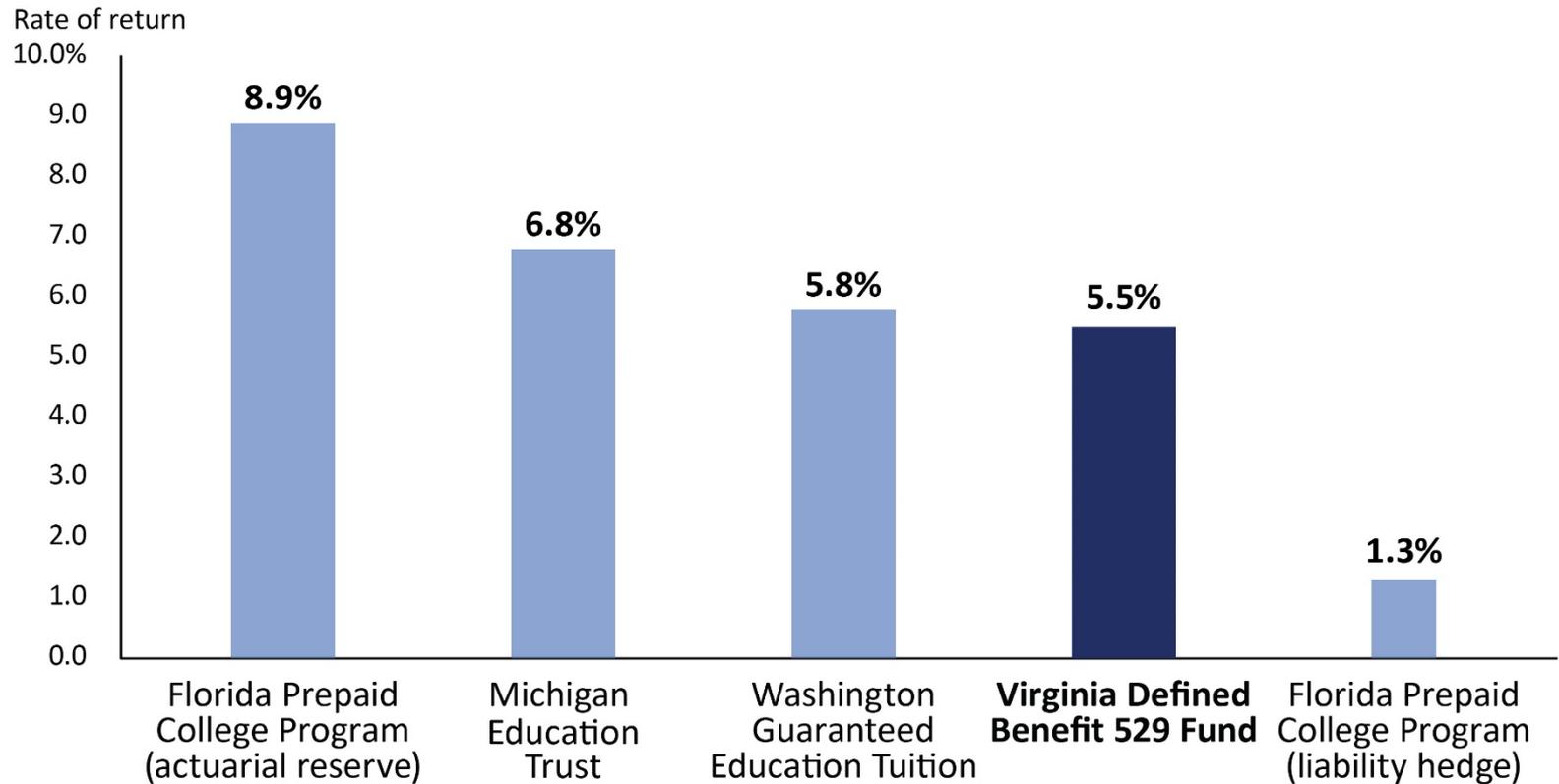
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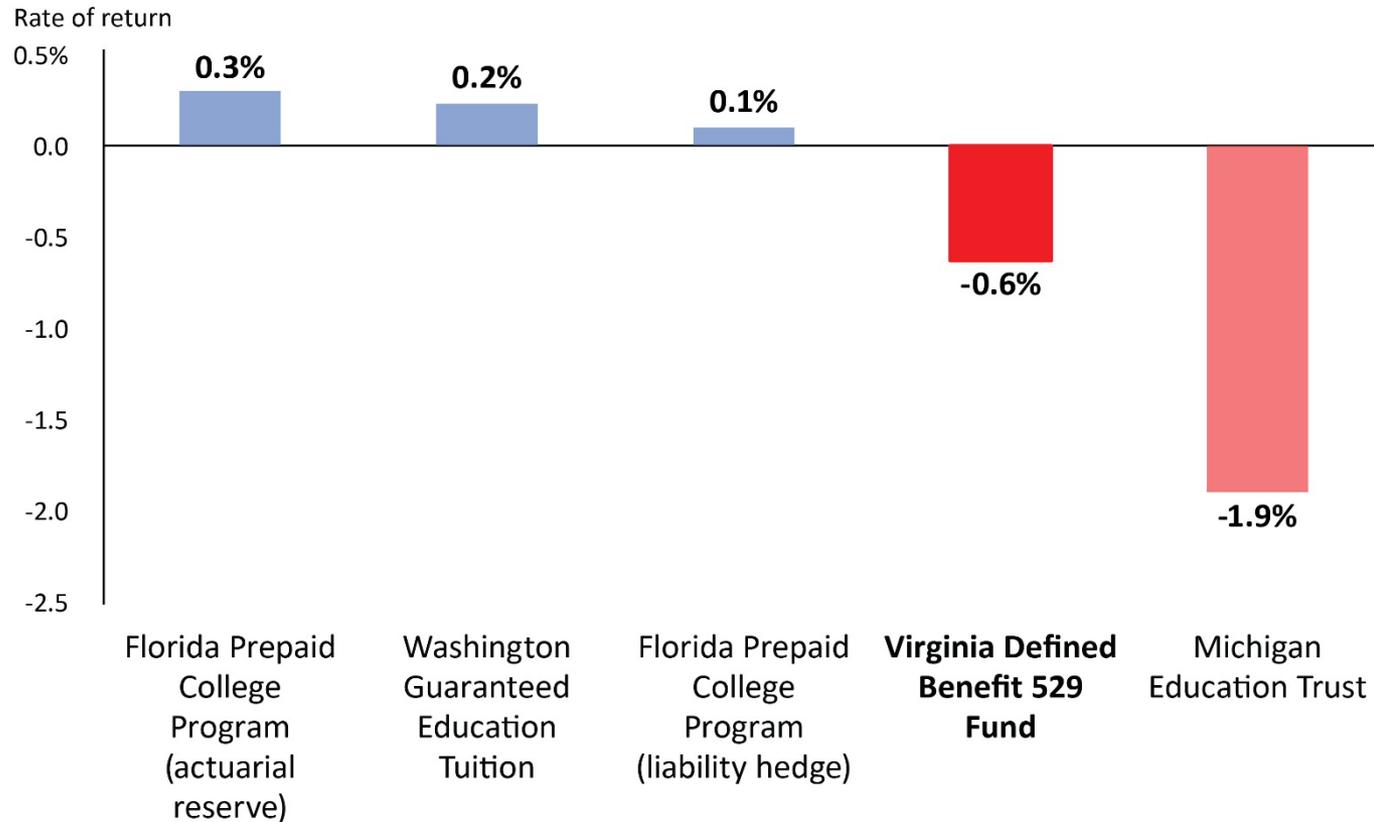
Updated from report with more recent data.

DB529 fund's 10-year return was lower than other state defined benefit college savings programs

(June 30, 2023)



DB529 fund was one of two DB college savings plans to underperform 10-year benchmark (June 30, 2023)



JLARC review of Virginia529's investment performance could be considered in the future

- DB529 funds have continued to underperform benchmarks, and returns are lower than defined benefit college savings programs in other states
- JLARC asset allocation review could be conducted in the future but should not occur immediately
 - Recent changes to public equity and fixed income have resulted in performance improvements in 2024
 - Legislation may be proposed for 2025 session that could require investment management changes

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