



# Virginia Retirement System Oversight Report (Updated)

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# JLARC oversight of VRS

- Virginia Retirement System (VRS) Oversight Act\* requires JLARC to
  - Oversee VRS on a continuing basis
  - Report on investments and other issues
  - Conduct a quadrennial actuarial analysis
  - Provide a guide for legislators

\*Code of Virginia, Title 30, Chapter 10.

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## In this presentation

Trust fund investments

Trust fund rates and legislation

Defined contribution plans

Benefits administration and agency management

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## Trust fund had **1.9%** return in **FY16**

- Assets = **\$68.1 billion**
- Some asset classes had negative 1-year returns
- All asset classes achieved positive returns for 3-, 5-, and 10-year periods

Investment returns and asset value are as of June 30, 2016.

# Trust fund returns exceeded benchmarks in all periods

Total fund	1-year	3-year	5-year	10-year
Return	1.9%	7.3%	7.0%	5.6%
Benchmark	1.3	6.6	6.4	5.1
Excess return	0.6	0.7	0.6	0.5

Returns as of June 30, 2016.

Benchmarks are a blend of indexes holding similar types of investments.

## Example returns for other public pension funds

Fund	1-year	10-year
VRS	1.9%	5.6%
CalPERS	0.6	5.1
CalSTRS	1.4	5.6
NY City	1.5	-
Florida – Pension Fund	0.6	5.9
Wisconsin – Core Retirement Fund*	1.4	5.8
North Carolina	0.8	5.5
Public fund median	1.8	-

Returns are net of fees for period ending 6/30/16, except Wisconsin which could not be confirmed as net or gross of fees. Returns are driven by asset allocations, which vary from fund to fund based on the fund manager's objectives. Funds presented here are non-statistical sample of the largest U.S. public pension funds that had publically reported FY16 return data as of September 2016. The median of public funds is median for MSCI InvestorForce universe of public pension plans.

# Returns for most asset classes met or exceeded benchmarks

Asset class	1-year	3-year	5-year	10-year
Public equity	✓	✓	✓	✓
Fixed income	✓	✓	✓	✓
Credit strategies	✗	✓	✓	✓
Real assets	✓	✓	✓	✓
Private equity	✓	✓	✓	✓
Strategic opportunities	✗	✗	<i>New asset class – not yet applicable</i>	

✓ Return met or exceeded benchmark

✗ Return did not exceed benchmark

Performance as of June 30, 2016.

## Board adjusted trust fund's target asset allocation

Asset class	Previous target	Change	New target
Public equity	42%	▼ 2%	40%
Fixed income	15		15
Credit strategies	15		15
Real assets	15		15
Private equity	12	▲ 3	15
Cash	1	▼ 1	0

Strategic opportunities asset class has no target but is capped at 5% of fund.



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## Investment expenses increased in FY15 due to growing trust fund

- \$370 million investment expenses in FY15
- Expenses increased \$50 million in four years
  - \$39 million external manager fees
  - \$11 million investment department expenses
- Increase mainly driven by growth of VRS trust fund

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## Consultant reported VRS investment expenses lower than its peers

	Percentage of trust fund assets*
Average peer expenses	65.8 basis points
VRS expenses	59.0 basis points
Difference	6.8 basis points
Dollar value of difference (FY13)	<b>\$41 million</b> lower than peer average

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\*100 basis points = 1 percent. Data is as of FY 2013, the most recent year for which it is available. Data is from CEM, a consultant hired by VRS to benchmark its costs to peer pension plans.

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# Employer contribution rates fully funded ahead of schedule

- Statute requires rates to be funded at about 90% for FY17 & FY18
- Rates funded at 100%
  - State plans, effective FY17\*
  - Teachers plan, effective FY18
- Estimated \$242 million savings over 20 years

\*State plans include State Employees, SPORS, VaLORS, and JRS plans.

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## Most deferred contributions paid off five years ahead of schedule

- In 2010, state deferred \$1.1 billion in contributions to address budget gap
- Deferred contributions were to be paid off by FY21
- In 2016, legislature paid off remaining deferred contributions for state plans (\$189 million)\*
  - Estimated \$26.5 million savings over 5 years

\*State plans include State Employees, SPORS, VaLORS, and JRS plans.

## Contribution rates for most plans changed by relatively small amount

	FY15	FY16	FY17	FY18
Teachers	14.50%	14.06%	14.66%	16.32%
State Employees	12.33	14.22	13.49	13.49
VaLORS	17.67	19.00	21.05	21.05
SPORS	25.82	27.83	28.54	28.54
JRS	51.66	50.02	41.97	41.97

Rates adjusted from FY15 to FY18 based on one-time contributions to individual plans and plan-specific increases in rate funding levels.

## 2012 legislative reforms (hybrid & plan 2 changes) reduced cost of retirement plans

Estimate of avoided costs	Fiscal year		
	2015	2016	2017
General fund	\$16 M	\$16.5 M	\$18 M
Non-general fund	22 M	22.5 M	24 M
<b>Total avoided costs</b>	<b>\$38 M</b>	<b>\$39 M</b>	<b>\$42M</b>

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## VRS manages defined contribution plans for state and local employees

- Eight defined contribution plans
- Intended to provide either primary or supplemental retirement income
- Participants choose their investments
- Aggregate assets = \$3.5 billion

Assets as of June 30, 2016.

# Investment options for most plans had returns that exceeded benchmarks

Defined contribution plan	1-year	3-year	5-year	10-year
Commonwealth 457 & Virginia 401(a)	✓	✓	✓	✓
Hybrid 457 & 401(a)				
Alternative plans*				
Higher education plan**	✗	✗	✗	✗

- ✓ Returns for most options exceeded benchmarks
- ✗ Returns for most options did not exceed benchmarks

Performance as of June 30, 2016.

\*Includes plans for political appointees, school superintendents, and the supplemental retirement plan for certain educators. \*\*Higher education plan offers different investment options than the other plans.

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## VRS is finalizing changes to Optional Retirement Plan for Higher Education

- Goals: reduce administrative fees charged to participants and improve investment options
- Original approach changed due to concerns raised by members and participating institutions
- VRS keeping two existing providers, adding option to use investments offered under other plans

## Example of returns generated by different investment options

Investment option	1-year	10-year
Retirement portfolio	2.5%	5.3%
Target date 2020 portfolio	1.9	5.1
Target date 2045 portfolio	-0.7	5.0
Stable value fund	1.6	3.0
Bond fund	6.1	5.2
Stock fund	4.0	7.5
Small/mid-cap stock fund	-3.4	7.5
International stock fund	-9.5	1.6

Returns net of fees for period ending June 30, 2016. Non-statistical sample of investment options available to state and local employees who participate in the Commonwealth 457 & Virginia 401(a) defined contribution plans.

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## VRS posting board materials electronically

- VRS is high-profile agency with statewide constituency
- Posting meeting minutes and advance agendas electronically will improve communication
  - Makes information readily available
  - Aligns VRS with other large public pension funds and Virginia's executive-branch boards

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## Proportion of Hybrid Plan members making voluntary contributions remains low

- Members need to make voluntary contributions to have adequate retirement savings
- 13% of members make voluntary contributions
- Participation likely to increase with January 2017 auto-enrollment

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## JLARC staff for this report

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JLARC's VRS oversight reports can be found here:

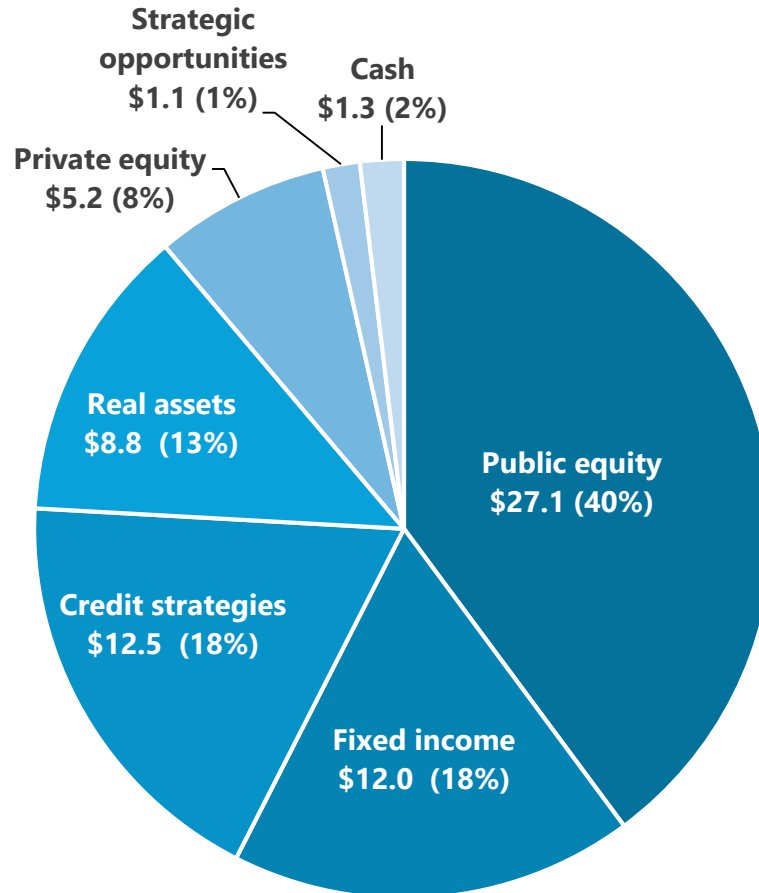
<http://jlarc.virginia.gov/vrs.asp>



## Reference: VRS asset class definitions

Asset class	Definition
Public equity	Stocks and other equity securities for publicly traded companies in U.S. and abroad
Fixed income	Bonds and money market instruments that pay a specific interest rate
Credit strategies	Emerging market debt, high yield bonds, convertible bonds, bank loans, and direct lending
Real assets	Real estate, infrastructure, and natural resources such as timber
Private equity	Equity securities for companies that are not listed on public exchanges
Strategic Opportunities	New investment approaches that are not widely used

# Reference: VRS trust fund asset allocations



Trust fund includes \$6.9 billion invested in hedge funds, \$5.1 billion of which is under public equity.

## Reference: VRS trust fund returns by asset class

Asset class	1-year	3-year	5-year	10-year
Public equity	-3.2%	7.5	7.1	5.1
Fixed income	6.8	4.5	4.2	5.8
Credit strategies	1.2	4.7	5.2	6.0
Real assets	11.6	12.5	12.0	7.4
Private equity	6.6	12.5	12.0	11.2
Strategic opportunities	-2.4	0.8	<i>New asset class – not yet applicable</i>	

Performance as of June 30, 2016.