

**VIRGINIA RETIREMENT SYSTEM
BOARD OF TRUSTEES**

September Thirteenth, Two Thousand Sixteen

The Virginia Retirement System Board of Trustees held its regular meeting on September 13, 2016 at the Bank of America Building, 1111 East Main Street, Richmond, Virginia with the following members present:

*Robert L. Greene, Chair
Diana F. Cantor, Vice-Chair
Hon. J. Brandon Bell, II
Wallace G. Harris
W. Brett Hayes
William H. Leighty
Joseph W. Montgomery
Mitchell L. Nason
Troilen Seward*

Also present were: Rod Smyth, Chairman of the Investment Advisory Committee; and VRS staff including Trish Bishop, Ron Schmitz, Steve Adelaar, John Alouf, Rory Badura, Farley Beaton, Frank Berry, Michael Cooper, Wandra Charles, Jeanne Chenault, Harriet Covey, Pam Elam, Jordan Evans, Barry Faison, Josh Fox, Bryan Gardiner, Brian Goodman, Charles Grant, J. T. Grier, Cordell Honrado, K.C. Howell, Robert Irving, Ross Kasarda, Curt Mattson, Steve McClelland, Laurie Nelson, Teresa Nguyen, Walker Noland, Greg Olif, Laura Pugliese, Ed Riley, Ken Robertson, Jennifer Schreck, Michael Scott, Jillian Sherman, Andrew Simpson, Larry Tentor, Bob Tyldsley, David Waltenbaugh, Dan Whitlock, Steve Woodall and Cindy Wilkinson.

Guests present were: Mark Gribbin with the Joint Legislative Audit and Review Commission; Michael Jay with the House Appropriations Committee; Conner Garstka and Josh Laws with the Office of the Attorney General; Ron Jordan with the Virginia Governmental Employees Association; Kristy Scott with the Office of the Auditor of Public Accounts; Emily Grimes with the Department of Planning and Budget; Jodi MacIntosh with CEM Benchmarking, Inc.; and Jennifer O'Dell with the Laborer's International Union of America.

Mr. Greene called the meeting to order at 1:00 p.m. Mr. Greene proposed a change in the order of the meeting agenda. Upon motion of Mr. Harris, with a second of Mr. Nason, the Board approved the changes.

At Mr. Greene's request, Ms. Bishop introduced Mr. Michael Cooper and Mr. Robert Irving, new members of the VRS Executive Committee. Mr. Cooper will serve as Chief Operating Officer (COO). Most recently, he was the Director of Administration and Operations at the Virginia Resources Authority. Mr. Irving will serve as Chief Customer Services Director. Most recently, he was an Assistant Commissioner at the Department of Motor Vehicles (DMV). The Board members introduced themselves. On behalf of the Board, Mr. Greene welcomed Mr. Cooper and Mr. Irving to VRS.

APPROVAL OF MINUTES

Upon a motion of Mr. Harris, with a second by Ms. Seward, the Board approved the minutes of the Board of Trustees meeting of June 7, 2016.

COMMITTEE ASSIGNMENTS

Mr. Greene announced that most assignment requests were honored. At his request, Ms. Bishop reviewed the proposed changes. Upon motion of Mr. Nason, with a second by Mr. Leighty, the Board approved the following action:

Request for Board Action: 2016-09-18 Committee Appointments

The Board confirms the list of committee appointments proposed by the Chair.

REPORT OF THE INVESTMENT ADVISORY COMMITTEE (IAC)

Mr. Smyth reported the Committee met on August 16, 2016 and discussed a scenario analysis exercise performed by VRS staff. Staff looked at expected Policy Portfolio performance in both historical and forward looking scenarios. Mr. Smyth also advised the Committee engaged in a robust discussion of managed futures, an uncorrelated asset class which is a disciplined trend-following process focusing on the inefficiencies in the market. In conclusion, Mr. Smyth noted Joe Grills rotated off of the IAC, and the Committee recognized his years of service to the Commonwealth.

Mr. Greene thanked Mr. Smyth for his report.

CIO REPORT

Mr. Schmitz began his report with a market update. He reported the Federal Reserve Chair, Janet Yellen, did not discuss negative interest rates at the August Federal Reserve's Jackson Hole Economic Policy Symposium. Mr. Schmitz noted new home sales, industrial production and durable goods orders were up in the

U.S.; retail sales were slowing; the European GDP was in line with expectations, with Germany showing surprising strength; and Japan production was flat. He also noted summer markets were somewhat quiet, after an initial decline with the Brexit vote.

Next Mr. Schmitz discussed asset allocation. He noted VRS is maintaining a defensive position. Specifically, the portfolio is underweight on stocks and underweight in each of the private market assets. He then reported the portfolio is overweight in fixed income, credit strategies, cash, and the Strategic Opportunities Portfolio.

Mr. Schmitz then reviewed the plan performance. He noted while the fiscal year-to-date performance as of July 31st was 2.1%, which was slightly below the benchmark of 2.4%, the one-year return outperformed the benchmark by 50 basis points. Mr. Schmitz also discussed fund volatility, tracking error, and information ratio. In conclusion, Mr. Schmitz reviewed the New Investments and Terminations Report, the Quarterly SWAM Report and the Quarterly External Investment Manager Referral Report.

Mr. Greene thanked Mr. Schmitz for his report.

ANNUAL CEM BENCHMARK REPORT

Ms. MacIntosh presented the results of the Annual CEM Benchmark Report for FY 2015. She advised that CEM's universe of participants is 72 systems. VRS was compared to a custom peer group of eleven public pension plans with similar characteristics. A copy of the report is attached as part of these minutes. Some highlights of the report included:

- The VRS total pension administration cost was \$64 per active member and annuitant, which was \$30 below the peer average of \$95 and \$56 below the average of \$121 for all the plans.
- The VRS service score was 81 out of 100, which was above the peer median of 80 and the all-participant median of 77.
- VRS could improve the service score by improving call waiting time and undesired call outcomes, and increasing attendance for presentations or group counseling.
- The VRS service score decreased from 83 to 81 between 2012 and 2015.
- For 2015, VRS had relatively high service and low cost.

Mr. Leighty asked about the complexity calculation. Ms. MacIntosh advised that VRS' score is very close to the median of

the peer group. Mr. Harris stated that the report is very positive. He asked the Director to convey the Board's appreciation to staff. Mr. Greene agreed and suggested that the Director share the report with staff.

REPORT OF THE AUDIT AND COMPLIANCE COMMITTEE

The Board received the Audit and Compliance Committee Report of September 12 and 13, 2016 and placed it on file.

Interviews for Internal Audit Director

Mr. Leighty reported that the Audit and Compliance Committee met on September 12, 2016 and convened a closed meeting to interview, discuss and consider candidates for the position of Internal Audit Director. Upon returning to open meeting, the Committee voted to recommend a candidate to the Board for appointment. A Request for Board Action (RBA) was presented to the Board later in the report.

Exit Conference with APA on Employer Assurance Audit

Mr. Leighty reported that the Audit and Compliance Committee also met on September 13, 2016. The Committee and APA met for an exit conference on the Employer Assurance Audit. The audit covered the data VRS prepared and supplied to employers and their auditors to support required financial reporting under Government Accounting Standards Board (GASB) Statement No. 68. The APA reported they issued unqualified audit opinions on all the Schedules of Employer Allocations and related information as prepared by VRS for GASB 68 purposes.

Audit Reports

Next, Mr. Leighty advised that the Committee received the following four audit reports:

- The Investment Governance Review Report found that the Board and Investment governance structures, processes and practices were aligned with the best practices of corporate governance. The review included one recommendation for improvement, which focused on the need to consider periodic comprehensive reviews of the Board Governance Policy. Management is in agreement with this recommendation and plans to schedule periodic recurring reviews of these documents.*
- The Review of the Deferred Compensation Plan, Cash Match Plan and Other Retirement Plans Report determined that the management oversight and monitoring of the plans and related investment products were sufficient and reasonable.*
- The IT Client-Server General Controls Report found the overall control environment was adequate. While controls*

were deemed adequate, the examination did identify certain areas where controls could be enhanced. Management has reviewed each of these areas and has either made or is in the process of making the needed enhancements.

- *The Release of Recommendations from the Audit Recommendation Follow-Up System (ARFUS) found that all the recommendations represented by management as implemented had been addressed appropriately, and accordingly, were released from ARFUS.*

Audit Recommendation Follow-up System Report

Mr. Leighty reported that Committee also received a separate presentation summarizing the activity within ARFUS for the current fiscal year. As of June 30, 2016, there were five past audit recommendations pending implementation. It was noted there were no undue risks associated with the pending implementation of these recommendations.

Quarterly Review on Modernization Program – Phase 4

Mr. Leighty advised that Committee received a report on Modernization Phase 4 through July 29, 2016, along with an updated status as of September 9, 2016. The project schedule has been re-baselined for a second time, shifting the planned completion date from December 2017 to April 2018, which will use of all planned budgetary and schedule contingencies. Mr. Leighty advised that a Request for Board Action was presented to the Administration and Personnel Committee to approve the funding of the contingencies, and that a related request will be presented to the Department of Planning and Budget to receive the necessary authorization to expend those funds.

Audit Plans

Then, Mr. Leighty noted that the Committee received status reports on the annual audit plan and the long-range audit plan. Internal Audit successfully completed most of both plans, despite significant turnover within the department over the four-year period. Those items not completed were generally impacted by modernization or legislation changes, and were deferred into the new four-year audit plan.

Future Meeting Schedule

The Committee considered its meeting schedule for calendar year 2017. The Committee will approve its 2017 meeting schedule at the Committee's December 2016 meeting.

Year-end Review

The Audit Director provided the Committee with a recap of the Department's accomplishments over the past year as well as a brief overview of the Department's initiatives and challenges for

the coming year. He recognized the contributions of both the long standing and new team members, noting he believes the Department is positioned well for the future.

Miscellaneous Briefings and Updates

Mr. Leighty reported that the Committee also received briefings and updates on the following miscellaneous items:

- *Side Letters – An overview of the use of Side Letter Agreements within VRS's externally managed investments.*
- *Review of APO and Operating Standards – Internal Audit reviewed management's representations regarding the Agency Performance Outcomes and Agency Operating Standards for the fiscal year ended June 30, 2016, noting that no items came to its attention which indicated that the outcomes and standards were not met for the fiscal year.*
- *Confirmation of Internal Audits Review of Investment Incentive Compensation – Internal Audit's review of the Investment Department's Proposed Incentive Compensation that reported that the calculated amounts were accurately computed and in accordance with the Board authorized pay plan.*
- *Results of Internal Audit's Quality Assurance and Improvement Program – The results of the annual Internal Quality Assurance Review as of June 30, 2016 were presented. The Audit Director noted that the review provided reasonable assurance that the VRS Internal Audit Department was performing in conformance with the International Standards for the Professional Practice of Internal Auditing.*

Quarterly report on Fraud, Waste and Abuse Hotline Cases

Next, Mr. Leighty reported that two Fraud, Waste and Abuse Hotline complaints reported to VRS via the Office of the State Inspector General during the period May 1, 2016 to July 31, 2016 were presented to the Committee. Neither alleged complaint was substantiated, therefore all investigations were closed.

Quarterly Travel Expense and Per Diem Report

Mr. Leighty advised that the Committee reviewed the quarterly travel expense and per diem report.

Audit Director - Bonus and Appointment of Audit Director

In conclusion, Mr. Leighty presented two Requests for Board Action regarding the Audit Director's bonus and the appointment of a new Audit Director.

***Request for Board Action: 2016-09-19
Audit Director's Bonus***

Upon motion of Ms. Cantor, with a second by Mr. Leighty, the Board approved the following action:

The VRS Board of Trustees approves a 5.0% sustained exceptional performance bonus to the Audit Director.

***Request for Board Action: 2016-09-20
Internal Audit Director Appointment***

Upon motion of Mr. Leighty, with a second by Ms. Cantor, the Board approved the following action:

The VRS Board of Trustees appoints Jennifer Preston Bell Schreck to the position of VRS Internal Audit Director, effective October 10, 2016.

The Board welcomed Ms. Schrek. Mr. Greene thanked Mr. Leighty for his report.

***REPORT OF THE DEFINED
CONTRIBUTION PLANS ADVISORY
COMMITTEE (DCPAC)
New DCPAC Members***

The Board received the Defined Contribution Plans Advisory Committee Report of September 7, 2016 and placed it on file.

Mr. Hayes advised that the Committee welcomed new members Shannon Irvin and Patricia Phillips to the Committee.

Investments Matters

Next, Mr. Hayes reported on several unbundled DC plans investment changes that took place on July 29, 2016. Staff reported that coordination among BlackRock, ICMA-RC and State Street representatives resulted in a smooth transition; the Emerging Markets Fund was discontinued and assets were transferred to the International Stock Fund; the investment mandate for the International Stock Fund was expanded to include small-cap and emerging markets equities; the Money Market Fund's investment mandate transitioned back to a prime mandate; and the Stable Value Fund's benchmark changed.

Then, Mr. Hayes discussed several actions required by the Committee Charter. The Committee reviewed the investment program for each DC plan, which included the twelve DC Investment Belief Statements previously approved by the Board; an overview of current DC best practices and trends; and fund performance and fees. The Committee and attending Board members discussed the underlying investments of each, with significant discussion related to the ORPHE TIAA and Fidelity investment options and performance. The Committee discussed a potential timeline for future changes to the ORPHE investment lineup.

Mr. Hayes also reported that the Committee also reviewed the defined contribution plans Investment Policy Statements, as required by the Charter. Staff presented several suggested changes for the Committee's review. Mr. Hayes advised that staff will provide the Committee with a final draft of the documents at the December 2, 2016 meeting.

Administration and Communications

Next, Mr. Hayes advised that the legislatively required automatic-escalation of Hybrid member voluntary contributions will occur in January. Also, he reported that VRS completed the required ORPHE contract amendment with ICMA-RC earlier this year and is still in discussions with TIAA and Fidelity regarding updated pricing and contract provisions.

Committee Meetings

Mr. Hayes reminded the Board of the upcoming ORPHE Annual Employer Update, required by the Charter, which is scheduled for September 16. Committee and Board members are welcome to attend in person or online, although it is not a regular meeting of the Committee. He also noted that the next Committee meeting will be on December 2 from 10:30 a.m. to 1:30 p.m.

Mr. Greene thanked Mr. Hayes for his report.

***REPORT OF THE ADMINISTRATION
& PERSONNEL COMMITTEE***

The Board received the Administration and Personnel Committee Report of September 12, 2016 and placed it on file.

Director's Report

Mr. Greene advised that Ms. Bishop introduced Michael Cooper, the new Chief Operating Officer for VRS, and Robert Irving, the new Customer Services Director for VRS.

Requests for Board Action

Mr. Greene noted that several Requests for Board Action (RBAs) were presented to the Committee. The requests were taken up by the Board at the conclusion of the Committee Report.

With regard to the first request, Mr. Greene reported that Mr. Robertson briefed the Committee on the status of the FY2016 Agency Performance Outcomes (APOs) and Agency Operating Standards. He noted that staff accomplished all of the APOs and all but one of the 21 operating standards (call abandonment rate, which was missed by a narrow margin). The Committee discussed the FY2016 results and agreed that the APOs and the requisite number of standards were met. The approximate cost for the FY2016 APO and gain-sharing bonus payments is \$652,331.

Next, Mr. Greene reported that the Committee received a request

to approve individual lump-sum performance bonuses for eligible Administrative and Investment Department operations and administration employees who received an overall rating of “exceptional” or “exceeds”, with a 2% bonus for exceeding expectations and a 4% bonus for exceptional performance. The approximate total cost for the FY2016 bonus payments is \$341,630. The bonuses are paid in accordance with the Administrative Pay Plan and the Investment Operations and Administration Staff Pay Plan.

Then, Mr. Greene reported that the Committee took up the reappointment of Mr. Economou to the IAC. The Committee recommended the reappointment of Theodore Economou to an additional 2-year term.

Mr. Greene advised that the Committee received a request for the release of Modernization contingency funds and a report on Modernization Phase 4 with an emphasis on the detailed plan for the final 18 months of the program. He also reported that the expenditures related to the completion of Phase 4 will remain within the original projected budget plus approved contingency funds.

Budget Variance Report (Year End Results)

Next, Mr. Greene reported that Ms. Bishop presented the FY2016 Budget Variance Report for the year end. She reviewed the administrative and investment expenses for FY2016 as well as the variances. She reported that, overall, the agency operating budget ended the fiscal year with a favorable variance of approximately \$3.7 million. The briefing was for information only and no action was required of the Committee.

Mr. Greene advised that the Committee met in closed session to discuss the FY2016 Incentive Pay for Investment Professionals. Mr. Schmitz reviewed the current and historic VRS fiscal year returns, excess returns versus the total fund benchmark; the incentive plan mechanics; significant Investment Department accomplishments and FY2016 returns by program; as well as historical performance versus custom benchmark by program. After engaging in an in-depth discussion, the Committee voted to recommend approval of the RBA to the Board.

Mr. Greene reported that the Committee met in closed session to discuss the VRS Director’s salary supplement. The Committee was very pleased with the performance of the Director and recommended a bonus and supplemental payment to reward her performance.

***Request for Board Action: 2016-09-21
FY2016 APOs & Operating Standards
and Lump-sum Bonus***

Upon motion of Mr. Harris, with a second by Mr. Leighty, the Board approved the following action:

The VRS Board of Trustees approves (i) the attainment of FY2016 APOs and Operating Standards and (ii) a lump-sum bonus equal to 4% of salary for eligible administrative employees and eligible Investment Department operations and administration employees.

***Request for Board Action: 2016-09-22
Lump-sum Bonus for Administrative &
Investment Department Operations and
Administration Employees***

Upon motion of Mr. Leighty, with a second by Mr. Harris, the Board approved the following action:

The Board of Trustees approves performance lump-sum bonuses for eligible administrative employees and eligible Investment Department operations and administration employees.

***Request for Board Action: 2016-09-23
Reappointment of IAC Member***

Upon motion of Ms. Cantor, with a second by Mr. Nason, the Board approved the following action:

The Board reappoints Theodore Economou for a two-year term ending September 18, 2018, to the Investment Advisory Committee.

***Request for Board Action: 2016-09-24
Spending Authority for Phase 4
Modernization***

Upon motion of Mr. Montgomery, with a second by Mr. Leighty, the Board approved the following action:

The VRS Board of Trustees authorizes staff to request spending authority from the Department of Planning and Budget for Phase 4 Modernization funding.

***Request for Board Action: 2016-09-25
FY 2016 Incentive Payments for VRS
Investment Professionals***

Upon motion of Mr. Montgomery, with a second by Ms. Cantor, the Board approved the following action:

The VRS Board of Trustees approves the payment of an incentive amount of \$5,975,521.12 for FY2016 to VRS investment professionals as authorized by the Investment Professionals' Pay Plan.

***Request for Board Action: 2016-09-26
VRS Director Bonus and Supplemental
Payment***

Upon motion of Mr. Montgomery, with a second by Ms. Cantor, the Board approved the following action:

The VRS Board of Trustees approves a performance bonus for the VRS Director payable on October 14, 2016 and a supplemental payment made November 16, 2016, as authorized in the 2016 Appropriation Act.

Ms. Cantor stated her appreciation to the staff, management and the Trustees for their tremendous efforts that resulted in moving the VRS goals forward. The recently approved RBAs recognize such efforts.

**COMMENDING RESOLUTION
Joe Grills**

Mr. Greene informed the Board that Mr. Grills term of appointment to the Investment Advisory Committee has expired. Mr. Greene read a resolution commending Mr. Grills for his service to the Virginia Retirement System and asked that it be included in the minutes of the Board meeting.

WHEREAS, Joe Grills began his service to the Virginia Retirement System in 1998 as a member of the Investment Advisory Committee; and

WHEREAS, Mr. Grills was appointed by the Virginia Retirement System Board of Trustees to serve as Chairman of the Investment Advisory Committee for a number of years and was appointed to serve as Vice Chairman of this committee as well, leading with integrity and distinction; and

WHEREAS, by virtue of his keen knowledge and understanding of investment, financial, and economic matters, and his experience serving on corporate boards, Mr. Grills contributed immeasurably to the success of the Investment Advisory Committee and the Virginia Retirement System; and

WHEREAS, during a challenging environment for investors, and especially during the Financial Crisis and Great Recession of 2008-2009, Mr. Grills' deep knowledge, significant experience, calm demeanor, and excellent leadership all contributed to robust Investment Advisory Committee dialogue and analysis, resulting in significant value added to the Chief Investment Officer and the Board of Trustees;

NOW, THEREFORE, BE IT RESOLVED, that on September 13, 2016, we the members of the Board of Trustees of the Virginia Retirement System hereby recognize Mr. Grills' loyal and unselfish service to the Investment Advisory Committee and acknowledge his contributions for the betterment of the System; we commend him for his wisdom, stewardship, and faithful service to the Investment Advisory Committee, the Board of Trustees, members and beneficiaries of the System, and the Commonwealth of Virginia.

Upon motion of Mr. Montgomery, with a second by Mr. Hayes, the Board affirmed the resolution.

REPORT OF THE DIRECTOR

Agency Roadmap Update

Ms. Bishop provided an update of the Agency Roadmap. She was pleased with the progress on all fronts. It was a collaborative effort on the part of all staff.

New Coverage

Next, Ms. Bishop provided a report on new coverage, noting that several employers elected to provide enhanced hazardous duty benefits, 50/25 age and service eligibility, and Health Insurance Credit; or joined the Group Life Insurance Plan.

Required Reporting of Employer in Arrears of Contribution Payment

Ms. Bishop advised that a new budget item requires VRS to report to the Chairs of House Appropriations and Senate Finance any employer in arrears by 60 days or more for the payment of contributions to VRS. The City of Petersburg is in such a situation. VRS is working with the City of Petersburg to resolve the situation.

GFOA Achievement Award for Excellence in Financial Reporting

Ms. Bishop was pleased to announce that Barry Faison and his staff received the GFOA Achievement Award for Excellence in Financial Reporting. VRS has received the award for 34 years. On behalf of the Board, Mr. Greene expressed his congratulations and requested that the minutes reflect the achievement.

National Association of Governmental Defined Contribution Plan Administrators (NAGDA) Award

Ms. Bishop was also pleased to report that the National Association of Governmental Defined Contribution Plan Administrators will recognize VRS on September 20 with a NAGDA Leadership Award for Improvements in the Voluntary Contributions Campaign regarding the Hybrid Plan. Voluntary contributions increased from 4% to 19.57%. The achievement is the result of efforts by the DC Plans team, the PR teams and the Third-Party Administrator.

In conclusion, Ms. Bishop reported that the Commission on Employee Retirement Security and Pension Reform working group on retirement met on September 11. The PEW Foundation and JLARC made presentations at the meeting. She advised that the full Commission will meet next month. Additionally, she reported that at a September 11 JLARC meeting, a motion was passed to review the College Savings 529 Investment Management Structure, and explore pros and cons of potentially moving the pre-paid portion of the plan to VRS or possibly to Treasury.

Other Business

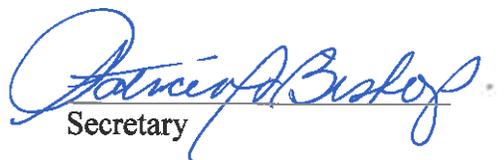
Mr. Leighty supported Ms. Cantor's comments that the

preparation for the Board meeting was substantial and the agenda was well executed. He noted that he was pleased with the work of the Board and staff.

ADJOURNMENT

There being no further business to discuss, the Board meeting adjourned at approximately 2:25 p.m.


Chair


Secretary

**VIRGINIA RETIREMENT SYSTEM
REPORT OF THE AUDIT AND COMPLIANCE COMMITTEE
TO THE BOARD OF TRUSTEES
SEPTEMBER 13, 2016**

ITEMS REPORTED TO THE BOARD OF TRUSTEES

The Chair of the Audit and Compliance Committee reported that the following matters were presented to the Committee for its review and consideration at the following Committee meetings.

The Audit and Compliance Committee met on September 12, 2016 and discussed the following:

INTERVIEWS FOR INTERNAL AUDIT DIRECTOR

After the meeting was called to order, the Committee convened a closed meeting to interview, discuss and consider candidates for the position of Internal Audit Director.

Upon returning to open meeting, the Committee voted to recommend a candidate to the Board for appointment. A Request for Board Action (RBA) will be presented to the Board at this end of this report.

The Audit and Compliance Committee met on September 13, 2016 and discussed the following:

EXIT CONFERENCE WITH THE AUDITOR OF PUBLIC ACCOUNTS (APA) ON THEIR EMPLOYER ASSURANCES AUDIT

The APA reported that they have concluded their "Employer Assurances" audit work. This audit covers the data VRS prepares and supplies to employers and their auditors to support required financial reporting under Government Accounting Standards Board (GASB) Statement No. 68. The APA reported they have issued unqualified audit opinions on all the Schedules of Employer Allocations and related information as prepared by VRS for GASB 68 purposes.

AUDIT REPORTS

The committee received four audit reports.

The *Investment Governance Review* found that the Board and Investment governance structures, processes and practices were aligned with the best practices of corporate governance. The review included one recommendation for improvement, which focused on the need to consider periodic comprehensive reviews of the Board Governance Policy. Management is in agreement with this recommendation and plans to schedule periodic recurring reviews of these documents.

The *Review of the Deferred Compensation Plan, Cash Match Plan and Other Retirement Plans* determined that the management oversight and monitoring of the plans and related investment products were sufficient and reasonable.

The *IT Client-Server General Controls* report found the overall control environment was adequate. While controls were deemed adequate, the examination did identify certain areas where controls could be enhanced. Management has reviewed each of these areas and has either made or is in the process of making the needed enhancements.

The final audit report pertained to the *Release of Recommendations from the Audit Recommendation Follow-Up System (ARFUS)*. The examination found all recommendations represented by management as implemented had been addressed appropriately, and accordingly, were released from ARFUS.

AUDIT RECOMMENDATION FOLLOW-UP SYSTEM REPORT

There was also a separate presentation summarizing the activity within ARFUS for the current fiscal year. As of June 30, 2016, there were five past audit recommendations pending implementation. It was noted there were no undue risks associated with the pending implementation of these recommendations.

QUARTERLY REVIEW ON MODERNIZATION PROGRAM – PHASE 4

Management presented its report on Modernization Phase 4 through July 29, 2016, along with an updated status as of September 9, 2016, via a flash report. Management acknowledged a second re-baselining of the project schedule, shifting the planned completion date from December 2017 to April 2018. The re-baselining will require the use of all planned budgetary and schedule contingencies. Management noted an RBA was presented to the Administration and Personnel Committee for approving the funding of the contingencies, and that a related request will need to be placed through the Department of Planning and Budget to receive the necessary authorizations to spend those funds.

Internal Audit then presented their Quarterly Review of Modernization Phase 4 as of August 1, 2016. Internal Audit acknowledged the re-baselining of the schedule and use of planned contingencies and further reported that nothing has come to their attention to cause them to believe that the Phase 4 scope, schedule, or budget is at risk, despite the use of the contingencies. Internal Audit also noted that it expects to see increased planning activities regarding the decommissioning of RIMS leading into and throughout calendar 2017.

AUDIT PLANS

Status reports were received on both the annual audit plan and the long-range audit plan. June 30, 2016 marked the end of the planned four-year audit cycle. Internal Audit successfully completed most of both plans, despite significant turnover within the department over the four-year period.

FUTURE MEETING SCHEDULE

The Committee considered its meeting schedule for calendar year 2017. The committee will be polled by Ms. Schreck via email and will approve its 2017 meeting schedule at the Committee's December 2016 meeting.

YEAR-END REVIEW

The Audit Director provided the Committee with a recap of the Department's accomplishments over the past year as well as a brief overview of the Department's initiatives and challenges for the coming year. He recognized the contributions of both the long standing and new team members, noting he believes the Department is positioned well for the future.

In accordance with the International Standards for the Professional Practice of Internal Auditing, the Audit Director explicitly confirmed to the Committee that the Department is organizationally independent of the activities they examine and is adequately staffed.

MISCELLANEOUS BRIEFINGS AND UPDATES

The committee received the following briefings and updates:

Side Letters – An overview of the use of Side Letter Agreements within VRS's externally managed investments was received.

Review of APO and Operating Standards – Internal Audit reviewed management's representations regarding the Agency Performance Outcomes and Agency Operating Standards for the fiscal year ended June 30, 2016, noting that no items came to its attention which indicated that the outcomes and standards were not met for the fiscal year.

Confirmation of Internal Audits Review of Investment Incentive Compensation – A report of Internal Audit's review of the Investment Department's Proposed Incentive Compensation amounts was received. Internal Audit reported that the calculated amounts were accurately computed and in accordance with the Board authorized pay plan.

Results of Internal Audit's Quality Assurance and Improvement Program – The results of the annual Internal Quality Assurance Review as of June 30, 2016 were presented. The Audit Director noted that the review provided reasonable assurance that the VRS internal Audit Department was performing in conformance with the International Standards for the Professional Practice of Internal Auditing.

QUARTERLY REPORT ON FRAUD, WASTE AND ABUSE HOTLINE CASES

A list of Fraud, Waste and Abuse Hotline complaints that were reported to VRS via the Office of the State Inspector General during the period May 1, 2016 to July 31, 2016 was presented to the Committee (2 in total). Neither alleged complaint was substantiated, therefore all investigations were closed.

MANAGEMENT'S QUARTERLY TRAVEL EXPENSE AND PER DIEM REPORT

The Committee reviewed the quarterly travel expense and per diem report.

AUDIT DIRECTOR'S PERFORMANCE EVALUATION

The Committee met in closed session to review the Audit Director's performance for the fiscal year ended June 30, 2016.

Request for Board Action: Before you is a Request for Board Action to approve a bonus for the Audit Director due to his sustained exceptional performance. The Committee recommends that the Board approve this RBA. I ask for a motion for the Board to approve this request.

APPOINTMENT OF NEW AUDIT DIRECTOR

Request for Board Action: Before you is a Request for Board Action to appoint Jennifer Preston Bell Schreck to the position of Audit Director effective October 10, 2016. The Committee recommends that the Board approve this RBA. I ask for a motion for the Board to approve this request.

ADJOURNMENT

There being no further business the meeting adjourned.

Respectfully submitted to the Board of Trustees on September 13, 2016.


Mr. William H. Leighty, Chair
Audit and Compliance Committee

**REPORT OF THE
DEFINED CONTRIBUTION PLANS ADVISORY COMMITTEE
For the Committee Meeting on Wednesday, September 7, 2016**

The Defined Contribution Plans Advisory Committee met on Wednesday, September 7th, and took up the following matters:

Introductions:

The Chair welcomed new members Shannon Irvin and Patricia Phillips to the Committee.

Investments:

Unbundled DC Plans

Staff provided the Committee with a final review of the unbundled DC plans investment changes that took place on July 29, 2016. Staff reported that coordination among BlackRock, ICMA-RC and State Street representatives resulted in a smooth transition. Staff told the Committee there was a slight fee increase in the expense ratio for the International Stock Fund from 6 basis points to 9 basis points because of the fund's expanded mandate to include small-cap stocks and emerging markets stocks. Staff reported the change in the Money Market Fund resulted in a slight fee decrease from 10 basis points to 8 basis points.

Staff informed the Committee effective August 2016 the custom book value benchmark for the Stable Value Fund changed from the 3-Year CMT Yield plus an annualized spread of 50 basis points to 50% 2-Year CMT Yield + 50% 3-Year CMT Yield] plus an annualized spread of 25 basis points. Staff reported returns from the updated custom benchmark will be linked to prior custom benchmark returns to produce the longer dated returns for performance reporting purposes.

Annual Investments Review

The Charter requires the Committee to perform a comprehensive review of the investment program for each DC plan. Staff began by reviewing the twelve DC Investment Belief Statements previously approved by the Board and providing an overview of current DC best practices and trends. Staff provided a detailed review of each DC plan as of Fiscal Year 2016, which included information about fund performance and fees. The Committee and attending Board members discussed the underlying investments of each, with significant discussion related to the ORPHE TIAA and Fidelity investment options. In response to a Committee member's question, the Committee discussed a potential timeline for future changes to the ORPHE investment lineup. Staff notes that it will come back to the Committee with proposals for an outreach plan and plan for any potential changes.

The Charter also requires the Committee to review the defined contribution plans Investment Policy Statements annually, and make recommendations to the Board. Staff provided recommended changes and asked the Committee to review and provide comments to staff. Staff will consolidate any additional edits and provide the Committee with a final draft of the documents at their December 2, 2016 meeting.

Assuming the Committee agrees with the suggested changes the policy documents will then be presented to the Board via a Request for Board Action for approval.

Other Projects

Staff informed the Committee that once outstanding ORPHE details are finalized, staff will re-start its off-the-shelf vs custom target date portfolios project as well as its investment advice and managed accounts project. Both projects were previously placed on hold due to the developments that occurred with the ORPHE.

Administration:

Administrative Reports and Communication Update

Due to time constraints, staff bypassed a detailed review of the reports and asked the Committee to email if they had any questions after reviewing the materials. Staff reminded the Committee that the first auto-escalation for the hybrid plan will take place in January, and provided a high-level overview of communications plan.

ORPHE:

Plan Structure Discussion and Communications Update

Staff advised that VRS completed the required contract amendment with ICMA-RC earlier this year and is still in discussions with TIAA and Fidelity regarding updated pricing and contract provisions. Implementation discussions and communications development is progressing with all three providers.

Staff reviewed the new VRS ORPHE website and provider microsites. Staff also reviewed various outreach efforts to inform employers and participants of the new resources and options available.

ORPHE Annual Employer Update

Staff reminded the Committee that the ORPHE Annual Employer Update required by the Charter is scheduled for September 16th. Committee and Board members are welcome to attend in person or online, although it is not a regular meeting of the Committee. A report will be provided to the Committee following the Update.

Other Business:

Staff advised that the institution that planned to opt-out of the ORPHE has postponed this action. Issues related to fiduciary responsibility and establishing an appropriate governance structure as a plan sponsor may have played a role in the institution's decision to postpone the opt-out action.

Staff also informed the Committee of eight class-action lawsuits against universities around the country related to their ERISA 403(b) plans. Complaints have been filed, but no other action has been taken yet. Staff will continue to monitor the cases and provide updates as available.

Next Meeting

The next meeting will take place on December 2nd from 10:30 a.m. to 1:30 p.m. Also, for those who are interested, the ORPHE Annual Employer Update is scheduled for September 16th.

That concludes my report to the Board.

Submitted to the Board of Trustees on September 13, 2016.



Brett Hayes, Chair
Defined Contribution Plans Advisory Committee

**REPORT OF THE
ADMINISTRATION AND PERSONNEL COMMITTEE
Meeting of September 12, 2016**

The Administration and Personnel Committee met on September 12, 2016 and discussed the following:

Director's Report

Ms. Bishop introduced Michael Cooper, the new Chief Operating Officer for VRS, and Robert Irving, the new Customer Services Director for VRS.

Requests for Board Action Regarding Compensation for Administrative Employees and Investment Department Operations and Administrative Employees

Mr. Robertson briefed the Committee on the status of the FY2016 Agency Performance Outcomes (APOs) and Agency Operating Standards. He noted that staff accomplished all of the APOs and all but one of the 21 operating standards (call abandonment rate). The Committee discussed the FY2016 results and agreed that the APOs and the requisite number of standards were met. The approximate cost for the FY2016 APO and gain-sharing bonus payments is \$652,331.

***Request for Board Action:** The VRS Board of Trustees approves (i) the attainment of FY2016 APOs and Operating Standards and (ii) a lump-sum bonus equal to 4% of salary for eligible administrative employees and eligible Investment Department operations and administration employees.*

Mr. Robertson presented a request to approve individual lump-sum performance bonuses for eligible Administrative and Investment Department operations and administration employees who received an overall rating of "exceptional" or "exceeds", with a 2% bonus for exceeding expectations and a 4% bonus for exceptional performance. The approximate total cost for the FY2016 bonus payments is \$341,630. The bonuses are paid in accordance with the Administrative Pay Plan and the Investment Operations and Administration Staff Pay Plan.

***Request for Board Action:** The Board of Trustees approves performance lump-sum bonuses for eligible administrative employees and eligible Investment Department operations and administration employees.*

Reappointment of IAC Member

The A&P Committee recommends reappointment of Theodore Economou to an additional 2-year term.

***Request for Board Action:** The Board reappoints Theodore Economou for a two-year term ending September 18, 2018, to the Investment Advisory Committee.*

Release Modernization Program Contingency Funds

Mr. Beaton presented a report on Modernization Phase 4 with an emphasis on the detailed plan for the final 18 months of the program. He also reported that the expenditures related to the completion of Phase 4 will remain within the original projected budget plus approved contingency funds.

Request for Board Action: *The VRS Board of Trustees authorizes staff to request spending authority from the Department of Planning and Budget for Phase 4 Modernization funding.*

Budget Variance Report (Year End Results)

Ms. Bishop presented the FY2016 Budget Variance Report for the year end. She reviewed the administrative and investment expenses for FY2016 as well as the variances. She reported that, overall, the agency operating budget ended the fiscal year with a favorable variance of approximately \$3.7 million.

This briefing was for information only and no action was required of the Committee.

Requests for Board Action Regarding Compensation for Investment Professionals and Director

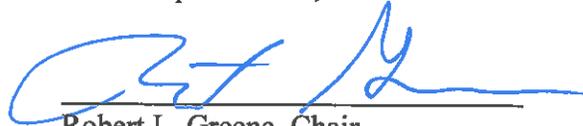
The Committee met in closed session to discuss the FY2016 Incentive Pay for Investment Professionals. Mr. Schmitz reviewed the current and historic VRS fiscal year returns, excess returns versus the total fund benchmark; the incentive plan mechanics; significant Investment Department accomplishments and FY2016 returns by program; as well as historical performance versus custom benchmark by program. After engaging in an in-depth discussion, the Committee voted to recommend approval of the RBA to the Board.

Request for Board Action: *The VRS Board of Trustees approves the payment of an incentive amount of \$5,975,521.12 for FY2016 to VRS investment professionals as authorized by the Investment Professionals' Pay Plan.*

The Committee met in closed session to discuss the VRS Director's salary supplement. The Committee is very pleased with the performance of the Director and recommends a bonus and supplemental payment to reward her performance.

Request for Board Action: *The VRS Board of Trustees approves a performance bonus for the VRS Director payable on October 14, 2016 and a supplemental payment made November 16, 2016, as authorized in the 2016 Appropriation Act.*

Respectfully submitted to the Board of Trustees on September 13, 2016.



Robert L. Greene, Chair
Administration and Personnel Committee