
Minutes

A regular meeting of the Administration and Personnel Committee of the VRS Board of Trustees was held on September 12, 2018 in Richmond, Virginia with the following members present:

Mitchell L. Nason, Chair
Diana F. Cantor, Vice Chair
Wallace G. Harris
Joseph W. Montgomery

Board members present:
O'Kelly McWilliams (by phone under § 2.2-.3708.2(D))
Troilen Gainey Seward

Also present: Trish Bishop, Ron Schmitz, Farley Beaton, Jeanne Chenault, Michael Cooper, Robert Irving, LaShaunda King, Curt Mattson, Angela Payne, Andrea Peeks, Matt Priestas, Jennifer Schreck, Jillian Sherman, Capri Stanley-Smith, Leslie Weldon, and Cindy Wilkinson of the VRS Staff; Michael Oak of McLagan; Adam Barnett of McLagan (*by phone*); Kimberly Sarte of the Joint Legislative Audit and Review Commission; Joe McMahon of the Joint Legislative Audit and Review Commission; Michael Jay of the House Appropriations Committee; Sarah Herzog of the Senate Finance Committee; Latosha Johnson of the Department of Planning and Budget; and Michael Martz of the Richmond Times-Dispatch.

The meeting convened at 1:01 p.m.

Approval of Minutes

Mr. Montgomery moved, with a second by Ms. Cantor, to approve the minutes of the May 31, 2018 Administration and Personnel Committee meeting.

The Committee approved the minutes upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

McLagan Working Session

Ms. Bishop began with an overview of the Board's decision to request a comprehensive market review of compensation and incentive pay practices for the Investment Professionals' Pay Plan. The Board requested McLagan perform the review and present a final report to the Board.

Mr. Oak then presented a summary of McLagan's "Investment Compensation Program Review", which found that:

- VRS' Investment Department base salaries, in aggregate, are 10% below the Board-approved philosophy (e.g., salaries should approximate the 75th percentile of leading public funds).
- VRS' targeted total cash compensation levels (actual salaries plus target incentives) are 9% below its targeted pay positioning, which is to provide cash compensation at the median of a blended peer group of leading public funds (weighted 75%) and a broad range of private sector firms (weighted 25%).
- The design features of VRS' investment incentive pay plan are generally mainstream versus leading public funds, with a few exceptions:
 - VRS' absolute return adjustment (positive and negative) is not common among public funds.
 - Aside from the absolute return adjustment, VRS does not have established guidelines (e.g., a documented process) that expressly sets out the Board's discretion to modify the amount or timing of incentive payments when absolute returns are negative. Such guidelines may serve to help provide guidance to the Board and manage staff expectations that incentive pay must be adjusted or deferred during periods of negative returns (apart from the "boilerplate" provisions stating that the Board can modify or cancel the Plan at any time).
 - VRS' mandatory deferral into a defined contribution retirement plan is unique.
- Taking all of the above into consideration, McLagan believes that VRS' pay program is, on balance, both competitive and appropriate as evidenced by VRS' ability to:
 - Attract and retain highly skilled investment professionals.
 - Generate excess returns.

Mr. Oak noted that overall, VRS' pay plan is well aligned with market practice and leading public funds.

Next, Mr. Barnett discussed four (4) alternative frameworks for the absolute return adjustment presented by McLagan. These included (i) no change, (ii) eliminating the absolute return adjustment, (iii) moving to a five-year adjustment, and (iv) adopting adjustment guidelines rather than a formula. Mr. Barnett suggested that VRS consider longer term measurement periods, or reweighting the three- and five-year periods to emphasize the five-year results.

The Committee discussed these points and the report at length and concluded that the Investment Policy Committee should discuss these matters at a future meeting and make a recommendation to the Administration and Personnel Committee.

Mr. Nason thanked Mr. Oak and Mr. Barnett for their report.

**Review and Approve Attainment of
FY 2018 APOs and Operating
Standards**

Next, Ms. Bishop and Mr. Cooper briefed the Committee on the agency's Annual Performance Outcomes (APOs) and Operating Standards during FY 2018.

Mr. Cooper advised that the agency's goal was to accomplish at least four (4) of the five (5) APOs. The goal for the Operating Standards was to meet 80% of the standards set for the year. He reported that the agency accomplished all twenty (20) of the Operating Standards and achieved four (4) out of five (5) of the APOs.

Successful attainment of the APOs and Operating Standards is the gainsharing portion of the performance management program, and is to be paid as a lump-sum bonus equal to 2.5% of salary for FY 2018 for eligible administrative employees. The Investment Department's operations and administration staff employees are also eligible to receive a lump-sum bonus equal to 2.5% of salary if their performance at least meets expectations, as rated in their annual performance assessment, and the employee consistently works to accomplish the goals of the Investment Department.

Mr. Montgomery moved, with a second by Mr. Harris, to recommend approval to the Board:

RBA: Approve Attainment of FY 2018 APOs and Operating Standards and Corresponding Lump-Sum Bonuses Equal to 2.5% of Salary for Eligible Administrative Employees and Investment Department Operations and Administration Employees

Request for Board Action: The Board approves (i) the attainment of FY 2018 APOs and Operating Standards and, (ii) a lump-sum bonus equal to 2.5% of salary for eligible administrative employees and eligible Investment Department operations and administration employees in the amount of approximately \$512,745.95.

The Committee approved the motion upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Review and Approve Performance Bonuses for Eligible Administrative and Investment Operations and Administration Employees

Next, Ms. Bishop discussed the proposed lump-sum bonuses for eligible administrative employees and eligible Investment Department operations and administration employees. Subject to the approval of the Board, employees who receive an overall rating of "exceptional" will receive a 4% bonus and employees who receive an overall rating of "exceeds" will receive a 2% bonus, based on their salary as of June 30, 2018.

Ms. Cantor moved, with a second by Mr. Montgomery, to recommend approval to the Board:

RBA: Approve Lump-sum Performance Bonuses for Eligible Administrative Employees and Investment Department Operations and Administration Employees

Request for Board Action: The Board approves the performance lump-sum bonuses in the amount of approximately \$395,413.49 for eligible administrative employees and eligible Investment Department operations and administration employees.

The Committee approved the motion upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Reappointment of IAC Members

Next, the Committee discussed the reappointments for Lawrence E. Kochard, Ph.D. and Thomas S. Gayner to the Investment Advisory Committee, each for an additional two-year term.

Ms. Cantor moved, with a second by Mr. Harris, to recommend approval to the Board of the following RBA:

RBA: Reappointment of IAC Members

Request for Board Action: The Board approves the reappointments to the Investment Advisory Committee of Lawrence E. Kochard, Ph.D., for a two-year term ending February 16, 2021; and, Thomas S. Gayner, for a two-year term ending February 19, 2021.

The Committee approved the motion upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Budget Variance Report (Year End Results)

Next, Ms. Peeks presented the summary of the Year-End (July 1, 2017 – June 30, 2018) Budget Variance Report for FY 2018 and an overview of the FY 2019 Budget Update on expenses from July 1, 2018 through August 31, 2018.

Update on Modernization – Phase 4 Schedule and Budget

Mr. Beaton discussed the remaining components of Modernization – Phase 4 releases, including the replacement of the RIMS mainframe system, with a new implementation target date of Spring 2019, and online retirement in Fall 2019. Based on revised projections, additional appropriation authority is needed to complete the remaining Modernization – Phase 4 releases expected to be implemented in FY 2019 and FY 2020.

Review of Other Budget Proposals for FY 2019 and FY 2020

Ms. Peeks then presented other spending proposals for which additional appropriation will be needed in FY 2019 and FY 2020, such as unavoidable increases in health care, salary, and rent costs, as well as establishing sufficient budget capacity for investment incentive compensation payments.

Mr. Harris moved, with a second by Mr. Montgomery, to recommend approval to the Board:

**RBA: Authorize Staff to Request
Appropriation Authority from
Department of Planning and Budget**

Request for Board Action: The VRS Board of Trustees authorizes staff to work with the Department of Planning and Budget and the legislature, as applicable, to execute the additional budget requests for FY 2019 and FY 2020.

The Committee approved the motion upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Informational Item

Next, as an informational item, the Committee reviewed the action taken by the Audit and Compliance Committee relative to the Audit Director's performance. The Audit and Compliance Committee reviewed and evaluated the performance of the Audit Director and, based on this review and evaluation, is recommending to the full Board an award of a 7% performance bonus to the Audit Director.

**COMPENSATION AND BENEFITS –
CLOSED SESSION**

Mr. Nason then moved, with a second by Ms. Cantor, that the Administration and Personnel Committee of the Virginia Retirement System Board of Trustees convene a closed meeting under the Virginia Freedom of Information Act to discuss the compensation and benefits of specific employees pursuant to the personnel exemption at *Code of Virginia* § 2.2-3711(A)(1).

Upon return to open meeting, Mr. Nason moved, with a second by Mr. Montgomery, the following resolution:

WHEREAS, the Administration and Personnel Committee of the Virginia Retirement System Board of Trustees convened a closed meeting on this date pursuant to an affirmative recorded vote and in accordance with the provisions of the Virginia Freedom of Information Act; and

WHEREAS, *Code of Virginia* § 2.2-3712 requires a certification by this Committee that such closed meeting was conducted in conformity with Virginia law;

NOW, THEREFORE, BE IT RESOLVED, that the Committee certifies that, to the best of each member's knowledge, (i) only public business matters lawfully exempted from open meeting requirements under this chapter were discussed in the closed meeting to which this certification resolution applies, and (ii) only such public business matters as were identified in the motion by which the closed meeting was convened were heard, discussed or considered by the Committee.

The Committee approved the resolution upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Mr. Montgomery moved, with a second by Mr. Harris, to recommend approval to the Board:

RBA: Approve FY 2018 Incentive Payments for VRS Investment Professionals

Request for Board Action: The Board approves the payment of an incentive amount of \$5,474,954.22 for FY 2018 to VRS investment professionals as authorized by the Investment Professionals' Pay Plan.

The Committee approved the motion on the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Mr. Harris moved, with a second by Mr. Montgomery, to recommend approval to the Board:

RBA: Approve Performance Bonus and Supplemental Payment to the VRS Director as Authorized in the 2018 Appropriation Act

Request for Board Action: The Board approves a performance bonus of 5% for the VRS Director payable on October 16, 2018 and a supplement of \$75,000, based on McLagan's analysis and comparisons with the salaries of Directors without CIO

responsibility at comparable public pension plans, payable December 1, 2018, as authorized in the 2018 Appropriation Act.

The Committee approved the motion upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Harris: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Adjournment

There being no further business, Mr. Nason adjourned the meeting at 4:32 p.m.

10-18-18
Date


Mitchell L. Nason, Chair