

A regular meeting of the Virginia Retirement System Board of Trustees was held on June 7, 2018 in Richmond, Virginia with the following members present:

Board members present:
Mitchell L. Nason, Chair
Diana F. Cantor, Vice Chair
Hon. J. Brandon Bell, II
Wallace G. Harris
O'Kelly E. McWilliams, III
Joseph W. Montgomery
Troilen G. Seward
W. Brett Hayes

Also present were: Patricia Bishop, Ron Schmitz, Stephen Adelaar, Rory Badura, Farley Beaton, Jeanne Chenault, Michael Cooper, Perry Corsello, Harriet Covey, Juanita Cribbs, Barry Faison, Bryan Gardiner, Jay Gentry, Katie Grawe, JT Grier, KC Howell, Robert Irving, Ross Kasarda, LaShaunda King, Kristina Koutrakos, Matthew Lacy, Ryan LaRochelle, Chung Ma, Curt Mattson, Steve McClelland, Laurie Nelson, Walker Noland, Angela Payne, Jennifer Schreck, Jillian Sherman, Daniel Whitlock, and Cindy Wilkinson.

Guests present were: Jim Flaherty, Attorney General's Office; Katie Boyle, VACo; Sarah Herzog, Senate Finance Committee; Joe McMahon, JLARC; Bernadette LeMasters, Virginia Management Fellow; Justin Ferrell, Auditor of Public Accounts; Bea Snidow, Virginia Education Association; and Jason Saunders, Department of Planning and Budget.

The meeting convened at 1:06 p.m.

APPROVAL OF MINUTES

Upon a motion by Mr. Harris, with a second by Mr. Montgomery, the minutes of the April 12, 2018 meeting were approved as amended.

**REPORT OF THE CHIEF
INVESTMENT OFFICER**

Mr. Schmitz began his report with a market overview. He discussed asset allocation and reviewed plan performance – which generally continues to be strong relative to benchmarks. He then discussed tracking error, information ratio and fund volatility – concluding that risk measures are all within Board-approved levels. Mr. Schmitz then reviewed the New Investments and Termination Report.

**ANNUAL REVIEW OF STRATEGIC
ASSET ALLOCATION**

Next, Mr. Schmitz reviewed the recommended changes to update the Defined Benefit Plan Strategic Asset Allocation and Allowable Ranges. These changes would reflect the new Board target asset mix to include dissolving the Strategic Opportunities Portfolio into its component parts, the Private Investment Partnership and Multi-Asset Public Strategies.

Mr. Schmitz then discussed the recommended benchmarks for the component parts of the Strategic Opportunities Portfolio (SOP): Private Investment Partnership (PIP) and Multi-Asset Public Strategies to be comprised of Dynamic Strategies (DStrat) and Risk-Based Investments (RBI).

Upon a motion by Mr. Montgomery, with a second by Mr. Harris, the Board approved the following actions:

**Request for Board Action: 2018-06-04
Review and Approve Defined Benefit
Plan Asset Allocation**

The Board approved the recommended changes to the Defined Benefit Plan Asset Allocation and Allowable Ranges.

**Request for Board Action: 2018-06-05
Review and Approve Benchmarks for
Private Investment Partnership and
Multi-Asset Public Strategies**

The Board approved the recommended benchmarks for Private Investment Partnership and Multi-Asset Public Strategies.

Mr. Nason thanked Mr. Schmitz for his report.

**REPORT OF THE AUDIT AND
COMPLIANCE COMMITTEE**

In Mr. Leighty's absence, Ms. Cantor presented the report from the Audit and Compliance Committee meeting that took place on May 31, 2018.

Employer Assurances Review

Ms. Cantor provided an update on the 2017 Employer Assurances Review. The APA reported the Employer Assurances Review was progressing as planned and they should conclude their work over the pension plans in the

coming weeks and over the Other Post-Employment Benefit (OPEB) plans in July and issue the related opinions by the end of June and July, respectively.

Annual Entrance Conference

Ms. Cantor reported that the Committee held its annual entrance conference with the APA to review the approach and scope of the examination of VRS' Comprehensive Annual Financial Report (CAFR) for the Fiscal Year ending June 30, 2018.

Audit Reports

Ms. Cantor advised that the Committee received two audit reports:

- The review of Long Term Care Programs noted that while no financially significant matters were identified, certain aspects of the administration of the programs warrant management's attention. There were four written recommendations resulting from the review.
- The review of Operating Expenses determined that controls over operating expenses, including the Small Purchase Charge Card and Travel Charge Card Programs, are operating effectively. There were no written recommendations resulting from the review.

Quarterly Review on Modernization - Phase Four

Next, Ms. Cantor discussed the Quarterly Review on the Modernization Program – Phase Four. Management presented its status report on the Modernization Program through May 24, 2018. Ms. Cantor noted that Release 8 is behind schedule and is now considered to be in a "red" status. Release 8 will not go live in October 2018 as planned and is in a "TBD" status until development can be completed, tentatively planned for September 2018. Management continues to monitor the project and has put risk mitigation initiatives in place.

Ms. Cantor reported that Internal Audit presented its Quarterly Review for the same period and indicated agreement with management's representations of the Modernization Program – Phase Four overall schedule, individual workstream progress and illustrated statuses. Internal Audit emphasized that it believes management is being risk-averse and pragmatic with its assertions and phase actions. Ms. Cantor added that Internal Audit noted it

is not unreasonable that overall schedule and financial impacts are unknown at this time and will review any proposed adjustments once assessed by management.

Fraud, Waste and Abuse Hotline Cases

Ms. Cantor then discussed the Quarterly Report on Fraud, Waste and Abuse Hotline Cases. A list of complaints reported to Internal Audit via the Office of the State Inspector General during the period of February 1, 2018 to April 30, 2018 was presented to the Committee (one in total). Ms. Cantor noted that the complaint alleged inappropriate classification of employees as Law Enforcement Officers at an employer; however, the allegation could not be substantiated and was therefore closed.

Quarterly Travel Expense and Per Diem Report

Ms. Cantor noted the Committee reviewed the quarterly travel expense and per diem report. Internal audit noted all reported travel was within approved limits.

Miscellaneous Updates

Ms. Cantor advised that the Audit Department was in the planning stages for the Governance Review over the Administrative aspects of VRS operations included in the annual work plan. As the project incorporates the duties of the Board, the Trustees will be provided the opportunity to provide input regarding the scope and objectives of the project as the planning activities progress. Further, the Trustees will be interviewed or surveyed for feedback over the course of the examination.

Lastly, Ms. Cantor advised the next Committee meeting is scheduled for September 6, 2018.

Mr. Nason thanked Ms. Cantor for her report.

**REPORT OF THE
ADMINISTRATION AND
PERSONNEL COMMITTEE**

The Board received the Administration and Personnel Committee report of May 31, 2018 and placed it on file.

McLagan 2018 Competitive Pay Plan Review

Mr. Nason began by discussing the McLagan review of the Investment Professionals' Pay Plan. McLagan will perform a comprehensive review of market compensation and incentive pay practices to ensure that:

- Individual pay levels (i.e., salary, incentive opportunities) are aligned with the competitive market and the Fund's pay philosophy.
- The pay program is considered fair, reasonable and appropriate by key Board and employee stakeholders.
- The program reflects market practices relative to incentive plan design.
- The program continues to help VRS attract, retain and motivate qualified investment talent.

McLagan presented their project approach to the Committee and plans to present a final report and recommended changes, if any, to the VRS Board in the fall.

Review and Approve FY 2019 Agency Performance Outcomes (APOs) and Operational Measures

Next, Mr. Nason reported that the Committee discussed the FY 2019 Agency Performance Outcomes (APOs) and Operational Measures. The proposed APOs presented to the committee in April included six (6) projects, one of which, the Cardinal Payroll System Implementation, has been postponed indefinitely by the Department of Accounts due to project scope changes. Mr. Nason advised that DOA's indefinite postponement likely precludes VRS from achieving APO #5 and, as a result, staff recommends removing APO #5 from the proposed FY 2019 APOs. Mr. Nason noted that VRS identified sixteen (16) Operational Measures in addition to the remaining five (5) APOs for FY 2019 and that successful attainment is the gainsharing portion of the performance management program of the Administrative Pay Plan.

***Request for Board Action: 2018-06-07
Review and Approve FY 2019 Agency Performance Outcomes (APOs) and Operational Measures***

Upon a motion by Mr. Nason, with a second by Ms. Cantor, the Board approved the FY 2019 Agency Performance Outcomes (APOs) and Operational Measures.

Review and Approve Executive Pay Plan and Revised Administrative Pay Plan

Mr. Nason advised that the Committee reviewed the Executive Pay Plan and the revised Administrative Pay Plan presented by the Human Resources Director, Capri Stanley-Smith. The Executive Pay Plan was created to provide guidelines regarding annual salary and bonus amounts for the three positions that report directly to the VRS Board of

Trustees (Director, Chief Investment Officer and Audit Director).

Next, Mr. Nason reviewed the revisions to the Administrative Pay Plan, which included streamlining language to focus on compensation, ensuring consistent language throughout the document, clarifying various provisions, incorporating a comprehensive bonus section and adding a salary grade to the technology plan. Mr. Nason added that the Committee discussed these revisions at length and that performance-related language previously included in the Administrative Pay Plan has been transitioned to a separate performance management policy.

***Request for Board Action: 2018-06-06
Review and Approve Executive Pay
Plan and revised Administrative Pay
Plan***

On a motion from Mr. Nason, with a second by Ms. Cantor, the VRS Board of Trustees approved the Executive Pay Plan and the revised Administrative Pay Plan.

***Review and Approve Revised Proxy
Voting and Litigation Policy***

Mr. Nason then discussed the proposed changes to the Board's Proxy Voting and Securities Litigation Policy. Specifically, the title of the policy is changed to remove the word "Securities" in order to address other types of litigation. The policy is amended to reflect Appropriation Act language authorizing VRS, without the approval of the Office of Attorney General, to "enter into agreements to seek i) recovery of investment losses in foreign jurisdictions, and ii) legal advice related to its investments."

Mr. Nason noted the policy is also amended to allow VRS staff to file necessary paperwork to recover investment losses in foreign jurisdictions with the approval of the Board Chair, Vice Chair or designee, the CIO and Director. The amended policy provides that VRS staff would report any new filings at the next Board meeting.

Mr. Nason listed the other proposed changes including:

- Clarifying how a firm (from among the appointed firms) is selected to assist with non-U.S. securities litigation cases.*
- Clarifying the process for approval of settlements.*

- *Adding the ability for the Chair to designate a Trustee to act when a decision must be made outside of a Board meeting and neither the Chair nor the Vice Chair are available.*
- *Adding an “Interpretation” section to provide added flexibility in cases that may arise that are not directly referenced in the policy.*
- *Adding references to reflect the delegation to the Director for Virginia Administrative Process Act cases to clarify that those are handled separately and are not governed by this policy.*
- *No changes have been proposed to the proxy voting sections.*

After discussing the proposed changes, the Board agreed to vote on the adoption of the “Proxy Voting and Litigation Policy” at the next Board meeting.

Enterprise Risk Management

Mr. Nason then discussed the Enterprise Risk Management (ERM) Report presented to the Committee. VRS convened an ERM working group, comprised of staff representing all business units, with the purpose of exploring ERM opportunities for the agency. The group reviewed the ERM models, including those in use by other public retirement systems, as well as ERM best-practices, to determine how VRS can implement its own ERM program. Mr. Nason advised that an ERM report was created by the working group and presented to the Committee. The working group has recommended a 3-phase implementation approach, with the first phase included as an APO for Fiscal Year 2019.

Quarterly Budget Variance Report

Lastly, Mr. Nason briefed the Board on the Quarterly Budget Variance Report for the fourth quarter (July 2017—May 2018), which indicated favorable variances for the fiscal year that ends on June 30, 2018.

Enterprise Risk Management Presentation and Report

Next, Mr. Cooper provided an overview of the Enterprise Risk Management (ERM) presentation given at the Committee meeting. He discussed the key components of the agency’s proposed ERM philosophy, which include:

- *Comprehensive and organization-wide in its overall view, generally focused on administration and*

exclusive of ongoing investment portfolio risk management initiatives

- *Strategic approach and implementation*
- *Utilize existing practices where appropriate*
- *Ensure ERM is in support of VRS' mission and commitment to members and stakeholders.*

Mr. Cooper discussed deploying an effective ERM management framework and developing appropriate risk and performance indicators. He also discussed maintaining an active monitoring process and engaging employees at all levels of the organization.

Mr. Nason thanked Mr. Cooper for his presentation.

***REPORT OF THE DIRECTOR
VRS New Coverage Elections for June
2018***

Ms. Bishop began her report by announcing the new employer coverage elections. The health insurance credit was adopted by Evergreen Soil and Water Conservation District, York County School Board, Scott County Soil and Water Conservation District, and King and Queen County. The Town of Troutville joined VRS as a new employer effective March 1, 2018 and the Valley Services Community Board adopted the COV Deferred Compensation Plan (457). Lastly, Ms. Bishop reported that King and Queen County also adopted the Enhanced Hazardous Duty Benefits for emergency medical technicians.

FY 2018 Roadmap – May 2018

Next, Ms. Bishop provided the Board with an overview of the Agency Road Map. She reported that most of the agency's projects and initiatives are on schedule; however, there were delays relating to the implementation of the Cardinal Payroll System, the Phase Four – Retirements and Disbursements, and Mainframe Migration projects. Regarding the mainframe migration project, Ms. Bishop noted that testing will occur in late July and VRS has received notification from VITA confirming the mainframe replacement will take place in August. Ms. Bishop noted that despite the delays, staff continues to make progress and monitor all projects closely.

Deficit Budget Bill

Ms. Bishop then discussed the state budget that included two percent (2%) raises for state employees and an additional merit-based increase for those employees with at least three

consecutive years of service. These raises, along with increases for various local state-supported employees and teachers, would be effective June 10, 2019.

Next, Ms. Bishop reported that VRS contribution rates remained funded at the actuarially determined contribution rate and that new language was adopted concerning a surcharge for institutions that administer their own Optional Retirement Plans for Higher Education (ORPHE). Ms. Bishop noted that universities have reclassified some positions so that they are now eligible to elect the ORPHE. VRS will work with the Department of Accounts (DOA) and the universities to develop a methodology for implementing the surcharge, reporting those individuals and calculating the unfunded liabilities attributed to these positions.

Miscellaneous Updates

Ms. Bishop provided the Board with various updates, including an overview of VRS' participation in Public Service Week and the positive feedback received from employers after the launching of the new VRS employer website.

Ms. Bishop noted the next JLARC meeting is scheduled for July 9, 2018, during which JLARC will deliver its VRS oversight report, as well as a report on the quadrennial actuarial audit.

Next, Ms. Bishop advised that Jennifer Peters in the VRS Information Technology department was included in a team star award from VITA. VITA presents star awards recognizing employees for hard work and exemplifying the agency's core values.

In conclusion, Ms. Bishop briefed the Board on the recent changes to the Freedom of Information Act (FOIA) regarding public remote access to Board meetings.

Mr. Nason thanked Ms. Bishop for her report.

Deficit Provision Acknowledgement Form

Mr. Faison noted that annually VRS and other state agencies are required to confirm that their obligations and expenditures do not exceed their appropriations. He advised that VRS expenditures and obligations did not exceed

appropriations. The reporting form specifically states that each member of the Board has been provided with a copy of the notice. The executed form will be sent to the Department of Planning and Budget.

Future Meetings

Mr. Nason announced that the next Investment Advisory Committee meeting is scheduled for August 28, 2018. After noting there were no agenda items for the July meeting, Mr. Nason cancelled the July 12, 2018 Board meeting.

MEETING ADJOURNED

There being no further business, the meeting adjourned at 2:46 p.m.


Chair


Secretary

Report

The Audit and Compliance Committee met on May 31, 2018 and discussed the following:

UPDATE ON THE 2017 EMPLOYER ASSURANCES REVIEW

The APA reported the Employer Assurances Review, covering GASB Statements No. 68 and 75, was progressing as planned and they should conclude their work over the pension plans in the next few weeks and over the Other Post-Employment Benefit (OPEB) plans in July and issue the related opinions by the end of June and July, respectively.

ENTRANCE WITH THE APA FOR THE VRS 2018 CAFR AUDIT

The Committee held its annual entrance conference with the APA to review the approach and scope of the examination of VRS' Comprehensive Annual Financial Report (CAFR) for the Fiscal Year Ending June 30, 2018.

AUDIT REPORTS

The Committee received two audit reports.

- The review of *Long Term Care Programs* noted that while no financially significant matters were identified, certain aspects of the administration of the programs warrant management's attention. There were four written recommendations resulting from the review.
- The review of *Operating Expenses* determined that controls over operating expenses, including the Small Purchase Charge Card and Travel Charge Card Programs, are operating effectively. There were no written recommendations resulting from the review.

QUARTERLY REVIEW ON MODERNIZATION PROGRAM – PHASE FOUR

Management presented its status report on the Modernization Program - Phase Four through May 24, 2018. Management acknowledged Release 8 is behind schedule and is now considered to be in a "red" status. Release 8 will not go-live in October 2018 as planned and is in a "TBD" status until development can be completed, tentatively September 2018. Management continues to monitor and has put risk mitigation initiatives in place.

Internal Audit presented its Quarterly Review for the same period and indicated agreement with management's representations regarding the Modernization Program – Phase Four overall schedule, individual workstream progress and illustrated statuses. Internal Audit emphasized that it believes management is being risk-averse and pragmatic with its assertions and phase actions. Additionally, Internal Audit noted it is not unreasonable that overall schedule and financial impacts are unknown at this time and will review any proposed adjustments once assessed by management.

QUARTERLY REPORT ON FRAUD, WASTE AND ABUSE HOTLINE CASES

A list of Fraud, Waste and Abuse Hotline complaints reported to Internal Audit via the Office of the State Inspector General during the period of February 1, 2018 to April 30, 2018 was presented to the Committee (one in total). The complaint alleged inappropriate classification of employees as Law Enforcement Officers at an employer. The allegation could not be substantiated and was therefore closed.

MANAGEMENT'S QUARTERLY TRAVEL EXPENSE AND PER DIEM REPORT

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

MISCELLANEOUS UPDATES

The Audit Director shared the Department was in the planning stages for the Governance Review over the Administrative aspects of VRS operations included in the annual work plan. As the project incorporates the duties of the Board, the Trustees will be provided the opportunity to provide input regarding the scope and objectives of the project as the planning activities progress. Further, the Trustees will be interviewed or surveyed for feedback over the course of the examination.

The next Committee meeting is scheduled for September 6, 2018.

Respectfully submitted to the Board of Trustees on June 7, 2018.



Ms. Diana F. Cantor, Vice-Chair
Audit and Compliance Committee

**REPORT OF THE
ADMINISTRATION AND PERSONNEL COMMITTEE
For the Committee Meeting on Thursday May 31, 2018**

The Administration and Personnel Committee met on Thursday, May 31st, and took up the following matters:

McLagan 2018 Competitive Pay Plan Review

As discussed at the previous Committee meeting, the VRS Board of Trustees asked that a comprehensive review of market compensation and incentive pay practices for the Investment Professional's Pay Plan be conducted. Based on that, McLagan was contacted to review the plan to ensure that:

- Individual pay levels (i.e., salary, incentive opportunities) are aligned with the competitive market and the Fund's pay philosophy.
- The pay program is considered fair, reasonable and appropriate by key Board and employee stakeholders.
- The pay program reflects market practices relative to incentive plan design.
- The pay program continues to help VRS attract, retain and motivate qualified investment talent.

McLagan presented their project approach to the committee and plans to present a final report of findings and recommended changes, if any, to the VRS Board in the fall.

Review and Approve FY 2019 Agency Performance Outcomes (APOs) and Operational Measures

Ms. Bishop briefed the Committee on the revised FY 2019 Agency Performance Outcomes (APOs) and Operational Measures. The proposed APOs presented to the Committee in April included six projects, one of which, the Cardinal Payroll System Implementation, has been postponed indefinitely by the Department of Accounts due to project scope changes. Ms. Bishop noted that DOA's indefinite postponement likely precludes VRS from achieving APO #5 and, as a result, staff recommends removing APO #5 from the proposed FY 2019 APOs. VRS identified sixteen (16) key operational measures in addition to the remaining five (5) APOs for FY 2019. Successful attainment of the APOs and operational measures is the gainsharing portion of the performance management program of the Administrative Pay Plan.

The Committee reviewed the revised FY 2019 Agency Performance Outcomes (APOs) and Operational Measures and recommends approval to the Board.

Request for Board Action: *The VRS Board of Trustees approves the revised FY 2019 Agency Performance Outcomes (APOs) and Agency Operational Measures.*

Review and Approve Executive Pay Plan and Revised Administrative Pay Plan

Ms. Stanley-Smith reviewed the draft of the Executive Pay Plan created to provide guidelines regarding the annual salary and bonus amounts for the three positions that report directly to the VRS Board of Trustees (Director, Chief Investment Officer and Audit Director).

Ms. Stanley-Smith also reviewed revisions to the Administrative Pay Plan. Those revisions included streamlining language to focus on compensation, ensuring consistency with the language throughout the document, clarifying various provisions, incorporating a comprehensive bonus section and adding a technology salary range. Ms. Stanley-Smith shared that performance related language previously included in the administrative pay plan has been transitioned to the performance management policy.

**REPORT OF THE
ADMINISTRATION AND PERSONNEL COMMITTEE
For the Committee Meeting on Thursday May 31, 2018**

The Committee reviewed the proposed Executive Pay Plan and amended Administrative Pay Plan and recommends approval to the Board.

Request for Board Action: *The VRS Board of Trustees approves an Executive Pay Plan and an amended Administrative Pay Plan.*

Review and Approve Revised Proxy Voting and Litigation Policy

Ms. Wilkinson briefed the Committee on proposed changes to the Board's Proxy Voting and Securities Litigation Policy, specifically, the title of policy is changed to remove the word "Securities" in order to address other types of litigation. The policy is amended to reflect Appropriation Act language authorizing VRS, without the approval of the Office of Attorney General, to "enter into agreements to seek i) recovery of investment losses in foreign jurisdictions, and ii) legal advice related to its investments."

The policy is also amended to allow VRS staff to file the necessary paperwork to recover investment losses in foreign jurisdictions with the approval of the Board Chair, Vice Chair or designee, the CIO and Director. The amended policy provides that VRS staff would report any new filing at the next Board Meeting.

Other proposed changes include:

- Clarifying how a firm (from among the appointed firms) is selected to assist with non-U.S. securities litigation cases.
- Clarifying the process for approval of settlements.
- Adding the ability for the Chair to designate a Trustee to act when a decision must be made outside of a Board meeting and neither the Chair nor the Vice Chair are available.
- Adding an "Interpretation" section to provide added flexibility in cases that may arise that are not directly referenced in the policy.
- Adding references to reflect the delegation to the Director for Virginia Administrative Process Act cases to clarify that those are handled separately and are not governed by this policy.
- No changes have been proposed to the proxy voting sections.

The Committee reviewed the amended policy, agreed to changes recommended by Mr. McWilliams, and recommends its approval to the Board after review at two Board meetings pursuant to the Board's Governance Policy.

Request for Board Action: *The VRS Board of Trustees adopts an amended "Proxy Voting and Litigation Policy".*

Review and Discuss Enterprise Risk Management Report

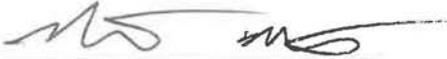
Mr. Cooper presented an overview of the components and benefits of Enterprise Risk Management (ERM) for VRS to the Committee. The agency convened an ERM working group, comprised of staff representing all business units, with the purpose of exploring ERM opportunities for VRS. The group reviewed ERM models, including those in use by other public retirement systems, as well as ERM best-practices, to determine how VRS can implement its own ERM program. An ERM report was created by the working group and presented to the committee. The working group recommends a 3-phased implementation approach, with the first phase included as an APO for Fiscal Year 2019.

**REPORT OF THE
ADMINISTRATION AND PERSONNEL COMMITTEE
For the Committee Meeting on Thursday May 31, 2018**

Quarterly Budget Variance Report

Ms. Peeks provided a review of the budget variance report for the fourth quarter (July 2017 – May 2018). The report indicated favorable variances for both the Administrative and Investment departments. All accounts appear to be on track for favorable variances for the fiscal year that ends on June 30, 2018.

Submitted to the Board of Trustees on June 7, 2018.



Mitchell L. Nason, Chair
Administration and Personnel Committee