
Minutes

A regular meeting of the Virginia Retirement System Board of Trustees was held on September 13, 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 (by phone under § 2.2-3708.2(D))

Wallace G. Harris

W. Brett Hayes

William H. Leighty (by phone under § 2.2-3708.2(D))

O'Kelly E. McWilliams, III (by phone under § 2.2-3708.2(D))

Joseph W. Montgomery

Troilen G. Seward

Also present were: Patricia Bishop, Ron Schmitz, Rory Badura, Farley Beaton, Matt Bennett, Deardrian Carver, Jeanne Chenault, Michael Cooper, Harriet Covey, Pamela Elam, Jordan Evans, Bryan Gardiner, Jay Gentry, Brian Goodman, JT Grier, Robert Irving, Dane Honrado, KC Howell, Ross Kasarda, LaShaunda King, Lawrence Kochard (by phone), Kristina Koutrakos, Matt Lacy, Chung Ma, Curt Mattson, Laurie Nelson, Walker Noland, Angela Payne, Andrea Peeks, Steve Peterson, Jennifer Schreck, Capri Stanley-Smith, Larry Tentor, Leslie Weldon, Dan Whitlock, and Cindy Wilkinson.

Guests present were: Katie Boyle, Virginia Association of Counties; Justin Ferrell, Auditor of Public Accounts; Sarah Herzog, Senate Finance Committee; Latosha Johnson, Department of Planning and Budget; Jody MacIntosh, CEM (via phone); Liz Myers, Office of the Attorney General; Kimberly Sarte, Joint Legislative Audit and Review Commission; and Bea Snidow, Virginia Education Association.

The meeting convened at 1:02 p.m.

APPROVAL OF MINUTES

Mr. Harris moved to approve the minutes of the June 7, 2018 meeting with a second by Mr. Montgomery. The Board approved the minutes of the June 7, 2018 meeting upon the following roll call vote:

Mr. Nason: Aye

Ms. Cantor: Aye

*Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

**REPORT OF THE INVESTMENT
ADVISORY COMMITTEE**

Mr. Kochard presented the report of the Investment Advisory Committee (IAC). He noted that a brown bag session was held between the Investment Policy Committee (IPC) and the IAC. Mr. Kochard then briefed the Board on topics discussed at the August 28, 2018 IAC meeting that included fiscal performance, macroeconomic outlook, market risk and portfolio performance. The committee discussed portfolio benchmarks, ongoing research projects, and received updates from the Investment Decision Support program.

Mr. Nason thanked Mr. Kochard for his report.

**REPORT OF THE CHIEF
INVESTMENT OFFICER**

Mr. Schmitz began his report with a market overview. Mr. Schmitz then discussed possible effects of Hurricane Florence on real assets properties in North Carolina.

Next, Mr. Schmitz 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 Terminations Report, the WaM Quarterly Summary and the Manager Referral Quarterly Summary with the Board.

Mr. Nason thanked Mr. Schmitz for his report.

**ANNUAL CEM BENCHMARKING
REPORT ON BENEFIT
ADMINISTRATION**

Next, Jody MacIntosh presented the annual CEM Benchmarking Report on Benefit Administration. CEM measures cost and service levels and reports on performance related to peer agencies. VRS was compared to a peer group of other U.S.-based retirement systems with similar membership size. The key areas of service measured were the call center, the VRS website, one-on-one member counseling and presentations, pension inceptions and member statements.

Ms. MacIntosh advised that the peer group average of total pension administration cost was \$98 per active member and annuitant. VRS is below both the peer group average and the

universe average with a cost of \$74 per active member and annuitant, and a total pension administration cost of \$39.7 million. Ms. MacIntosh explained that the VRS pension administration cost is below the peer group average because of fewer transactions per member, higher staff productivity, lower cost of back-office costs and lower third-party costs.

Lastly, Ms. MacIntosh stated that, in the "Pension Administration Benchmarking Results FY 2017" report, VRS' total service score was 83 compared to the peer group median of 80. Ms. MacIntosh noted that VRS has both a relatively high service score and lower cost compared to its peers. Ms. MacIntosh also noted that while the VRS total cost per year had increased 6% from 2014 to 2017, VRS continues to come in at a lower cost than the peer group. Ms. MacIntosh concluded that VRS has been able to maintain overall outstanding results during the agency's modernization project.

Mr. Nason thanked Ms. MacIntosh for her presentation.

The Board praised the hard work of the administration staff, which was reflected in the positive results of the CEM report.

**REPORT OF THE AUDIT AND
COMPLIANCE COMMITTEE**

***Exit Interview for the Auditor of
Public Accounts (APA) 2017
Employer Assurances Review***

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

Ms. Cantor began by discussing the exit interview for the Auditor of Public Accounts (APA) 2017 Employer Assurances Review. The APA reported that they are in the final stages of their Employer Assurances audit work, which covers the data VRS prepares and supplies to employers and their auditors.

Ms. Cantor advised that the APA reported that they have issued an unmodified audit opinion on all the Schedules of Employer Allocations and related information as prepared by VRS for GASB 68 and expect to issue the same by Friday, September 14th for GASB 75 purposes with the exception of the Line of Duty Act (LODA) related opinion. Ms. Cantor noted that the APA's opinion related to LODA is pending receipt of the final actuarial report and will be released within the next week.

Ms. Cantor then noted one emphasis of matter relating to VRS not having access to certain census data elements for retirees from an Optional Retirement Plan who are eligible

for the Health Insurance Credit or Group Life Insurance programs and have not claimed a benefit, but that the APA's opinion was not modified with respect to this matter.

VRS 2018 CAFR Audit Update

Next, Ms. Cantor reported that the APA informed the Committee that the audit work over the fiscal year 2018 VRS Comprehensive Annual Financial Report (CAFR) was ongoing. There were no findings at this point and the APA will present its conclusion at the December Audit and Compliance Committee meeting.

Audit Reports

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

- The review of "Application Controls: AQM, Private i and MUNIS Systems" assessed the completeness, accuracy and validity of the controls over these systems. The review included one recommendation addressing compliance with the Commonwealth's Hosted Environment Information Security Standard.*
- The review of "Employer Records and Accounts" determined that VRS is appropriately managing the employer records and accounts to ensure validity, accuracy and completeness of the transactions posted to the accounts. There were no written recommendations resulting from the review.*

Quarterly Review on Modernization Program – Phase 4

Ms. Cantor then discussed the Quarterly Review of the Modernization Program – Phase 4 and advised that management had presented its status report through September 6, 2018. Management discussed the re-baselined schedule for the remaining releases and presented budgetary impacts of the schedule changes. Go-live for the retirements and disbursements functionality has shifted to Spring 2019 and ability to submit on-line retirement applications to Fall 2019. Ms. Cantor advised that management continues to intensively monitor progress and has put risk mitigation initiatives in place, including a scope reduction and the move to a fixed price statement of work for certain components.

Ms. Cantor discussed the Quarterly Review as of August 27, 2018, that was presented to the Committee by Internal Audit and observed management's efforts to adjust the schedule to complete the design and development of the remaining releases and to ensure quality implementation, noting the extension of the overall project schedule through the fall of 2019 and the need for additional funds to complete work. Ms. Cantor advised that with the revised schedule, development

activities for retirements and disbursements will continue into January 2019, which will allow VRS to perform only one month of full system mock production testing prior to the revised go-live date.

Internal Audit Annual Progress Reports for Fiscal Year 2018

Next, Ms. Cantor and Ms. Schreck discussed the Internal Audit Annual Progress Reports for Fiscal Year 2018, providing the following updates:

- The Annual Report on the Audit Recommendation Follow-Up System (ARFUS) as of June 30, 2018 contained ten (10) internal audit recommendations for the fiscal year, five (5) of which were represented as implemented, tested and released. One recommendation issued by the Auditor of Public Accounts during their FY 2016 CAFR audit was noted as cleared during the FY 2017 audit and removed from ARFUS, resulting in five (5) outstanding recommendations as of June 30, 2018.*
- A recap of accomplishments over the past year as well as an overview of the department's initiatives and challenges for the coming year. The Audit Director recognized the team's contributions, noting the department is down one staff member and that recruiting efforts are ongoing.*
- The review of the department's Annual Quality Assurance Improvement Program Review as of June 30, 2018 concluded there is reasonable assurance that the VRS Internal Audit Department is operating in conformance with the International Standards for the Professional Practice of Internal Auditing.*
- The annual audit plan results for the past fiscal year were highlighted, along with the status of the long-range audit plan for the four years ending June 30, 2020, noting as of the conclusion of the second fiscal year of the long-range plan, modifications have been made to the remaining plan to accommodate the changing risk environment, adjustments to the Modernization Program – Phase 4 schedule, and unplanned resource constraints. Specifically, changes have been made to the timing and duration of certain examinations, including the addition of two projects, deferral of some projects to a period outside of the current approved long-range plan and the consolidation of other projects within the existing long-range plan.*

Proposed FY 2019 Audit Work Plan

Ms. Schreck then advised that the Committee received the proposed audit plan for fiscal year 2019, a component of the long-range plan, and noted the adjustments to the annual

plan as pulled from the long-range plan to better align available resources with organizational risks. Ms. Schreck noted there were four (4) FY 2018 carry over projects and two (2) new IT related projects focused on key risks within the Modernization Program – Phase 4, among other modifications. The Committee approved the plan as presented.

Ms. Cantor then moved, with a second by Mr. Harris, that the Board approve the FY 2019 Audit Work Plan.

The Board approved the proposed work plan upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

Quarterly Report on Fraud, Waste and Abuse Hotline Cases

Ms. Cantor continued with her report and 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 May 1, 2018 to July 31, 2018 was presented to the Committee (two in total). The complaints alleged abuse of the short-term disability program. One case was unfounded and therefore closed. The second allegation was under review as of the date of the report.

Quarterly Travel Expense and Per Diem Report

Next, Ms. Cantor advised that the Committee received and reviewed the Quarterly Travel Expense and Per Diem report and noted all reported travel was within approved limits.

Miscellaneous Updates

Ms. Cantor then discussed the following miscellaneous updates provided to the Committee:

- Internal Audit reviewed management's representations regarding the Agency Performance Outcomes and Agency Operating Standards for the fiscal year ended June 30, 2018, noting nothing came to its attention that indicated that the outcomes and standards were not met for the fiscal year.*
- Internal Audit completed its review of the Investment Department's proposed incentive compensation amounts*

and determined they were accurately computed in accordance with the authorized pay plan.

- The Audit Director discussed the proposed Committee meeting schedule in light of the published Board meeting schedule for the 2019 Calendar Year. The Committee members confirmed their availability and approved the proposed schedule. The next meeting is scheduled for December 13, 2018, at 10:00 a.m.

***Audit Director's Performance
Evaluation***

Lastly, Ms. Cantor advised that the Committee met in closed session to review the Audit Director's performance for the fiscal year ending June 30, 2018. The Committee recommended that the Board approve the proposed bonus for the Audit Director.

***Request for Board Action: 2018-09-8
Review and Approve Performance
Bonus for Audit Director***

Mr. Montgomery then moved, with a second by Mr. Harris, that the Board approve the 7% performance bonus for the Audit Director.

The Board approved the action upon the following roll call vote:

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

***REPORT OF THE
ADMINISTRATION AND
PERSONNEL COMMITTEE***

The Board received the Administration and Personnel Committee report of September 12, 2018, and placed it on file.

McLagan Working Session

Mr. Nason began by discussing the McLagan report of the Investment Compensation Program that was presented to the Committee. The report found that:

- VRS' base salaries, in aggregate, are 10% below its Board-approved pay philosophy (e.g., salaries should approximate the 75th percentile of leading public funds).
- VRS' targeted cash compensation levels (actual salaries plus target incentives) are 9% below its targeted pay positioning, which is to provide target 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 "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; and*
 - *generate excess returns.*

Mr. Nason advised that McLagan's "Investment Compensation Program Review" presented four (4) alternative frameworks for the absolute adjustment that included (i) no change, (ii) eliminating the adjustment, (iii) moving to a five-year adjustment, and (iv) adopting adjustment guidelines rather than a formula. McLagan also discussed the idea of VRS considering longer term measurement periods – or reweighting the three- and five-year periods to emphasize the five-year results. Mr. Nason noted that the Committee discussed these points at length and concluded that the Investment Policy Committee (IPC) should take up these matters at a future meeting and make a recommendation to the Administration and Personnel Committee.

***Review and Approve Attainment of
FY 2018 APO's and Operating
Standards***

Next, Mr. Nason discussed VRS' successful attainment of the Agency Performance Outcomes (APOs) and Operating Standards during FY 2018. Successful attainment of the APOs is the gainsharing portion of the performance management program, and it is to be paid as a lump-sum

bonus equal to 2.5% of salary for FY 2018. VRS also identifies key operating standards each year which are coupled with the APOs and the goal is to meet at least 80% of the standards set for the year. The agency achieved all twenty (20) of the operating standards and, in addition, VRS successfully achieved four (4) out of five (5) of the APOs for FY 2018.

Mr. Nason advised the Investment Department's operations and administration staff employees are also eligible for the gainsharing portion of the performance management plan 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. Nason noted that the Committee discussed the VRS attainment of FY 2018 Agency Performance Outcomes (APOs) and Operating Standards and the proposed lump-sum bonus for eligible administrative employees and eligible Investment Department operations and administration employees and recommended approval to the Board.

***Request for Board Action: 2018-09-9
Approve Attainment of FY 2018
APOs and Operating Standards and
corresponding lump-sum bonus equal
to 2.5% of salary for eligible
administrative employees and
Investment Department operations
and administration employees***

Ms. Cantor then moved, with a second by Mr. Montgomery, to approve the (i) 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.

The Board approved the action upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

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

Mr. Nason next discussed the proposed lump-sum bonuses for eligible administrative employees and eligible Investment Department operations and administration employees. Subject to 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.

Mr. Nason stated that the Committee reviewed the proposed performance bonuses for eligible administrative employees and Investment Department operations and administration employees and recommended approval to the Board.

Request for Board Action: 2018-09-10
Approve lump-sum bonuses for
eligible administrative employees and
Investment Department operations
and administration employees

Ms. Cantor then moved, with a second by Mr. Montgomery, to approve the performance lump-sum bonuses for eligible administrative employees and eligible Investment Department operations and administration employees.

The Board approved the action upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye

Reappointment of IAC Members

Next, Mr. Nason advised that the Committee has recommended the reappointments of Lawrence E. Kochard, Ph.D., and Thomas S. Gayner to the Investment Advisory Committee, each for an additional two-year term.

Request for Board Action: 2018-09-11
Approve reappointment of IAC
Members

Ms. Cantor moved, with a second by Mr. Harris, that the Board reappoint to the Investment Advisory Committee: 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 Board approved the action upon the following roll call vote:

Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye

*Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

Budget Variance Report (Year End Results)

Mr. Nason briefed the Board on the summary of the Year-End (July 1, 2017 – June 30, 2018) Budget Variance Report for FY 2018 and a budget update on FY 2019 expenses (July 1, 2018 – August 30, 2018). The Committee discussed the additional appropriation authority needed in FY 2019 and FY 2020 to accommodate planned spending. The Committee concurred with the planned spending items and recommended approval to the Board.

***Request for Board Action: 2018-09-4
Authorize staff to request
appropriation authority from
Department of Planning and Budget***

Ms. Cantor then moved, with a second by Mr. Harris, that the Board authorize 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 Board approved the action upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

Informational Item

Next, Mr. Nason advised the Committee had reviewed the action taken by the Audit and Compliance Committee relative to the Audit Director's performance. As noted previously in the report, the Audit and Compliance Committee reviewed and evaluated the performance of the Audit Director. Based on this review and evaluation, that Committee is recommending to the full Board an award of a 7% performance bonus to the Audit Director.

Compensation and Benefits

Mr. Nason discussed the closed session items taken up at the last Committee meeting that included benefits and compensation related to specific individuals. Upon returning to open meeting, the Committee recommended approval of the items discussed to the Board.

***Request for Board Action: 2018-09-13
Approve performance bonus and
supplemental payment to the VRS
Director as authorized in the 2018
Appropriation Act***

Mr. Nason moved, with a second by Ms. Cantor, to approve 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 Board approved the action upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

***Request for Board Action: 2018-09-12
Approve FY 2018 incentive payments
for VRS Investment Professionals***

Mr. Nason then moved, with a second by Ms. Cantor, to approve 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 Board approved the action upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Nay
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

Lastly, Mr. Nason briefly discussed the proposed changes to the Proxy Voting and Litigation Policy, noting that pursuant to Board policy, the change had to be considered at two meetings.

Request for Board Action: 2018-09-15 Adopt amended Proxy Voting and Litigation Policy

Mr. Nason then moved, with a second by Mr. Harris, to adopt the amended Proxy Voting and Litigation Policy. The Board approved the action upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

***REPORT OF THE DIRECTOR
New Coverage***

Ms. Bishop began her report by discussing new VRS coverage for September 2018.

Next, Ms. Bishop briefed the Board on language that was included in the 2018 Appropriation Act relating to a surcharge for certain individuals participating in the Optional Retirement Plan for Higher Education (ORPHE). VRS is working directly with the five (5) universities (George Mason, Virginia Tech, William and Mary, Virginia Commonwealth University, and University of Virginia) that have opted out in order to facilitate the surcharge.

Ms. Bishop then provided an update on an offer from Deutsche Bank to purchase the remaining claims in the Lehman Brothers bankruptcy. She, Mr. Nason and Mr. Schmitz met under the Proxy Voting and Litigation Policy to discuss the offer and decided to decline the offer and continue receiving distributions in the bankruptcy. The purpose of this update serves to inform the full Board of this action at its next regular meeting, pursuant to the policy.

Ms. Bishop reported that VRS received an award from the Government Finance Officers Association (GFOA) on its Popular Annual Financial Report (PAFR), as well as an award for the Comprehensive Annual Financial Report (CAFR). The National Association of Government Defined Contribution Administrators (NAGDCA) presented VRS with an award for its work on the online election project for optional retirement plans. The online election eliminates the use of paper processing, creates a secure online experience and helps members make an informed decision during a one-time irrevocable election.

FY 2019 Roadmap Update – August

Lastly, Ms. Bishop provided an update on the FY 2019 VRS Roadmap. Generally, items are on track with a few exceptions related to Modernization and the Cardinal Payroll System Implementation, which is dependent on the Department of Accounts (DOA).

Mr. Nason thanked Ms. Bishop for her report.

LITIGATION UPDATE (CLOSED SESSION)

Mr. Hayes then moved, with a second by Mr. Montgomery, that the Virginia Retirement System Board of Trustees convene a closed meeting under the Virginia Freedom of Information Act for the purpose of consultation with legal counsel about actual or probable litigation pursuant to the exemption contained in Virginia Code § 2.2-3711(A)(7).

The Board agreed to convene a closed session upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

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

WHEREAS, 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;

WHEREAS, Code of Virginia § 2.2-3712 requires a certification by the Board that such closed meeting was conducted in conformity with Virginia Law;

NOW, THEREFORE, BE IT RESOLVED, that the Board 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 Board.

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

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

***WOOLWORTHS LIMITED
SECURITIES LITIGATION***

Mr. Montgomery then moved, with a second by Mr. Harris, that the Board authorize the Director to take the necessary actions for VRS to register with the replacement litigation funder for the Woolworths Limited Securities Litigation in Australia.

The Board approved the action upon the following roll call vote:

*Mr. Nason: Aye
Ms. Cantor: Aye
Mr. Bell: Aye
Mr. Harris: Aye
Mr. Hayes: Aye
Mr. Leighty: Aye
Mr. McWilliams: Aye
Mr. Montgomery: Aye
Ms. Seward: Aye*

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



Chair



Secretary

Report

The Audit and Compliance Committee met on September 6, 2018 and discussed the following:

EXIT ON THE AUDITOR OF PUBLIC ACCOUNTS (APA) 2017 EMPLOYER ASSURANCES REVIEW

The APA reported that they are in the final stages of their Employer Assurances audit work. This audit covers the data VRS prepares and supplies to employers and their auditors to support required financial reporting over pension plans and other post-employment benefits (OPEBs) under Governmental Accounting Standards Board (GASB) Statements No. 68 and No. 75.

The APA reported they have issued or expect to issue on Friday an unmodified audit opinions on all the Schedules of Employer Allocations and related information as prepared by VRS for GASB 68 and 75 purposes with the exception of the Line of Duty Act (LODA) related opinion. The APA's opinion related to LODA is pending receipt of the final actuarial report and will be released within the next week.

The APA included one emphasis of matter relating to VRS not having access to certain census data elements for retirees from an Optional Retirement Plan who are eligible for the Health Insurance Credit or Group Life Insurance programs and have not claimed a benefit, but the APA's opinion was not modified in respect to this matter.

UPDATE FROM THE APA ON THE VRS 2018 CAFR AUDIT

The APA informed the Committee the audit work over the fiscal year 2018 VRS Comprehensive Annual Financial Report (CAFR) was ongoing. There are no findings at this point and the APA will present its conclusion at the December Audit and Compliance Committee meeting.

AUDIT REPORTS

The Committee received two audit reports.

- The review of *Application Controls: AQM, Private i and MUNIS Systems* assessed the completeness, accuracy and validity of controls over these systems. The review included one recommendation addressing compliance with the Commonwealth's Hosted Environment Information Security Standard.
- The review of *Employer Records and Accounts* determined that VRS is appropriately managing the employer records and accounts to ensure the validity, accuracy and completeness of the transactions posted to the accounts. There were no written recommendations resulting from the review.

QUARTERLY REVIEW ON MODERNIZATION PROGRAM – PHASE 4

Management presented its status report on the Modernization Program - Phase 4 through September 6, 2018. Management discussed the re-baselined schedule for the remaining releases and presented budgetary impacts of the schedule changes. Go-live for the retirements and disbursements functionality has shifted to Spring 2019 and ability to submit retirement applications to Fall 2019. Management confirmed it continues to intensively monitor the phase's progress and has put risk mitigation initiatives

in place, including a scope reduction and the move to a fixed price statement of work for certain components of remaining work.

Internal Audit presented its Quarterly Review as of August 27, 2018 and acknowledged management's efforts to adjust the schedule to complete the design and development of the remaining releases and to ensure quality implementation, noting the extension of the overall project schedule through the fall of 2019 and the need for additional funds to complete the work. Internal Audit shared that with the planned revised schedule, development activities for retirement and disbursements will continue into January 2019 which will allow VRS to perform only one month of full system mock production testing prior to the revised go-live date.

INTERNAL AUDIT ANNUAL PROGRESS REPORTS FOR FISCAL YEAR 2018

The Committee received the following updates:

Annual Report on the Audit Recommendation Follow-Up System (ARFUS)

The Committee received the Annual Report on the Audit Recommendation Follow-Up System (ARFUS) as of June 30, 2018. ARFUS contained ten internal audit recommendations for the fiscal year, five of which were represented as implemented, tested and released. In addition, one recommendation issued by the Auditor of Public Accounts during their FY 2016 CAFR audit, was noted as cleared during the FY 2017 audit and removed from ARFUS. Therefore, as of June 30, 2018, there were five outstanding recommendations in ARFUS.

Internal Audit Annual Report

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. She recognized the contributions of the internal audit team, noting that the Department is currently down one staff member and that recruiting efforts are ongoing.

The Audit Director explicitly confirmed to the Committee that the VRS Internal Audit Department and its staff are organizationally independent of the activities they examine and possess the appropriate qualifications to meet the needs of the approved audit plans.

Results of Internal Audit's Annual Quality Assurance Improvement Program Review

The Audit Director presented the results of the Department's Annual Quality Assurance Improvement Program Review as of June 30, 2018, noting the review concluded there is reasonable assurance that the VRS Internal Audit Department is operating in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Annual and Long-Range Audit Plan Progress

The Audit Director highlighted the annual audit plan results for the fiscal year ended June 30, 2018, along with the status of the long-range audit plan for the four years ending June 30, 2020.

The Audit Director noted that as of the conclusion of the second fiscal year of the long-range plan, modifications have been made to the remaining plan to accommodate the changing risk environment, adjustments to the Modernization Program – Phase Four schedule, and unplanned resource constraints.

Specifically changes have been made to the timing and/or duration of certain examinations, including the addition of two new projects, deferral of some projects to a period outside of the currently approved long-range plan and the consolidation of other projects within the existing long-range plan.

PROPOSED FY 2019 AUDIT WORK PLAN

The Committee received the proposed audit plan for fiscal year 2019, which is a component of the long-range plan. The Audit Director discussed adjustments to the annual plan as pulled from the long-range plan to better align available resources with the organizational risks. The Director noted there were four FY 2018 carry over projects and two new IT related projects focused on key risks within the Modernization Program – Phase Four, amongst other modifications. The Committee approved the plan as presented.

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 May 1, 2018 to July 31, 2018 was presented to the Committee (two in total). The complaints alleged abuse of the short-term disability program. One case was unfounded and therefore closed. The second allegation was under review as of the date of the report.

MANAGEMENT'S QUARTERLY TRAVEL EXPENSE AND PER DIEM REPORT

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

MISCELLANEOUS UPDATES

The Committee received the following updates:

Results of Agency Performance Outcomes and Agency Operating Standards

Internal Audit reviewed management's representations regarding the Agency Performance Outcomes and Agency Operating Standards for the fiscal year ended June 30, 2018, noting nothing came to its attention that indicated that the outcomes and standards were not met for the fiscal year. This information will be provided to the Administration and Personnel Committee and Board of Trustees in September for their consideration.

Confirmation of Internal Audit's Review of Investment Incentive Compensation

Internal Audit completed its review of the Investment Department's proposed incentive compensation amounts and determined they were accurately computed in accordance with the authorized pay plan. This information will be provided to the Administration and Personnel Committee and Board of Trustees in September for their consideration.

Proposed Committee Meeting Schedule for the 2019 Calendar Year and Next Meeting

The Audit Director discussed the proposed Committee meeting schedule in light of the published Board meeting schedule for the 2019 Calendar Year. The Committee member's confirmed their availability and approved the proposed schedule.

The Committee's next meeting is scheduled for on December 13, 2018 at 10 a.m.

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, 2018.

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

Respectfully submitted to the Board of Trustees on September 13, 2018.



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

Report

The Administration and Personnel Committee met on September 12, 2018 and discussed the following:

MCLAGAN WORKING SESSION

The VRS Board of Trustees asked McLagan to conduct a review of market compensation and incentive pay practices for the Investment Professionals' Pay 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.
- The pay program reflects market best practices relative to incentive plan design.
- The compensation program continues to help VRS attract, retain, and motivate qualified investment talent.

Michael Oak and Adam Barnett presented McLagan's report of the Investment Compensation Program and found that:

- VRS' base salaries, in aggregate, are 10% below its Board-approved pay philosophy (e.g., salaries should approximate the 75th percentile of leading public funds).
- VRS' targeted cash compensation levels (actual salaries + target incentives) are 9% below its targeted pay positioning, which is to provide target 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' 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 provide the Board with the discretion to modify the amount and/or timing of incentive payments when absolute returns are negative. Such guidelines help manage staff expectations that incentive pay may be adjusted or deferred (apart from "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.

McLagan presented four alternative frameworks for the absolute return adjustment that included (i) no change, (ii) eliminating the adjustment, (iii) moving to a five-year adjustment, and (iv) adopting adjustment guidelines rather than a formula. McLagan also discussed the idea of VRS considering longer term measurement periods – or reweighting the 3 and 5 year periods to emphasize the 5 year results.

The Committee discussed these points at length and concluded that the Investment Policy Committee should take up these matters at a future meeting and make a recommendations to the Administration and Personnel Committee.

REVIEW AND APPROVE ATTAINMENT OF FY2018 APO'S AND OPERATING STANDARDS

Ms. Bishop and Mr. Cooper briefed the Committee on VRS' successful attainment of the APOs and Operating Standards during FY2018. Successful attainment of the APOs is the gainsharing portion of the performance management program, and it is to be paid as a lump-sum bonus equal to 2.5% of salary for FY2018. VRS also identifies key operating standards each year. The standards are coupled with the APOs and the goal is to meet at least 80% of the standards set for the year. The agency achieved all twenty (20) of the Operating Standards for FY2018. Additionally, VRS successfully achieved four (4) out of five (5) FY2018 APOs.

The Investment Department's operations and administration staff employees are 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.

The Committee discussed the VRS attainment of FY2018 Agency Performance Outcomes (APOs) and Operating Standards and the proposed lump-sum bonus for eligible administrative employees and eligible Investment Department operations and administration employees and recommended approval to the Board.

Request for Board Action: *The VRS Board of Trustees 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 employees and eligible Investment Department operations and administration employees in the amount of approximately \$512,745.95.*

REVIEW AND APPROVE PERFORMANCE BONUSES FOR ELIGIBLE ADMINISTRATIVE AND INVESTMENT OPERATIONS AND ADMINISTRATION EMPLOYEES

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.

The Committee reviewed the proposed performance bonuses for eligible administrative employees and Investment Department operations and administration employees and recommended approval to the Board.

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

REAPPOINTMENT OF IAC MEMBERS

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

Request for Board Action: *The VRS Board of Trustees reappoints to the Investment Advisory Committee: 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.*

BUDGET VARIANCE REPORT (YEAR END RESULTS)

Ms. Peeks presented a summary of the Year-End (July 1, 2017 – June 30, 2018) budget variance report for FY 2018 and a budget update on FY 2019 expenses (July 1, 2018 – August 30, 2018).

REVIEW AND AUTHORIZE BUDGET REQUEST TO THE DEPARTMENT OF PLANNING AND BUDGET

The Committee discussed the additional appropriation authority needed in FY 2019 and FY 2020 to accommodate planned spending. The Committee concurred with the planned spending items and recommended approval to the Board.

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.*

INFORMATIONAL ITEM

As an information item, the Committee reviewed the action taken by the Audit and Compliance Committee relative to the Audit Director's performance. As noted previously in the Audit Chair's report, the Audit and Compliance Committee reviewed and evaluated the performance of the Audit Director. Based on this review and evaluation, that committee is recommending to the full Board an award of a 7% performance bonus to the Audit Director.

COMPENSATION AND BENEFITS (CLOSED SESSION)

The Committee went into closed session to discuss benefits and compensation related to specific individuals.

Upon returning to open meeting, the Committee recommended that the following RBAs be approved by the full Board.

Request for Board Action: *The VRS Board of Trustees approves 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. It is worth noting that Internal Audit reviewed the proposed investment incentive compensation for the fiscal year ended June 30, 2018 and found that the aggregate amount, as well as the proposed payment amounts, were accurately computed in accordance with the Investment Professionals' Pay Plan.*



**Administration and Personnel Committee
Committee Report to the Board of Trustees
September 12, 2018**

Request for Board Action: *The VRS Board of Trustees approves a performance bonus of 5% for the VRS Director payable on October 16, 2018 and a supplemental payment 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.*

Submitted to the Board of Trustees on September 13, 2018.

A handwritten signature in black ink, appearing to read 'M. Nason', written over a horizontal line.

Mitchell L. Nason, Chair
Administration and Personnel Committee