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## Minutes

*A regular meeting of the Virginia Retirement System Board of Trustees was held on December 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  
Wallace G. Harris  
W. Brett Hayes  
William H. Leighty  
O'Kelly E. McWilliams, III  
Joseph W. Montgomery  
Troilen G. Seward*

*Also present were: Patricia Bishop, Ron Schmitz, John Alouf, Suja Amir, Rory Badura, Parham Behrooz, Jeanne Chenault, Michael Cooper, Perry Corsello, Harriet Covey, Sara Denson, Pamela Elam, Barry Faison, Josh Fox, Brian Goodman, JT Grier, Dane Honrado, KC Howell, Ross Kasarda, LaShaunda King, Matt Lacy, Curt Mattson, Steve McClelland, Taylor Melton, Laurie Nelson, Walker Noland, Andrea Peeks, Laura Pugliese, Denise Rasmussen, Jillian Sherman, Capri Stanley-Smith, Daniel Whitlock, Cindy Wilkinson, and Nick Zizzo of the VRS staff.*

*Guests present were: Sarah Herzog and Adam Rosatelli, Senate Finance Committee; Bea Snidow, Virginia Education Association; Liz Myers, Office of the Attorney General; Tom Scheibelhut with CEM Benchmarking, Inc.; Jessica Ackerman, Virginia Municipal League, and Jeremy Bennett and Katie Boyle, Virginia Association of Counties.*

*The meeting convened at 1:15 p.m.*

### **APPROVAL OF MINUTES**

*Upon a motion by Mr. Nason, with a second by Mr. Leighty, the minutes of the November 14, 2018 meeting were approved.*

### **CEM COST EFFECTIVENESS ANALYSIS OF VRS INVESTMENT PROGRAM**

*Mr. Tom Scheibelhut, Managing Principal of CEM Benchmarking Inc., presented the CEM peer group comparison for the VRS Investment Program. The report, which was for the five-year period ending December 2017, compared VRS's cost and return performance to CEM's extensive pension database as well as against a more*



*selective group of peer funds. A copy of the report is attached as part of these minutes. The key points of the report included:*

- *The VRS investment cost of 64.5 basis points was below the benchmark cost of 70.0 basis points, suggesting that the VRS fund was low cost compared to its peers.*
- *VRS was low cost because it had a lower cost implementation style, it used more in-house management and less fund of funds, and it paid less for external management.*
- *VRS's five-year performance placed VRS in the positive value added, low cost quadrant of the cost effectiveness chart.*
- *The VRS 5-year policy return was 8.5%, which was slightly below the U.S. Public median of 8.8% and close to the peer median of 8.6%.*
- *The VRS 5-year net value added was 0.5%, which was above the U.S. Public median of 0.2% and above the peer median of 0.2%.*

*Mr. Nason thanked Mr. Scheibelhut for his presentation.*

***REPORT OF THE CHIEF  
INVESTMENT OFFICER***

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

*In conclusion, Mr. Schmitz provided a retrospective of the Total Fund Performance in light of the 10 year anniversary of the financial crisis.*

*Mr. Nason thanked Mr. Schmitz for his report.*

***REPORT OF THE DEFINED  
CONTRIBUTION PLANS  
ADVISORY COMMITTEE***

*The Board received the Defined Contribution Plans Advisory Committee (DCPAC) report of December 6, 2018 and placed it on file.*

***Annual Administrative Expense  
Reports and ORPHE Update***

*Mr. Hayes advised that staff provided an overview of the Annual Administrative Expense Reports for FY 2018. The report provided both direct and indirect costs associated with administering VRS' Defined Contribution Plans. FY 2018 costs were provided, along with cost trend analysis over the five-year period from FY 2014 to FY 2018. In 2016, the VRS*

*Board approved smoothing costs over five years for ORPHE employers, providing more predictable costs for their budgeting purposes. This five-year period ends in FY 2020 with a rate adjustment due in FY 2021. The rate will be re-evaluated every two years thereafter. Staff expects the rate to increase to \$160 per participant on July 1, 2020.*

***Administrative Reports and  
Communication Update***

*Mr. Hayes provided an update of administrative reports for the third quarter of 2018. Updates included an overview of assets and accounts across the various defined contribution plans, as well as participant trends and the impact of various plan initiatives.*

***ORPHE Update***

*Mr. Hayes advised that staff provided an overview of ORPHE reports for the third quarter of 2018, including plan assets and accounts, and provider election data. Staff also provided a recap of recent and upcoming outreach efforts. In addition to upcoming outreach initiatives to engage employers and faculty, staff shared the proposed timeline for recommendations to move forward with ORPHE changes that would be presented to DCPAC at the first meeting in 2019, and to the Board for approval at the May 2019 meeting. Mr. Larson also provided the DCPAC with a report on the ORPHE Annual Employer Update, held on September 27, 2018.*

***Investment Performance Reports***

*Mr. Hayes advised that staff provided an overview of the October 31, 2018 performance reports to the DCPAC. Staff informed the Committee that obtaining accurate performance return information from Fidelity in a timely manner continues to be a problem.*

***CEM Defined Contribution Plans  
Survey***

*He also discussed the CEM DC Plans 2017 survey results, which represented 103 corporate and 23 public or other DC plans. Staff informed the Committee that the survey results included the unbundled DC Plans supplemental 457 Deferred Compensation Plan, in addition to the bundled TIAA and Fidelity programs for ORPHE. Staff noted the TIAA and Fidelity information was based solely on the "selected" plan investment options.*

*For the calendar year ending 2017 CEM reported the following:*

- The 457 Deferred Compensation Plan was a high value added, low cost plan based on total plan costs of 0.22%, which was below CEM's calculated VRS 457 Plan benchmark cost of 0.42%.*

- *The TIAA ORPHE program was a high value added, high cost plan based on total plan costs of 0.44%, which was slightly higher than CEM's calculated TIAA ORPHE benchmark cost of 0.40%.*
- *The Fidelity ORPHE program was a high value added, high cost plan based on total plan costs of 0.58%, which was higher than CEM's calculated Fidelity ORPHE benchmark cost of 0.34%.*

*Positive value added indicates that, on average, the plan's investment options are outperforming their benchmark indices, whereas negative value added indicates that they are underperforming. Value add for passive investment is not expected to be significant since the goal of a passive investment is to match the return of the benchmark.*

#### ***Custom Target Date Evaluation Project***

*Staff provided the DCPAC with information about what other public plan sponsors are doing related to custom target date funds. Additionally, staff shared with the DCPAC fund expense ratio peer group information for various asset classes.*

#### ***Code of Ethics and FOIA Update***

*Mr. Hayes noted that the Committee members reaffirmed their acknowledgement of the Code of Ethics and Standards of Conduct Policy, required annually of VRS advisory committee members. Staff also reviewed with the Committee the revised FOIA Electronic Meeting Attendance Policy.*

*He concluded by noting the approved 2019 DCPAC meeting schedule. The first meeting date of the year will be confirmed shortly, after input from Committee members.*

- *Spring – to be announced (since announced as April 25, 2019 at 10:30 a.m.)*
- *June 6, 2019 at 1:00 p.m.*
- *September 5, 2019 at 1:00 p.m. (Annual investment review)*
- *November 7, 2019 at 10:30 a.m.*

*The ORPHE Annual Employer Update is scheduled for September 26, 2019. This is not a DCPAC Committee meeting, but members may attend if interested.*

*Mr. Nason thanked Mr. Hayes for his report.*

***REPORT OF THE AUDIT AND  
COMPLIANCE COMMITTEE***

*The Board received the Audit and Compliance Committee report of December 13, 2018 and placed it on file.*

***Exit on the 2018 Comprehensive  
Annual Financial Audit***

*Mr. Leighty briefed the Board on the Auditor of Public Accounts' (APA) audit work relating to the 2018 VRS Comprehensive Annual Financial Report (CAFR), indicating that it was in its final stage. He noted that additional discussion transpired related to the future implementation of GASB No. 84 – Fiduciary Activities.*

***Entrance with APA Regarding  
Employer Assurances***

*The APA next provided to the Committee an overview of its upcoming examinations related to GASB No. 68, which addresses employer reporting of pension liabilities, and GASB No. 75, which deals with employer reporting of other post-employment benefit plans.*

***Audit Reports***

*Mr. Leighty briefed the Board on the discussion of audit reports. The Committee received one report on the review of Modernization Phase 4 – Mock Production.*

***Annual Report on Code of Ethics***

*Mr. Leighty informed the Board that the Chief Operating Officer and the Chief Administrative Officer provided annual reports on their respective processes for communicating VRS' Code of Ethics and Conduct and for monitoring compliance, as required by the Audit and Compliance Committee Charter. Both indicated 100 percent compliance with the reporting and certification requirements for their respective programs.*

***Quarterly Review on Modernization  
Program – Phase 4***

*Lastly, Mr. Leighty briefed the Board on the remaining topics discussed at the Audit and Compliance meeting, which included the Quarterly Review on Modernization Program Phase 4 through November 30, 2018, the Quarterly Report on Fraud, Waste, and Abuse Hotline Cases, and Management's Quarterly Travel Expense and Per Diem Report.*

*He concluded by noting that the Audit and Compliance Committee's next meeting is scheduled for March 20, 2019 at 2 p.m.*

*Mr. Nason praised the hard work of the administration staff on Modernization and thanked Mr. Leighty for his report.*

**REPORT OF THE DIRECTOR**

*Ms. Bishop briefed the Board on the election of Enhanced Hazardous Duty Benefits for Emergency Medical Technicians for the City of Hopewell (Effective November 1, 2018).*

*Ms. Bishop provided an update on the VRS Roadmap and Modernization Project. She noted that not much has changed since November. The review of Modernization Phase 4 – Mock Production was also discussed in the Audit and Compliance Committee. The Cardinal Payroll System Implementation status remains yellow as the host agency, the Department of Accounts, continues to evaluate its revised project schedule. VRS has completed all requirements to date and will resume project activities when the new project schedule is released.*

*Ms. Bishop provided additional information in response to questions presented by the Board at its last meeting related to the Public Access and Building Use Policy and the FOIA Electronic Meeting Attendance Policy.*

*Ms. Bishop noted that the Joint Legislative Audit and Review Commission (JLARC) staff presented its semi-annual report on December 10, 2018 and that it was well received.*

*Ms. Bishop briefed the Board on VRS-related legislation that has been filed for the upcoming 2019 General Assembly session. She also discussed the annual Conflict of Interest Act notice which will be sent out soon and must be submitted electronically. The filing covers January 1- December 31, 2018. It is due on Friday, February 1, 2019 with a late filing fee of \$250 for any submissions after that date.*

*Ms. Bishop highlighted the Agency Annual Meeting on December 5, 2018 and thanked the Board members in attendance, O'Kelly E. McWilliams, III and Wallace G. "Bo" Harris. She remarked that the meeting was a celebration of the many accomplishments of the Investment, Administrative and Internal Audit teams and a good reflection of all that has been accomplished this year.*

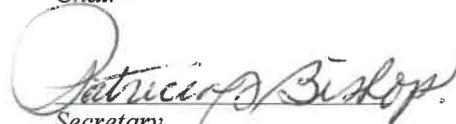
*Ms. Bishop concluded that a January 14, 2019 Board meeting may be needed and that additional information will be provided.*

*Mr. Nason thanked Ms. Bishop for her report.*

**ADJOURNMENT**

*There being no further business, Mr. Nason concluded the meeting at 2:20 p.m.*

  
Chair

  
Secretary

## **Report**

The Defined Contribution Plans Advisory Committee met on December 6<sup>th</sup> and took up the following matters:

### **Administration:**

#### Annual Administrative Expense Reports

Staff provided an overview of the annual administrative expense report for FY 2018, as required by the DCPAC Charter. The report provided both direct and indirect costs associated with administering VRS' Defined Contribution Plans. FY 2018 costs were provided, along with cost trend analysis over the five-year period from FY 2014 to FY 2018. In 2016, the VRS Board approved smoothing costs over five years for ORPHE employers, providing more predictable costs for their budgeting purposes. This five-year period ends in FY 2020 with a rate adjustment due in FY 2021. The rate will be re-evaluated every two years thereafter. Staff expects the rate to increase to \$160 per participant on July 1, 2020.

#### Administrative Reports and Communication Update

Staff provided an update of administrative reports for the third quarter of 2018. Updates included an overview of assets and accounts across the various defined contribution plans, as well as participant trends and the impact of various plan initiatives.

#### ORPHE Update

Staff provided an overview of ORPHE reports for the third quarter of 2018, including plan assets and accounts, and provider election data. Staff also provided a recap of recent and upcoming outreach efforts. In addition to upcoming outreach initiatives to engage employers and faculty, staff shared the proposed timeline for recommendations to move forward with ORPHE changes would be presented to DCPAC at the first meeting in 2019, and to the Board for approval at the May 2019 meeting.

#### ORPHE Annual Employer Update Report

Mr. Larson provided an update on the ORPHE Annual Employer Update hosted by VRS on September 27, 2018.

### **Investments:**

#### Performance Reports

Staff provided an overview of the October 31, 2018 performance reports to the DCPAC. Staff informed the Committee that obtaining accurate performance return information from Fidelity in a timely manner continues to be a problem.

### CEM Defined Contribution Plans Survey

Staff reviewed the CEM DC Plans 2017 survey results, which represented 103 corporate and 23 public or other DC plans. Staff informed the Committee that the survey results included the unbundled DC Plans supplemental 457 Deferred Compensation Plan, in addition to the bundled TIAA and Fidelity programs for ORPHE. Staff noted the TIAA and Fidelity information was based solely on the “selected” plan investment options.

For the calendar year ending 2017 CEM reported the following:

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Positive value added indicates that, on average, the plan’s investment options are outperforming their benchmark indices, whereas negative value added indicates that they are underperforming. Value add for passive investment is not expected to be significant since the goal of a passive investment is to match the return of the benchmark.

### Custom Target Date Evaluation Project

Staff provided the DCPAC with information about what other public plan sponsors are doing related to custom target date funds. Additionally, staff shared with the DCPAC fund expense ratio peer group information for various asset classes.

#### **Other Business:**

##### Code of Ethics

Staff reviewed the Board of Trustees’ Code of Ethics and Standards of Conduct, which is required annually of VRS advisory committee members. DCPAC members reaffirmed their acknowledgement of the policy by signing the certification forms, which are kept on file.

##### FOIA Update

Staff reviewed the revised FOIA Electronic Meeting Attendance Policy.

#### **Proposed 2019 Meetings:**

Staff confirmed the following DCPAC meeting dates for 2019:

- June 6 at 1:00 p.m.
- September 5 at 1:00 p.m.

- November 7 at 10:30 a.m.

The first meeting date of the year will be confirmed shortly with input from Committee members. The ORPHE Annual Employer Update is scheduled for September 26, 2019. This is not a DCPAC Committee meeting, however, members may attend if interested.

There was no other business to come before the Committee.

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



Brett Hayes, Chair  
Defined Contribution Plans Advisory Committee

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## Report

The Audit and Compliance Committee met on December 13, 2018 and discussed the following:

### **EXIT ON THE 2018 COMPREHENSIVE ANNUAL FINANCIAL AUDIT**

The APA informed the Committee the audit work over the 2018 VRS Comprehensive Annual Financial Report (CAFR) was in its final stage. Upon completion, the APA anticipates issuing an unmodified opinion on VRS's financial statements. They noted their companion "Report on Internal Controls and Compliance" would be issued later this month (December) and at this time they do not anticipate including any formal recommendations.

Additional discussion transpired related to the future implementation of *GASB No. 84 – Fiduciary Activities*.

### **ENTRANCE WITH THE APA REGARDING EMPLOYER ASSURANCES (GASB 68)**

The APA then provided the Committee with an overview of its upcoming examinations designed to provide participating employers and their auditors the assurances necessary to prepare their own annual financial statements in accordance with Governmental Accounting Standards Board (GASB) Statements:

- No. 68, which focuses employer reporting over pension plans, and
- No. 75, which deals with employer reporting over other post-employment benefit plans.

The APA anticipates issuing its opinions on these matters on or about June 30, 2019.

### **AUDIT REPORTS**

The Committee received one audit report.

- The review of *Modernization Phase 4 – Mock Production* assess whether VRS is adequately and completely validating the VNAV disbursement engine and results achieved are accurate, valid and succinctly meet VRS business needs. The examination found that the new disbursement engine is functioning properly and supports its organizational readiness efforts. The report included a risk alert, given VRS will have at most two months to perform all planned disbursement-related mock production activities with a stable code base to ensure that these amounts are being disbursed accurately and as designed prior to go-live.

### **ANNUAL REPORT ON CODE OF ETHICS**

The Chief Operating Officer and the Chief Administrative Officer provided their annual reports on their respective processes for communicating VRS's Code of Ethics and Conduct and for monitoring compliance, as required by the Audit and Compliance Committee Charter. Both indicated 100 percent compliance with the reporting and certification requirements for their respective programs.

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**QUARTERLY REVIEW ON MODERNIZATION PROGRAM – PHASE 4**

Management presented its status report on the Modernization Program - Phase 4 through November 30, 2018. Management discussed the remaining Phase Four releases. Go-live for the retirements and disbursements functionality remains focused on Spring 2019 with an ability to submit retirement applications online in Fall 2019. Management confirmed it continues to intensively monitor the phase's progress and has put risk mitigation initiatives in place. Management discussed continued Mock Production progress and emphasized priorities that must be completed prior to go-live.

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, budget, and scope. Internal Audit acknowledged management's efforts to ensure disbursement engine generates correct amounts through the Mock Production exercises, noting the recent review in this area. Internal Audit shared that management is taking proper and proactive actions to ensure the newly developed environment is secure through system penetration tests and the updating of Continuity Plans.

**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 August 1, 2018 through October 31, 2018 was presented to the Committee (two in total). The complaints alleged abuse of the short-term disability program. One case could not be substantiated and the second allegation was unfounded; therefore both were closed.

**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:

**Introduction of New Team Member**

Internal Audit introduced Kristy Scott, Senior Auditor – Benefits and Investments, who joined the team.

**Next Committee Meeting Date**

The Committee's next meeting is scheduled for on March 20, 2019 at 2 p.m.

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



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