

**Joint Legislative Audit and Review Commission
of the Virginia General Assembly**



**VRS Oversight:
Biennial Status and Semi-Annual
Investment Report -- December 2004**

**JLARC Staff Briefing
Trish Bishop
December 13, 2004**

VRS Oversight Act

- **Section 30-78 *et seq.* of the *Code of Virginia* requires JLARC to oversee and evaluate VRS on a continuing basis**

- **Areas for review and evaluation include:**
 - **Structure, governance, administration, and management**
 - **Biennial status report required**
 - **Actuarial policy and actuarial soundness**
 - **Investment practices, policies, and performance**
 - **Semi-annual investment report required**

1994 Review of the Virginia Retirement System

3

- HJR 392 of the 1993 General Assembly directed JLARC to complete a comprehensive study of VRS

- The study focused on the:
 - structure and governance of the system,
 - investment practices and performance, and
 - actuarial soundness of the funds

1994 Review of the Virginia Retirement System (continued)

4

- JLARC found the fund to be financially sound, but the report recommended:
 - VRS be established as an independent agency;
 - Appointment of Trustees should be shared by the Governor and the General Assembly;
 - VRS funds be established as independent trusts in the *Constitution of Virginia*;
 - Structure of advisory committees be established in law;
 - General Assembly establish permanent legislative oversight; and
 - Pre-funding of the COLA

- Most of the recommendations in the 1994 report have been substantially implemented

Overview of the Virginia Retirement System

5

- **VRS administers the statewide retirement systems for public employees:**
 - **234 State agencies**
 - **151 cities and towns**
 - **92 counties**
 - **321 school boards and special authorities**

Overview of the Virginia Retirement System

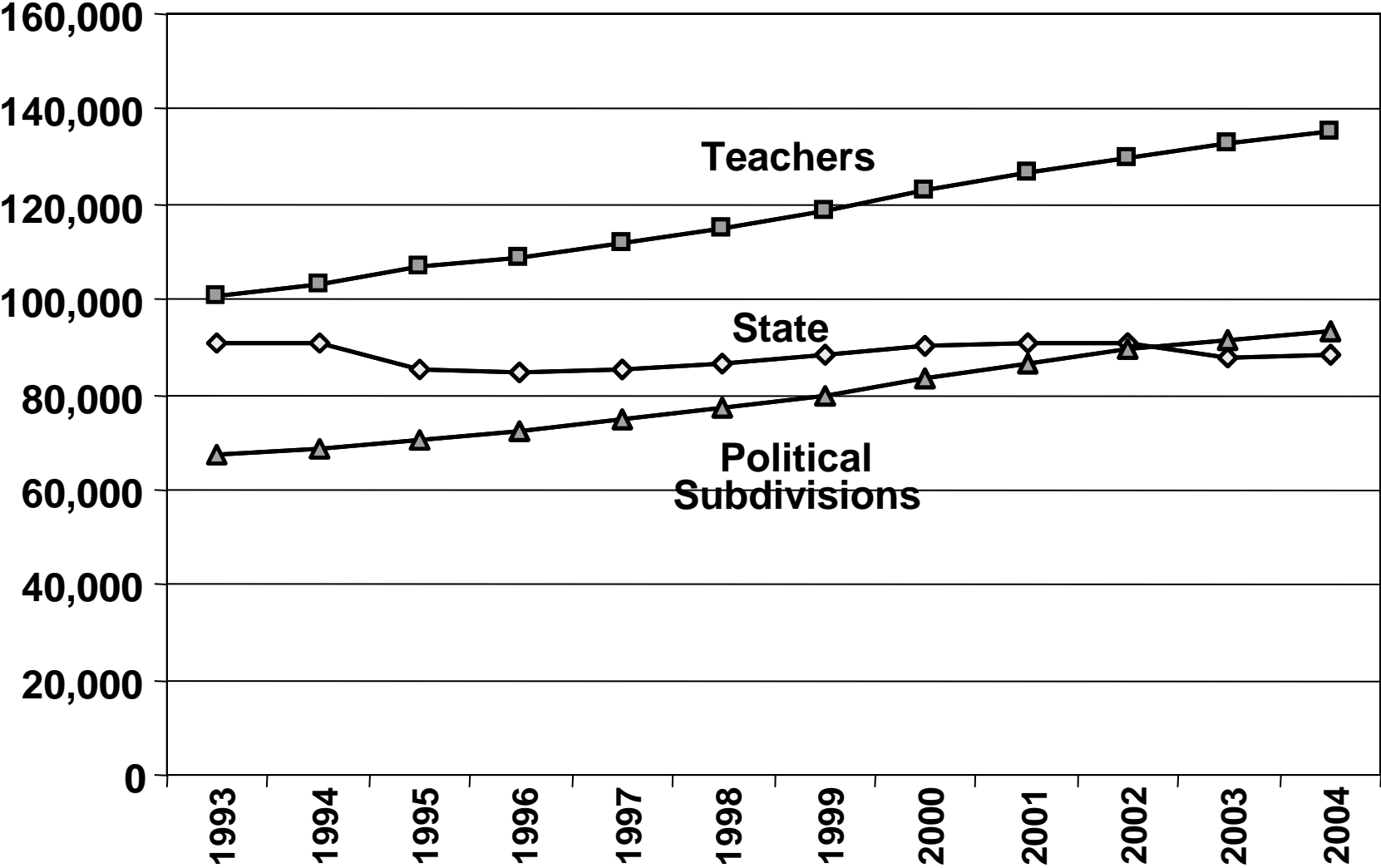
(continued)

6

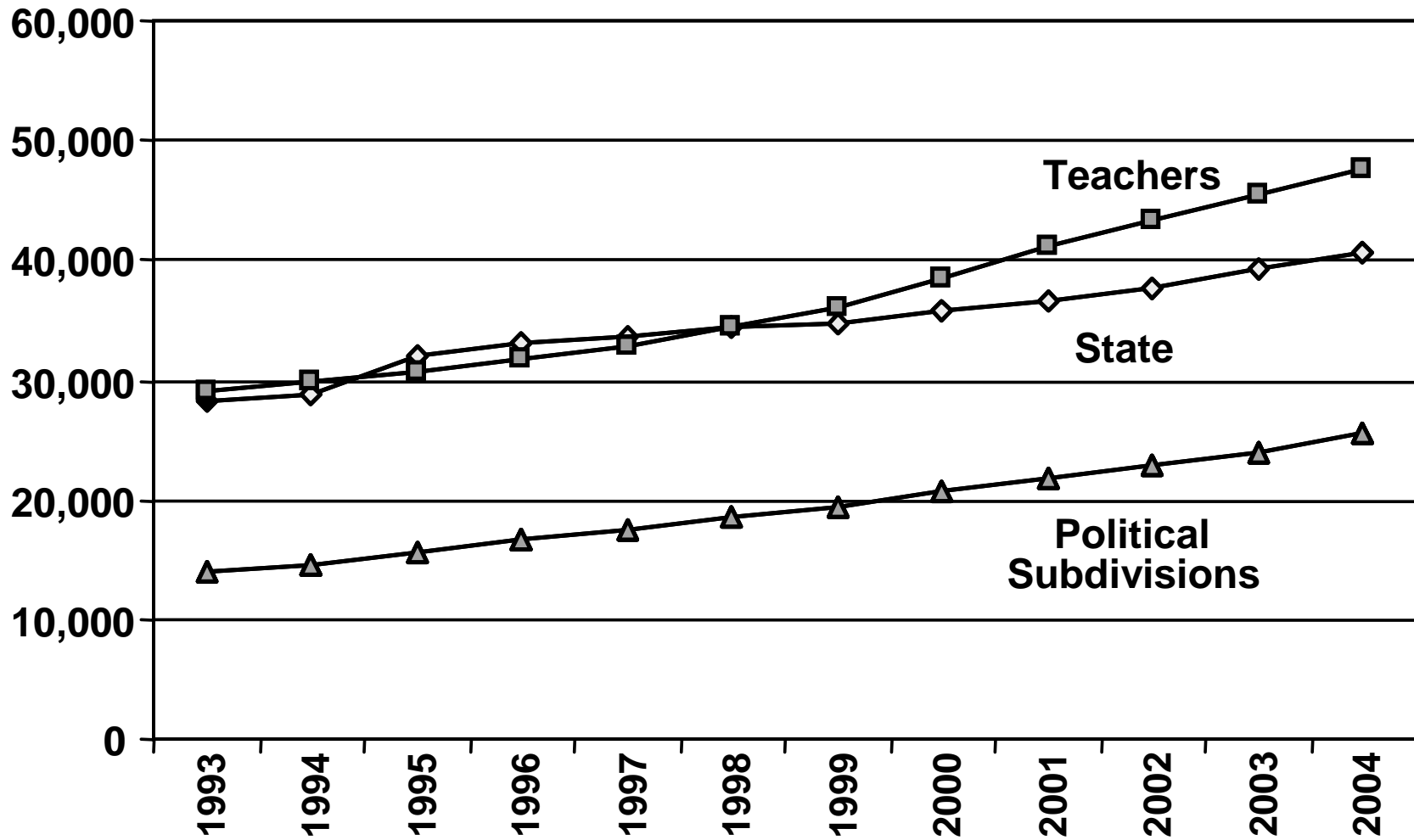
- **Retirement Benefits Administered by VRS**
 - **Virginia Retirement System (VRS)**
 - **Judicial Retirement System (JRS)**
 - **State Police Officers' Retirement System (SPORS)**
 - **Virginia Law Officers' Retirement System (VaLORS)**

- **Local Enforcement Officers' Retirement System (LEOS)**
 - **All sheriffs have LEOS coverage**
 - **Benefits are equivalent to SPORS**
 - **Local option to provide LEOS coverage to police, deputy sheriffs, firefighters, regional jail officers and superintendents**

VRS Active Membership Data FY 1993 – FY 2004



VRS Retirees, FY 1993 – FY 2004



Recent Fund Performance

- **Market value of the fund's assets as of September 30, 2004, was \$39.99 billion**
- **VRS' investment returns fell short of the actuarial assumed investment return of 8 percent in the fiscal-year-to-date-, three- and five-year periods ending September 30, 2004**

First Quarter FY 2005	One-Year Return	Three-Year Return	Five-Year Return	Ten-Year Return
0.8%	14.4%	7.3%	4.1%	10.1%

Recent Fund Performance

(continued)

10

- The public equity program continues to be VRS' largest asset class, comprising 65.2 percent of the portfolio
- Returns for the public equity program for the one-year period ending September 30, 2004 were 17.5 percent
- However, returns for the first quarter of FY 2005 declined sharply and were negative for the period (-0.6 percent)
- Conditions in the public equity market negatively influenced the total fund's overall investment performance for the first quarter of FY 2005 (0.8 percent)

Recent Fund Performance

(continued)

11

- **The fixed income and real estate programs**
 - offered necessary fund diversification,
 - exceeded performance benchmarks, and
 - provided positive returns for the one-, three-, and five-year periods ending September 30, 2004

- **The annualized internal rate of return for the private equity program as of June 30, 2004, since the inception of the program in 1989, was 23.71 percent**

Recent Fund Performance

(continued)

12

- **The high yield program is in the alternative investment class**

- **The current high yield program began on July 1, 2004**
 - **For the period ending September 30, 2004, the program:**
 - **had \$944 million in assets,**
 - **represented 2.4 percent of the total fund,**
 - **exceeded its benchmark, and**
 - **returned 3.4 percent for the fiscal-year-to-date**

Recent Fund Performance

(continued)

13

■ Hedge Fund Program:

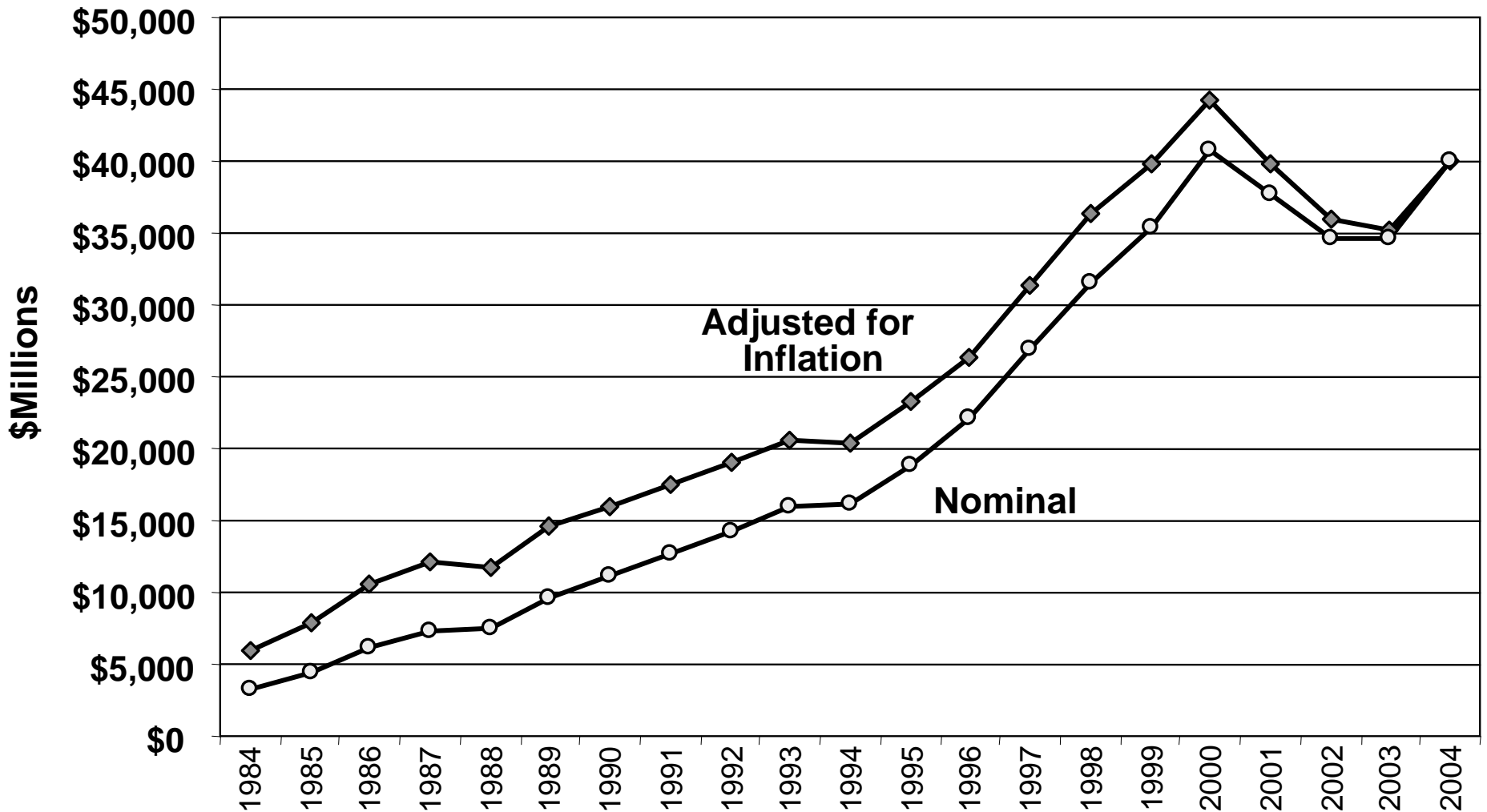
- Authorized by the Board in November 2002
- For the period ending September 30, 2004:
 - represented 3.4 percent of the VRS portfolio or \$1.3 billion,
 - exceeded its established performance benchmark, and
 - generated positive returns for the fiscal-year-to-date- and one-year periods (1.4 percent and 9.6 percent respectively)

Real Estate Program Update

14

- Real estate provides attractive returns, offers diversification benefits, and serves as an inflation hedge
- New Director of Real Estate Investments hired in August 2004
- Real estate currently constitutes 3.8 percent of the portfolio or \$1.5 billion, but VRS plans to grow the program
- Investing in REITS provides liquidity
- In this challenging market environment, VRS plans to invest opportunistically:
 - Large amounts of capital from public and private pension funds, as well as endowments, are flowing into real estate
 - Currently, real estate fundamentals are generally weak relative to valuations and pricing

Market Value of VRS Fund FY 1984 – FY 2004



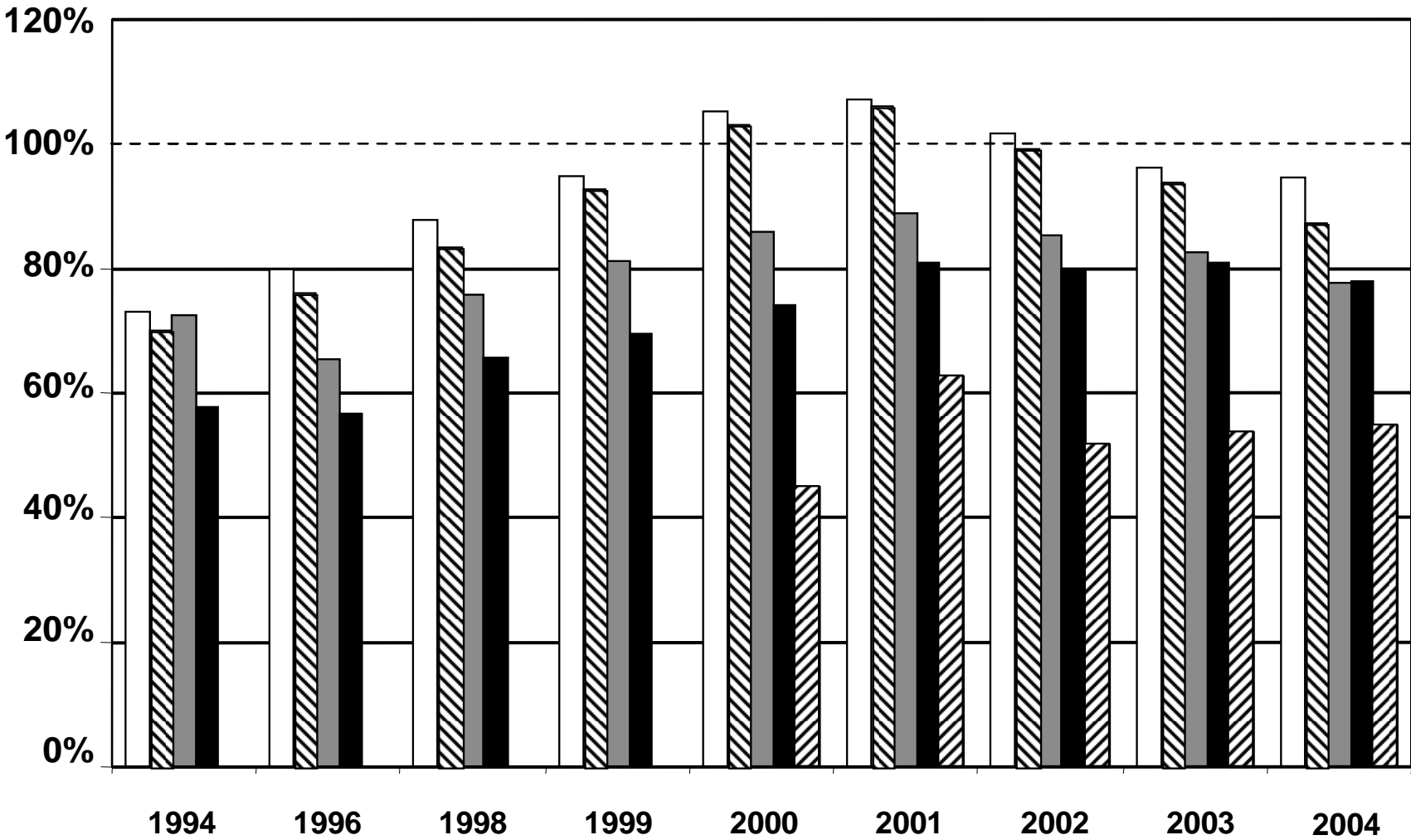
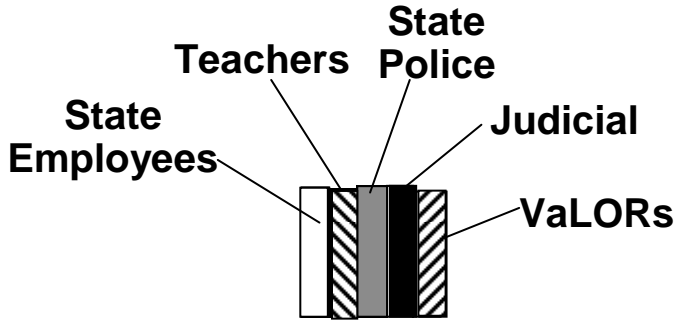
VRS Funding

- **VRS has made funding progress over the last nine years:**
 - **Pre-funding the cost-of-living allowance (COLA) has helped put the fund in a better actuarial position**
 - **Unlike many pension systems during the late nineties, the legislature generally approved only fairly modest benefit enhancements**
 - **Large numbers of service purchases created significant recent liability losses**

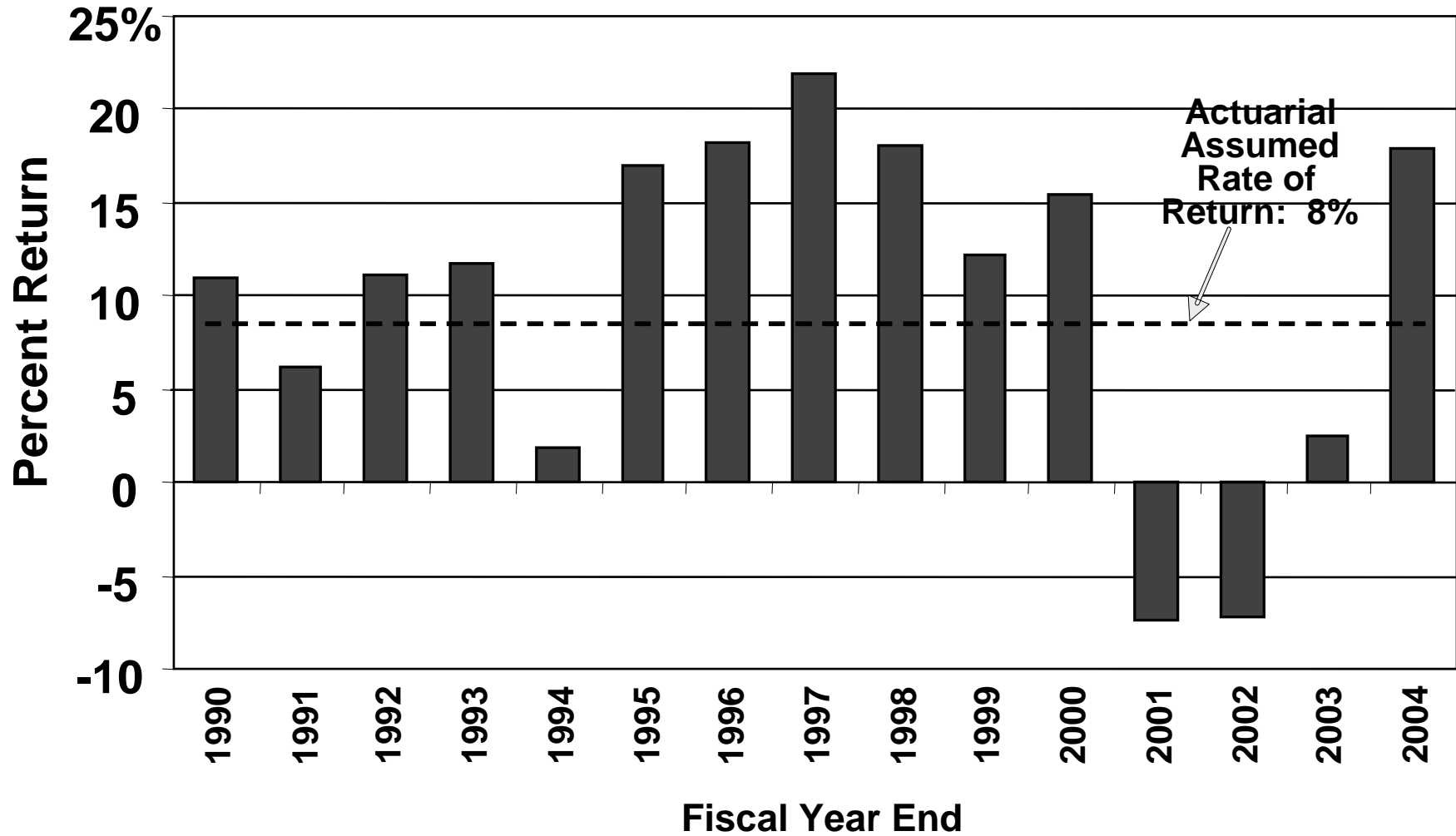
VRS Funding

- **The number of active members compared to retired members is declining:**
 - **1984: 5.04 active members per retiree**
 - **1994: 3.59 active members per retiree**
 - **2004: 2.79 active members per retiree**

Funded Ratios for VRS' Five Major Systems, FY 1994 – FY 2004



VRS Annual Performance



Group Life Funding

20

- **Group Life is funded through contributions from employers and investment income**
- **\$778 million in net assets were available for benefits as of June 30, 2004**
- **Premium holidays in 1994, 1997, 1999, 2000, part of 2002, 2003, 2004, and 2005 will result in increases in future group life insurance rates**

Major VRS Program Changes and Enhancements Since 1994

21

- **Since 1994, many changes have been made to the benefits and programs administered by VRS**

- **Changes vary widely in complexity from technical clarifications to the establishment of entirely new systems and programs**
 - **Virginia Law Officers' Retirement System (VaLORS)**
 - **Virginia Sickness and Disability Program (VSDP)**
 - **Cash Match Plan**
 - **Purchase of Service**

Major VRS Program Changes and Enhancements Since 1994

22

- Early retirement with reduced benefits at 50/10 (1994)
- Optional Life program established (1995)
- State covers cost of retiree health care credit for teachers (1996)
- Virginia Sickness and Disability Program (1998)
- Optional Retirement Plan for Political Appointees (1998)
- Optional Retirement Plan for School Superintendents (1998)
- Single benefit formula with 1.7 multiplier of average final compensation (1999)
- Virginia Law Officers' Retirement System (1999)
- Volunteer Firefighters and Rescue Squad Workers Award Fund (1999)
- Cash Match Plan for the deferred compensation program (1999)
- Centralized administration and oversight of the Optional Retirement Program (2000)
- Self-directed brokerage account added to the DCP (2000)

Major VRS Program Changes and Enhancements Since 1994 (continued)

23

- Purchase of service streamlined (2001)
- Higher multiplier (2.0 %) for newly enrolled members of VaLORS, and existing members of VaLORS may elect the new multiplier in lieu of supplement (2001)
- Partial Lump-Sum Option Payment (PLOP) (2001)
- Leveling Option eliminated (2001)
- Under limited circumstances, retired teachers may draw retirement benefits and continue to work full-time (2001)
- VSDP participants receive long-term care coverage (2002)
- Waiting period for Cash Match Plan eliminated (2002)
- Wage employees eligible to participate in deferred compensation plan (2002)
- Advance Pension Option (2003)
- Virginia Supplemental Retirement Plan (2004)

Quadrennial Actuarial Audit

24

- Section 30-81 of the Code of Virginia directs JLARC to conduct an actuarial review of VRS once every four years
- The last audit was based on the June 30, 2000 valuation
- The June 30, 2004, valuation was completed by the same VRS actuary, based on the same experience study, and employed generally the same actuarial assumptions as those used in the 2000 valuation
- Once the 2004 valuation has been finalized by the VRS actuary, the JLARC actuary will perform a general review
- VRS hired a new actuary, who will complete the June 30, 2005 valuation and experience study
- JLARC staff recommend basing the full quadrennial audit on the 2005 valuation in order to obtain a
 - review of the work completed by the new actuary,
 - review of the new experience study, and
 - review any new methods and assumptions

Quadrennial Actuarial Audit

(continued)

- **In compliance with Section 30-81 of the Code of Virginia, JLARC requests the JLARC actuary to conduct a review and analysis of the June 30, 2004, valuation of VRS, confirming that the VRS actuary used the same experience study, methods, and assumptions as represented in the 2001 valuation.**

- **The results of this review shall be provided to the Commission and the House Appropriations and Senate Finance Committees.**

- **Further, the quadrennial actuarial audit shall be based on the June 30, 2005, valuation and shall be presented to the Commission in late 2005 or early 2006.**