

Virginia Retirement System

Joint Legislative Audit and Review Commission

July 11, 2005

Paul W. Timmreck
VRS Board of Trustees
Chairman

Recent Changes

- *Bob Schultze*, VRS Director effective May 2, 2005.
- *Paul Timmreck*, Chair, VRS Board of Trustees.
- Chief Investment Officer search.

VRS Board Members

- Paul W. Timmreck, Chair
- Alfonso I. Samper, Vice Chair
- John M. Albertine, Ph.D.
- Edwin T. Burton III, Ph.D.
- J. Douglas Conway, Jr.
- Judith Ewell, Ph.D.
- Palmer P. Garson
- Vernard W. Henley
- Raymond B. Wallace, Jr.

VRS Overview

- VRS is the 27th largest public or private pension system in the U.S.
- There are more than 540,000 members, retirees and beneficiaries.
- Assets total \$43.9 billion, as of 6/30/05.

VRS Board Retreat

- Retreat scheduled August 18.

- Investment topics include:
 - Monetary Policy in a Global Economy
 - Impact of China/Global Competition
 - Energy Market Outlook
 - Standards of Prudence
 - Investment Strategies used by VRS “All Star” Managers

Agenda

➤ VRS Investments Presented By:

Charles Grant

Acting Chief Investment Officer

➤ VRS Administration Presented By:

Bob Schultze

Director

Virginia Retirement System

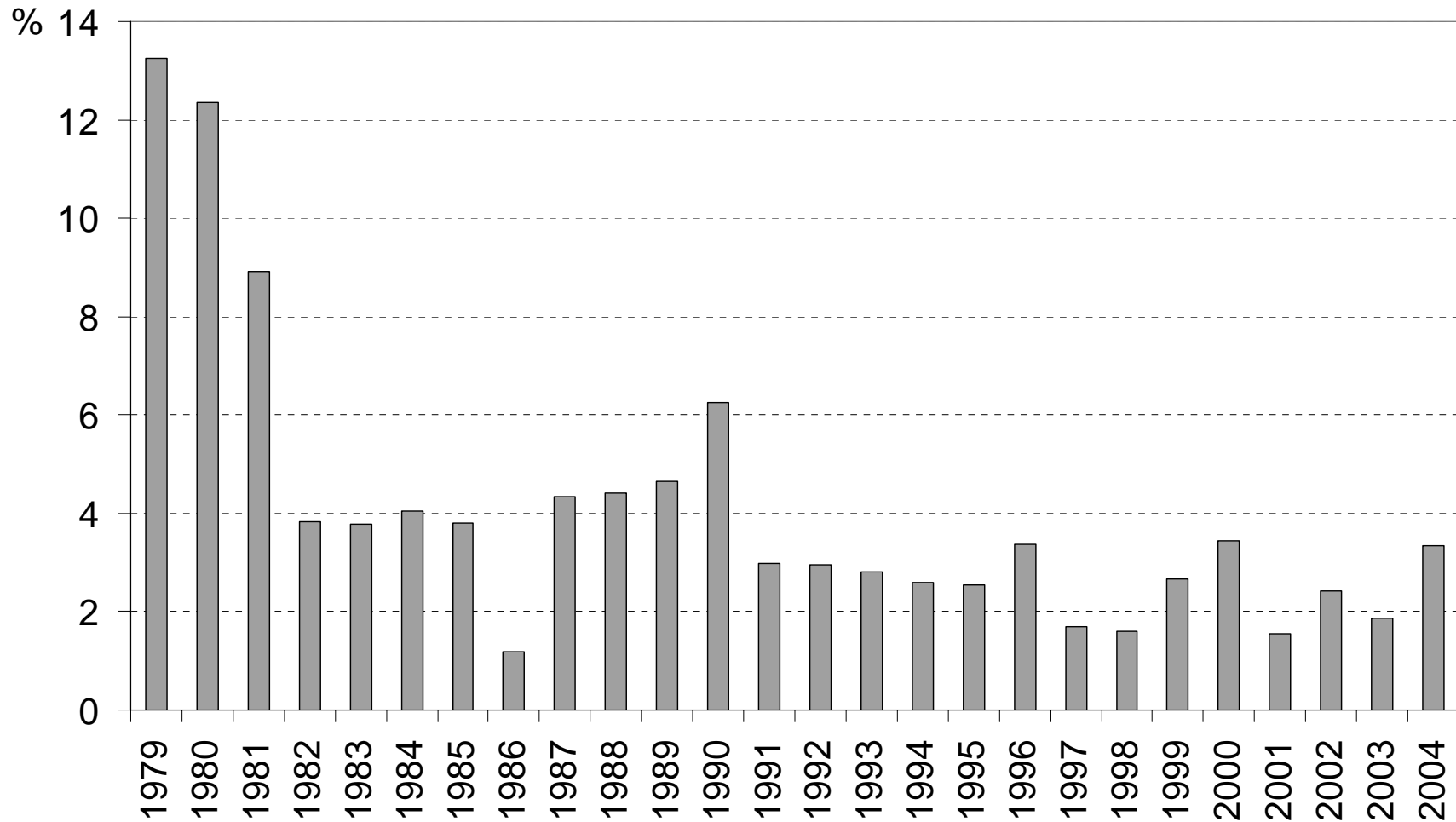
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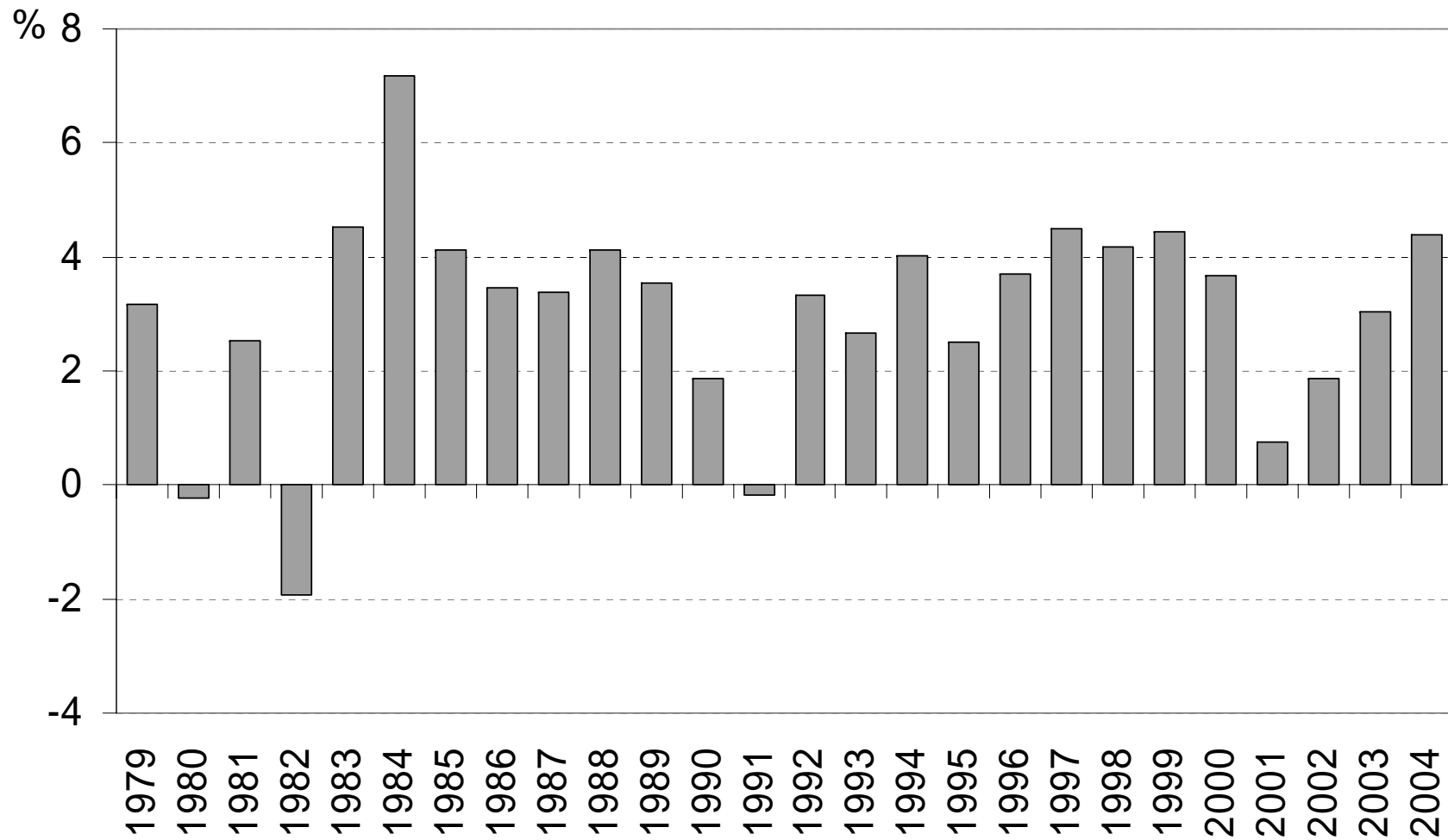
Charles W. Grant, CFA
Acting Chief Investment Officer

- Market Conditions
- Investment Performance
- Investment Process
- Alternative Investments
- Outlook

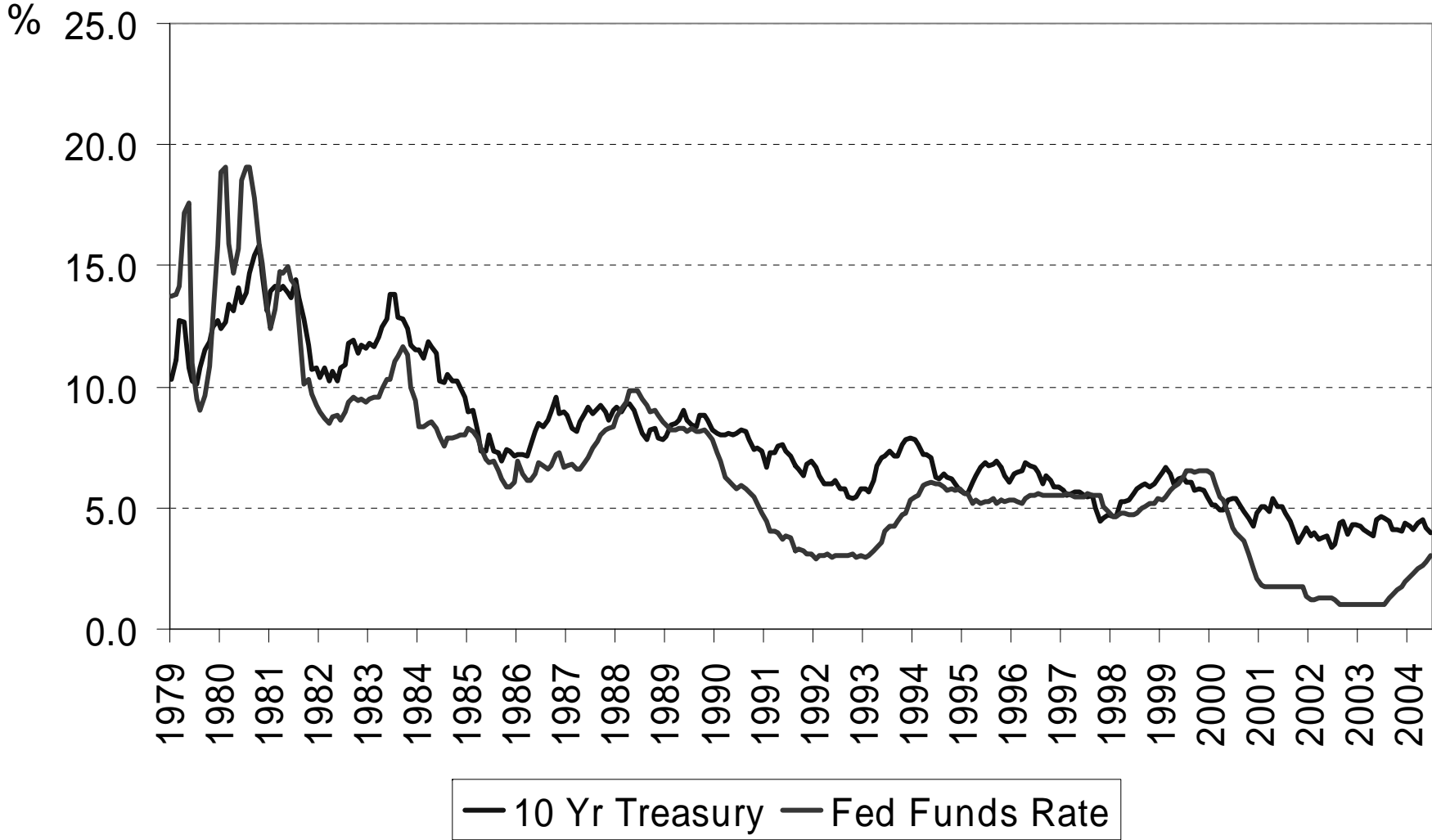
Inflation: CPI



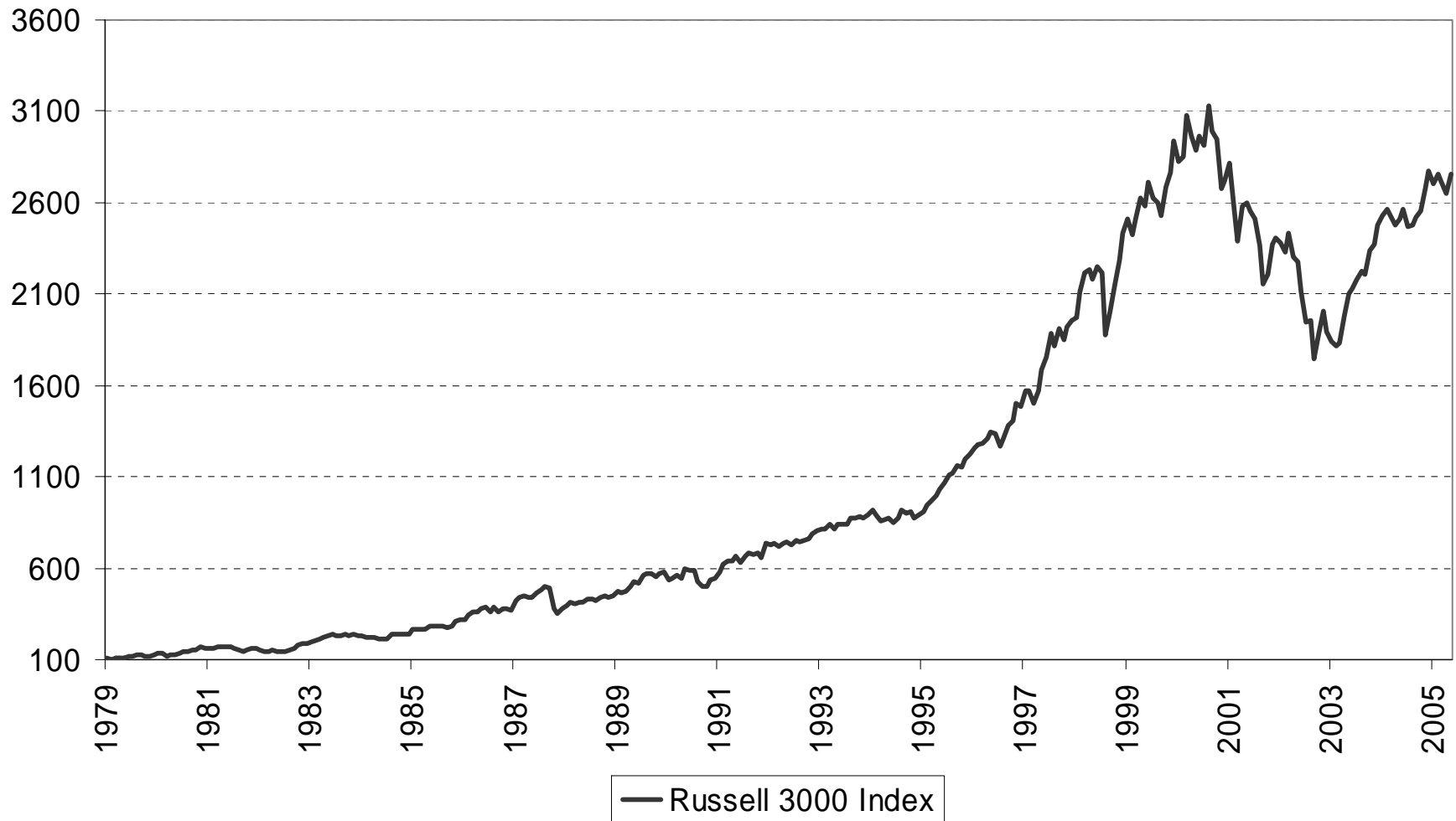
Real GDP



Interest Rates



U.S. Equity Market



Investment Performance (as of 5/31/05)

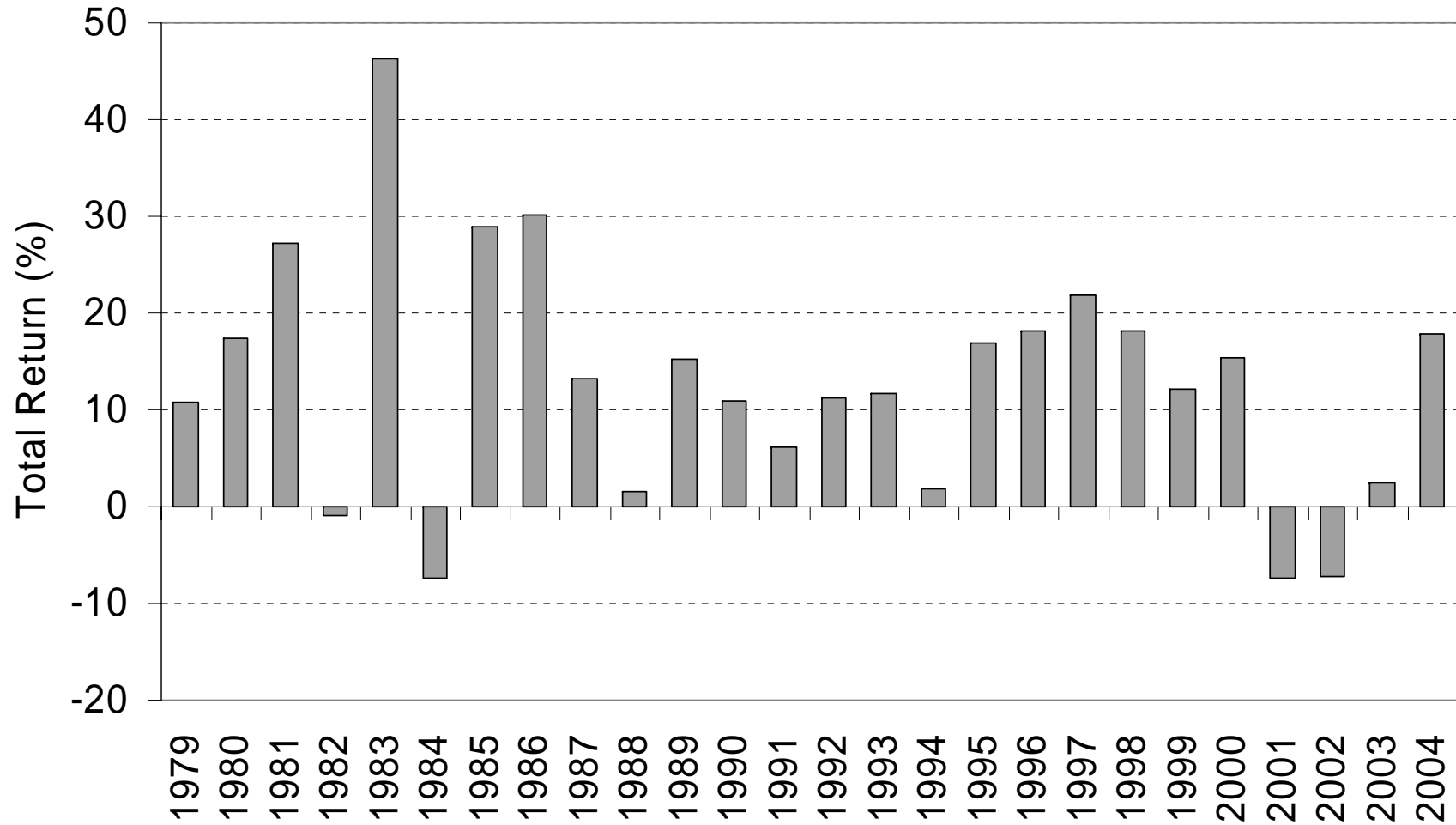
	VRS (%)	Benchmark (%)	Difference (%)
Fiscal 2005	10.4	9.3	1.1
1 Yr	12.5	11.0	1.5
3 Yr	8.6	8.3	0.3
5 Yr	3.7	3.1	0.6
10 Yr	9.9	9.3	0.6

Note: VRS performance is net of fees

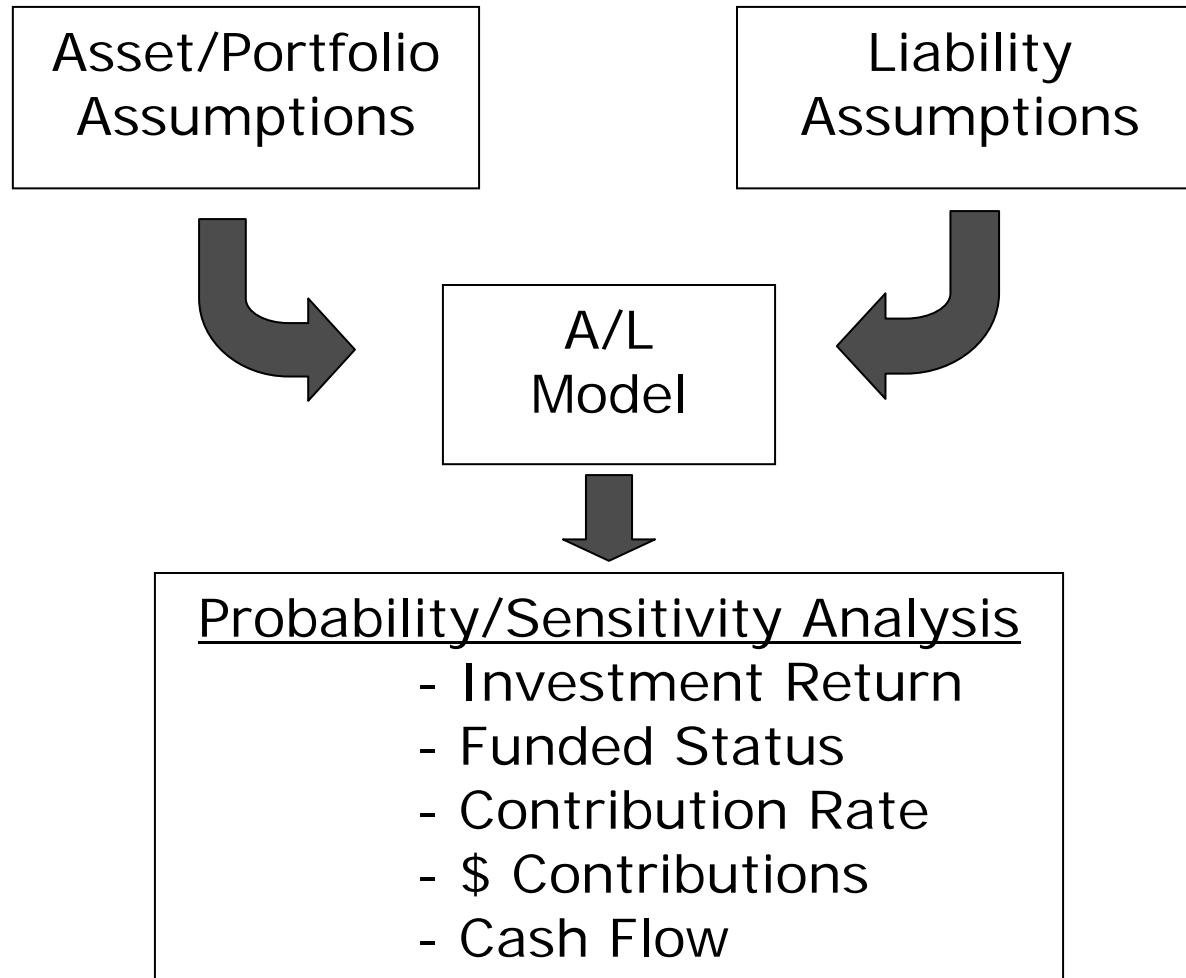
Performance vs Benchmark (as of 5/31/05)

Asset Class	1 Yr (%)	3 Yr (%)	5 Yr (%)	10 Yr (%)
Fixed Income	0.3	0.2	0.3	0.4
Public Equity	1.2	0.2	0.4	-0.1
Real Estate	1.1	1.1	0.7	-0.8
Private Equity	14.5	1.5	3.9	9.5
Hedge Funds	1.3	N/A	N/A	N/A

VRS Annual Performance (FY)



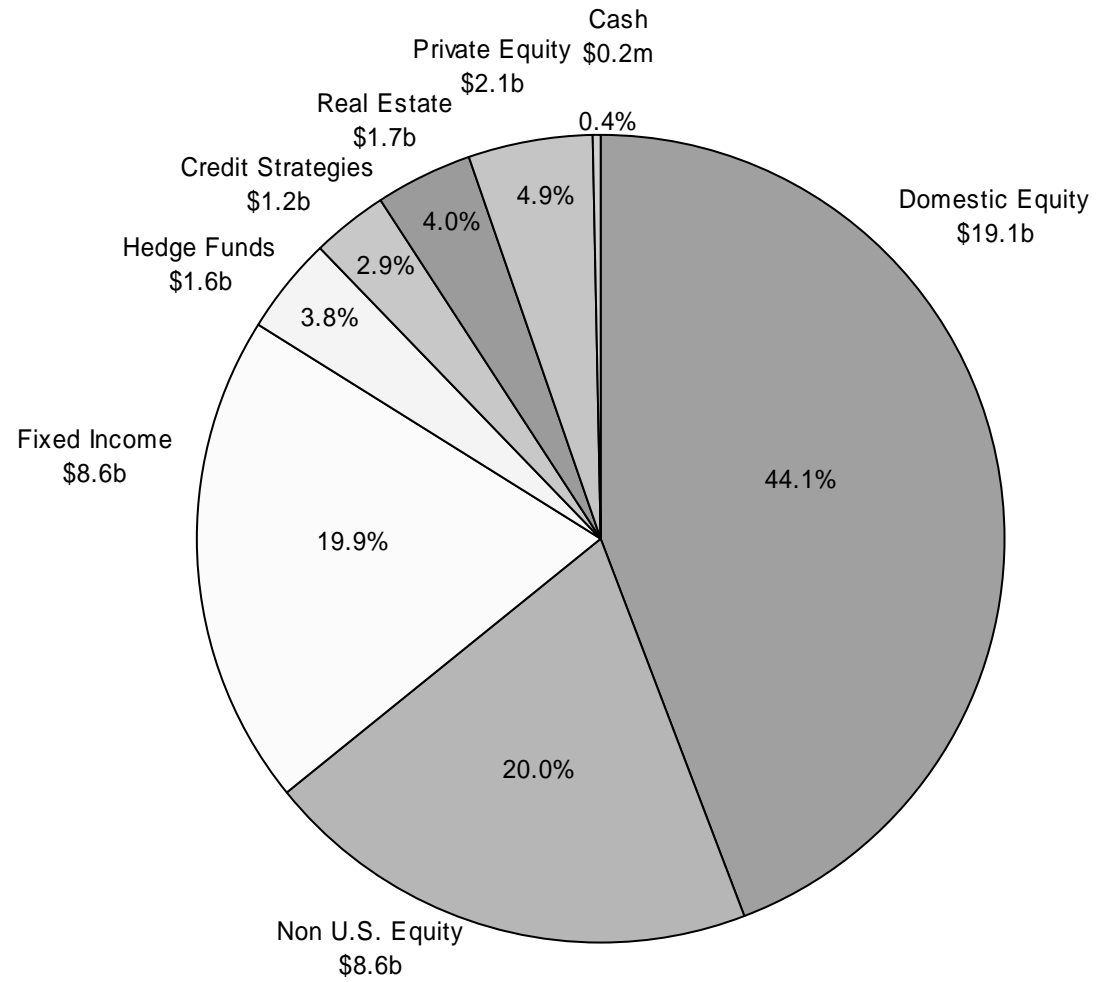
Asset Liability Approach



Investment Opportunities

Asset Class	Expected Return	Characteristics
Fixed Income	4.98	Low to moderate risk , high quality, income producing, deflation hedge
Dom Equity	6.75	Higher risk, low income, growth oriented, long-term inflation hedge
Int'l Equity	7.26	Higher risk, growth investment, currency risk, diversifier
Credit Strategies	6.79	Moderate risk, high income, diversifier
Real Estate	8.25	Moderate to high risk, income and growth, diversifier, inflation hedge
Private Equity	10.30	High risk, high return, illiquid, high fees
Hedge Funds	7.00	Moderate risk, active strategies, steady return objective, illiquid, high fees

Current Asset Allocation (as of 5/31/05)



Total Fund \$43.1b

Asset Allocation: VRS vs Peers

Asset Class	VRS %	Peers %	Difference %
Fixed Income	19.9	25.9	-6.0
Domestic Equity	44.1	46.2	-2.1
International Equity	20.0	16.5	3.5
Credit Strategies	2.9	1.5	1.4
Real Estate	4.0	4.6	-0.6
Private Equity	4.9	3.8	1.1
Hedge Funds	3.8	0.6	3.2

Portfolio Management Strategies (5/31/05)

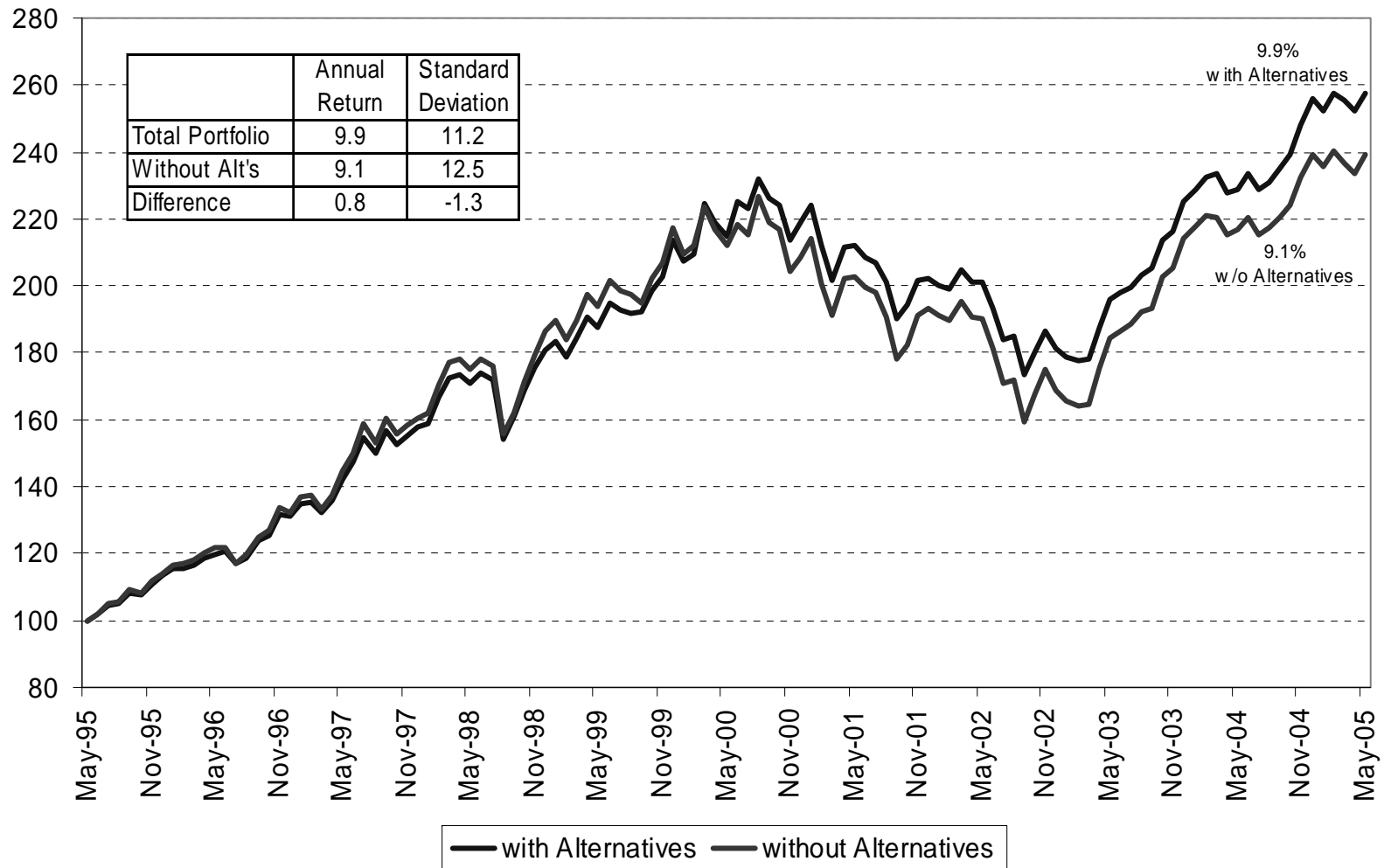
Asset Class	Active %	Passive %	External %	Internal %
Fixed Income	50	50	63	37
Domestic Equity	46	54	63	37
Int'l Equity	100	0	100	0
Credit Strategies	100	0	100	0
Real Estate	94	6	94	6
Private Equity	100	0	100	0
Hedge Funds	100	0	100	0
TOTAL FUND	66	34	76	24

VRS “Alternative” Investments (5/31/05)

	Inception Date	# of Funds	Current \$	Current % Of Fund	Annualized Inception Return
Real Estate	May 1981	20	1.7 b	4.0	7.8%
Private Equity	April 1989	210	2.1 b*	4.9	23.9%*
Credit Strategies	July 2001	10	1.2 b	2.9	6.9%
Hedge Funds	July 2003	51	1.6 b	3.8	8.7%
Total		281	6.6 b	15.6	

*As of 12/31/04, return is \$ weighted

10 Yr Performance Impact of Alternatives (5/31/05)



- Moderate economic growth
- Continued effective monetary policy
- Higher inflation in short run, low inflation in long run
- Moderate nominal returns next 5-10 years

7.50% nominal return
-2.50% inflation
5.00% real return

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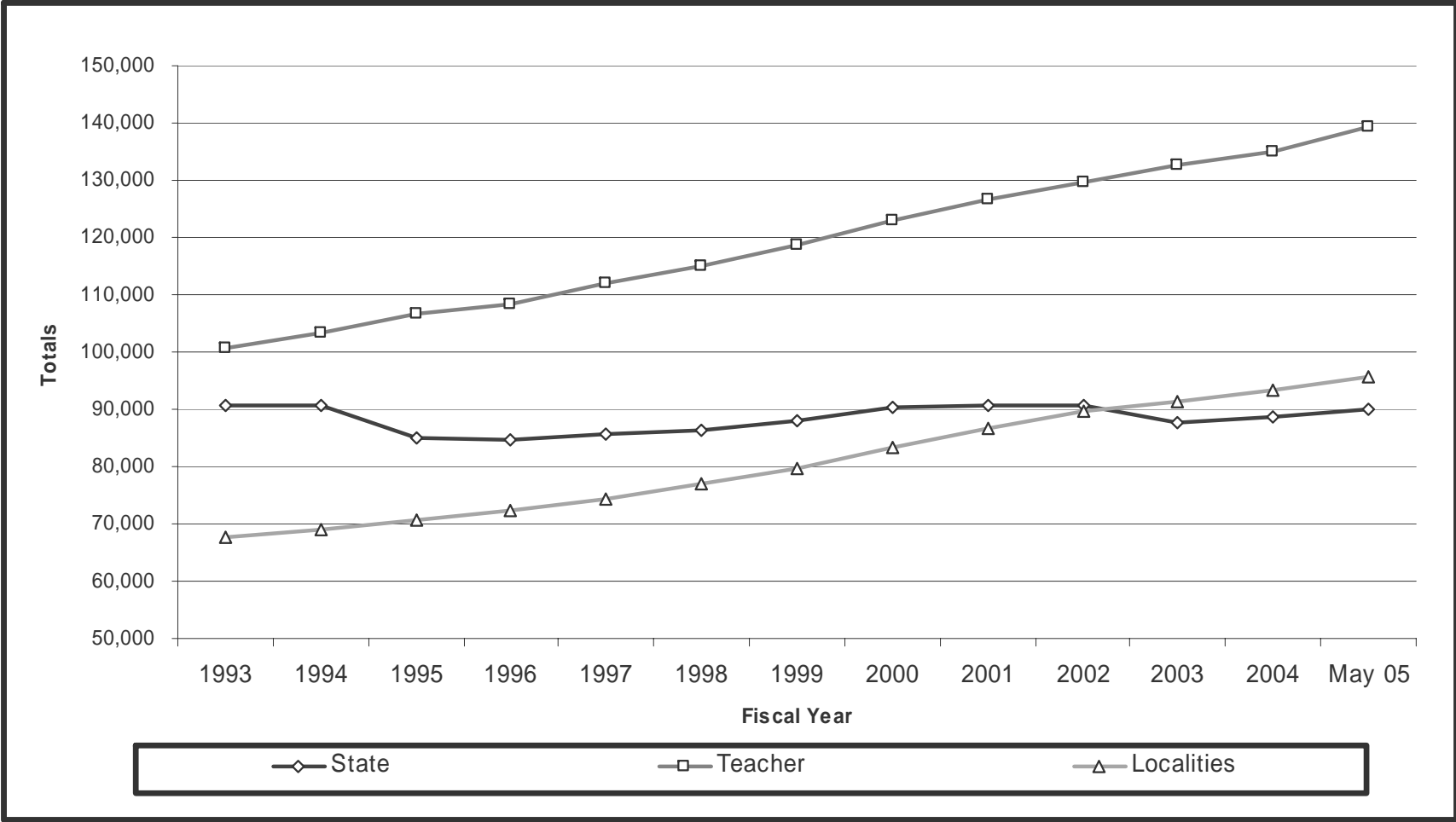
Robert P. Schultze
Director

VRS Total Membership

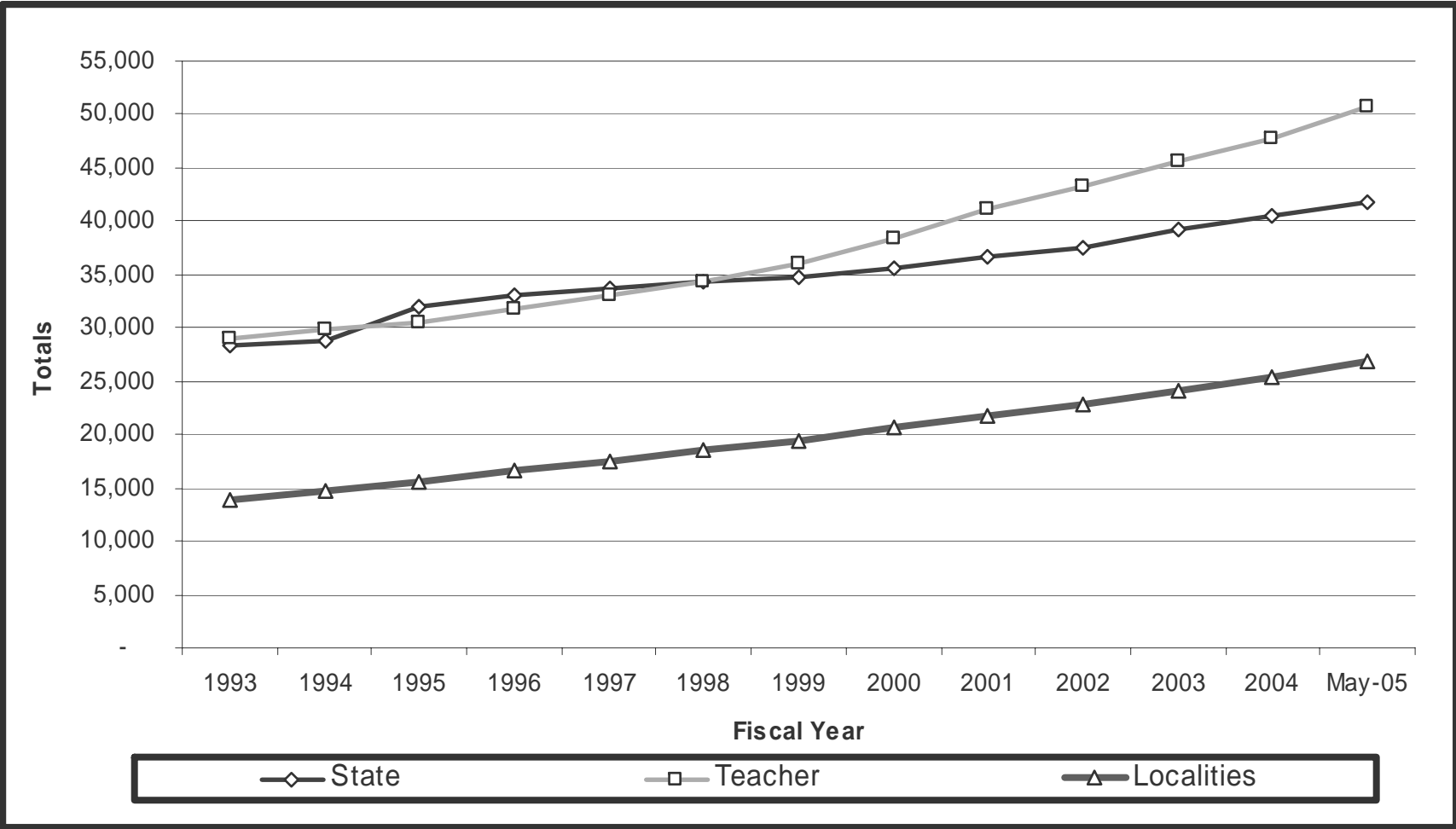
(May 2005)

State Employees	78,082
Teachers	139,431
Political Subdivisions	95,693
State Police Officers' Retirement System (SPORS)	1,811
Judicial Retirement System (JRS)	411
Virginia Law Officers' Retirement System (VaLORS)	9,740
Total	325,168
Retirees/Beneficiaries	119,230
Inactive/Deferred Members	97,921
VRS Overall Impact	542,319

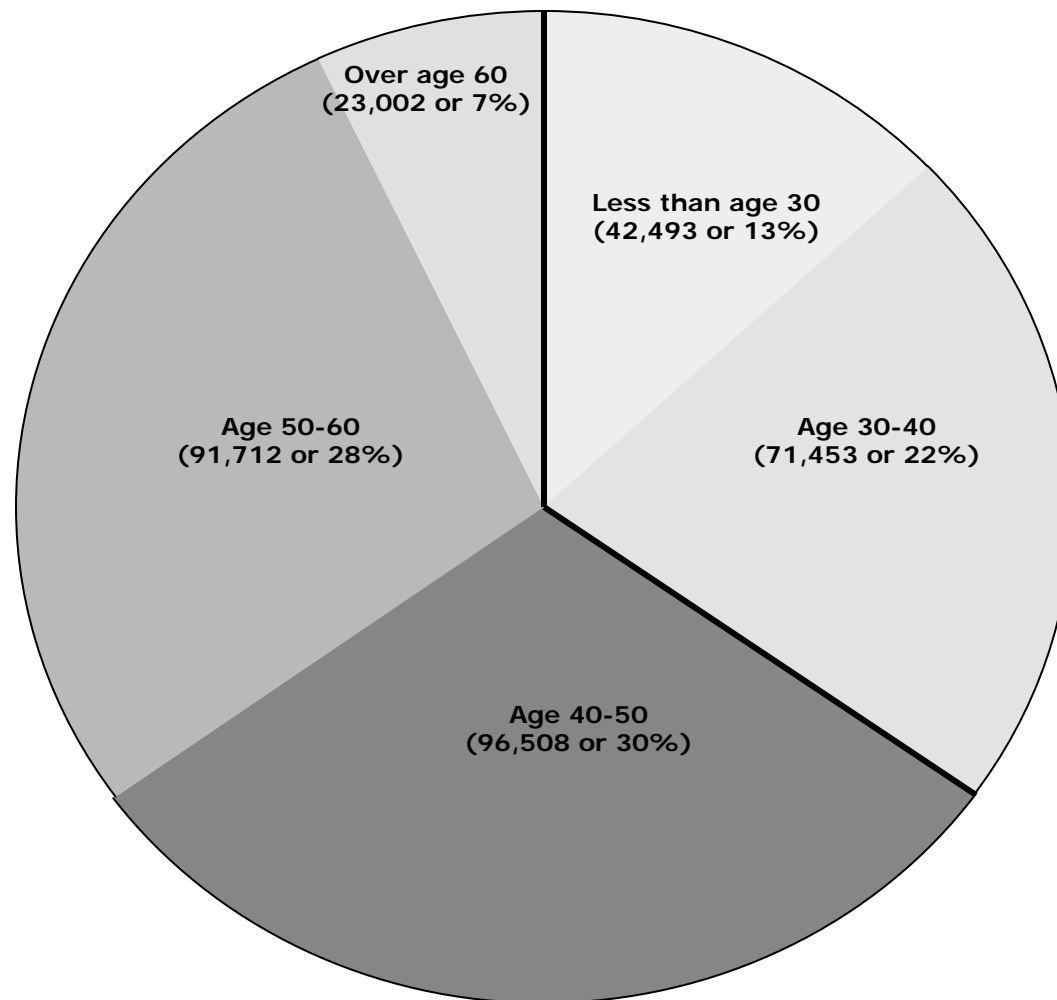
VRS Members



VRS Retirees



Age Categories of Active Members



How Retirement Benefits Are Funded

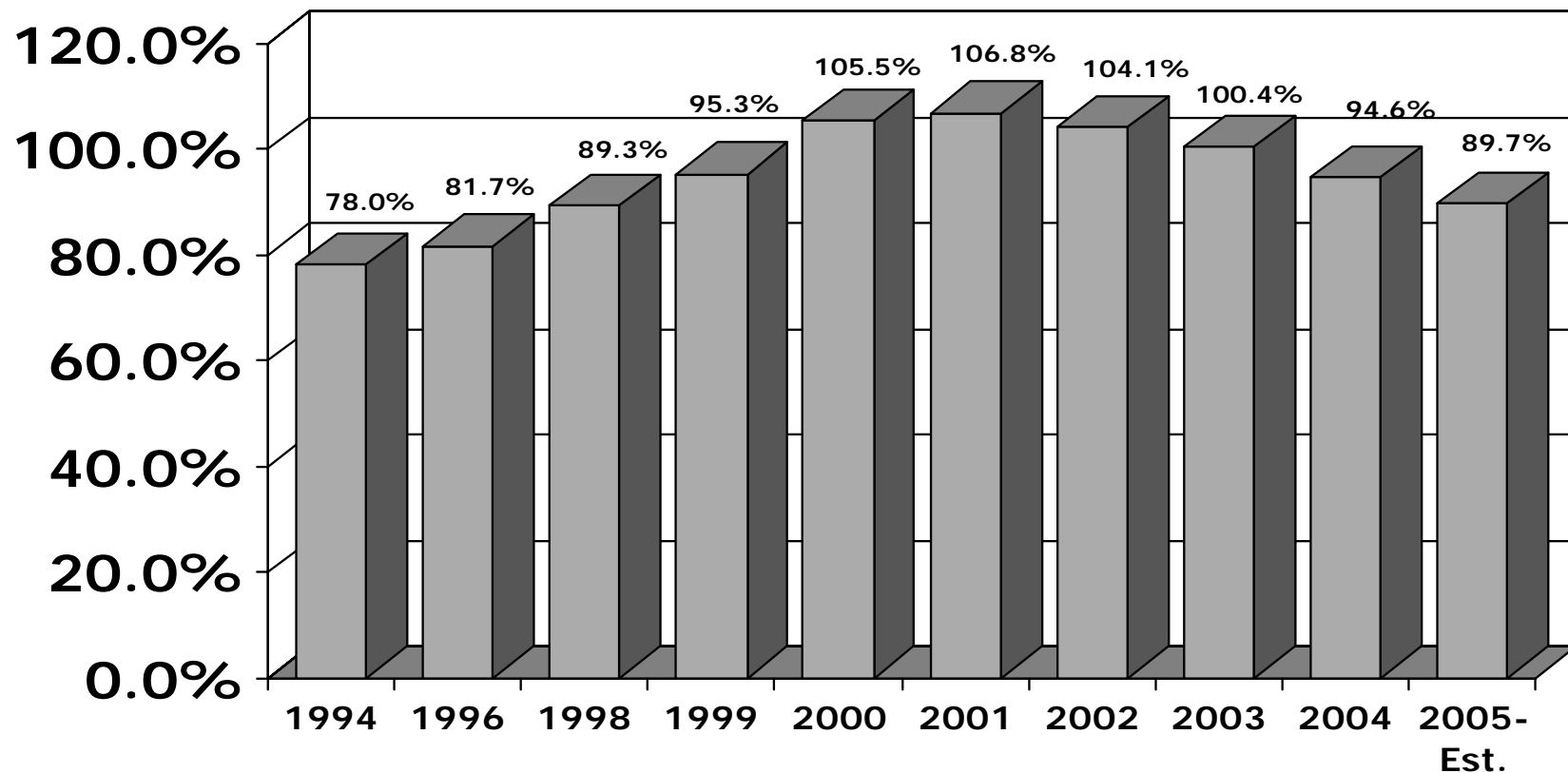
- For the average VRS member who retires at age 61 and lives for 23 years:

- The 23 years of benefits are paid:
 - 65% from investment earnings.
 - 22% from employer contributions.
 - 13% from employee contributions.

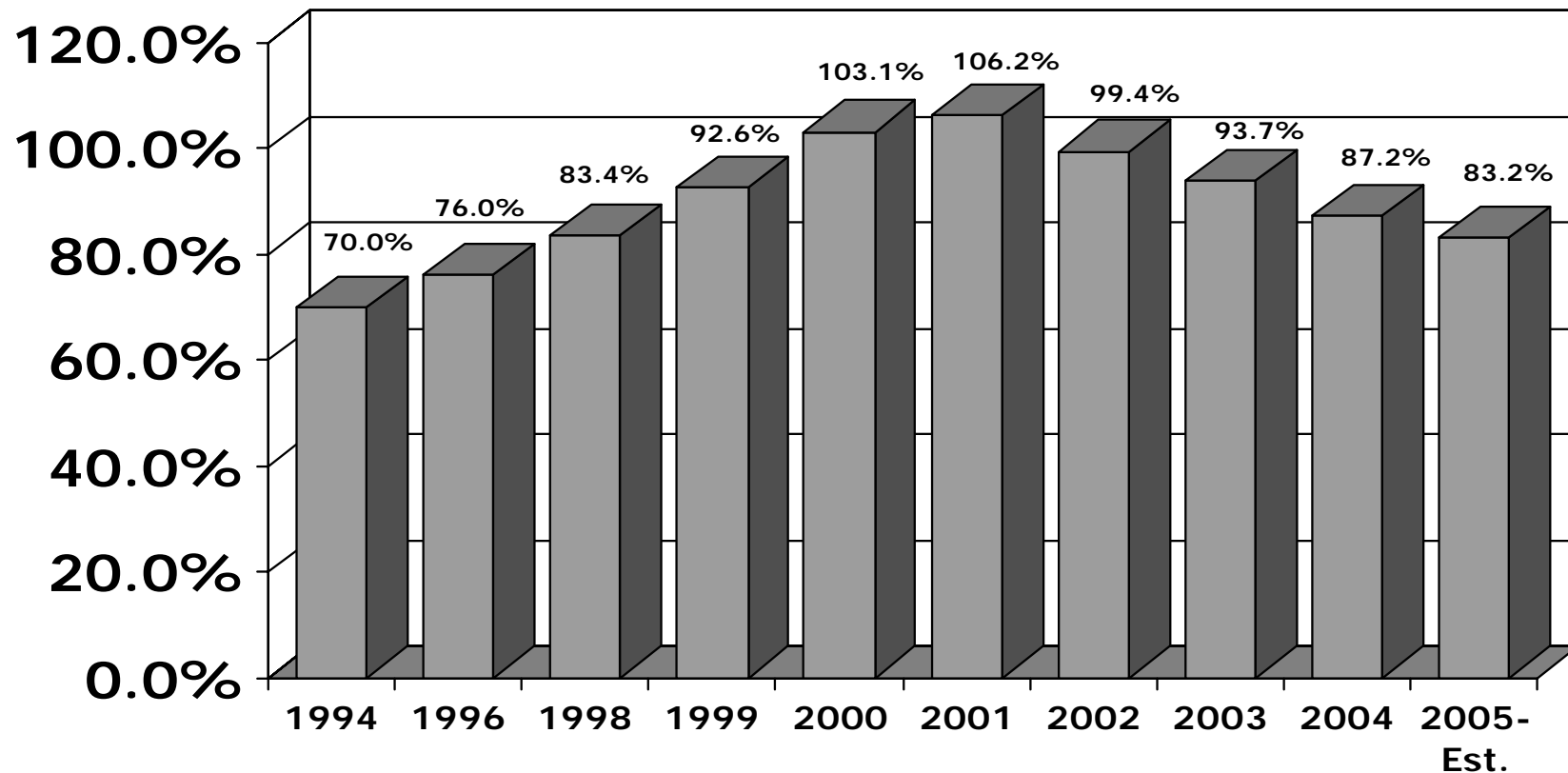
Funded Status

- Anticipated assets/anticipated liabilities.
- Assuming compounded annual investment gains of 7.5%.
- A risk-free rate of return (Treasury Notes) would substantially reduce funded status.
- 10-year rate of return averaged 9.9%.
- 5-year rate of return averaged 3.7%.

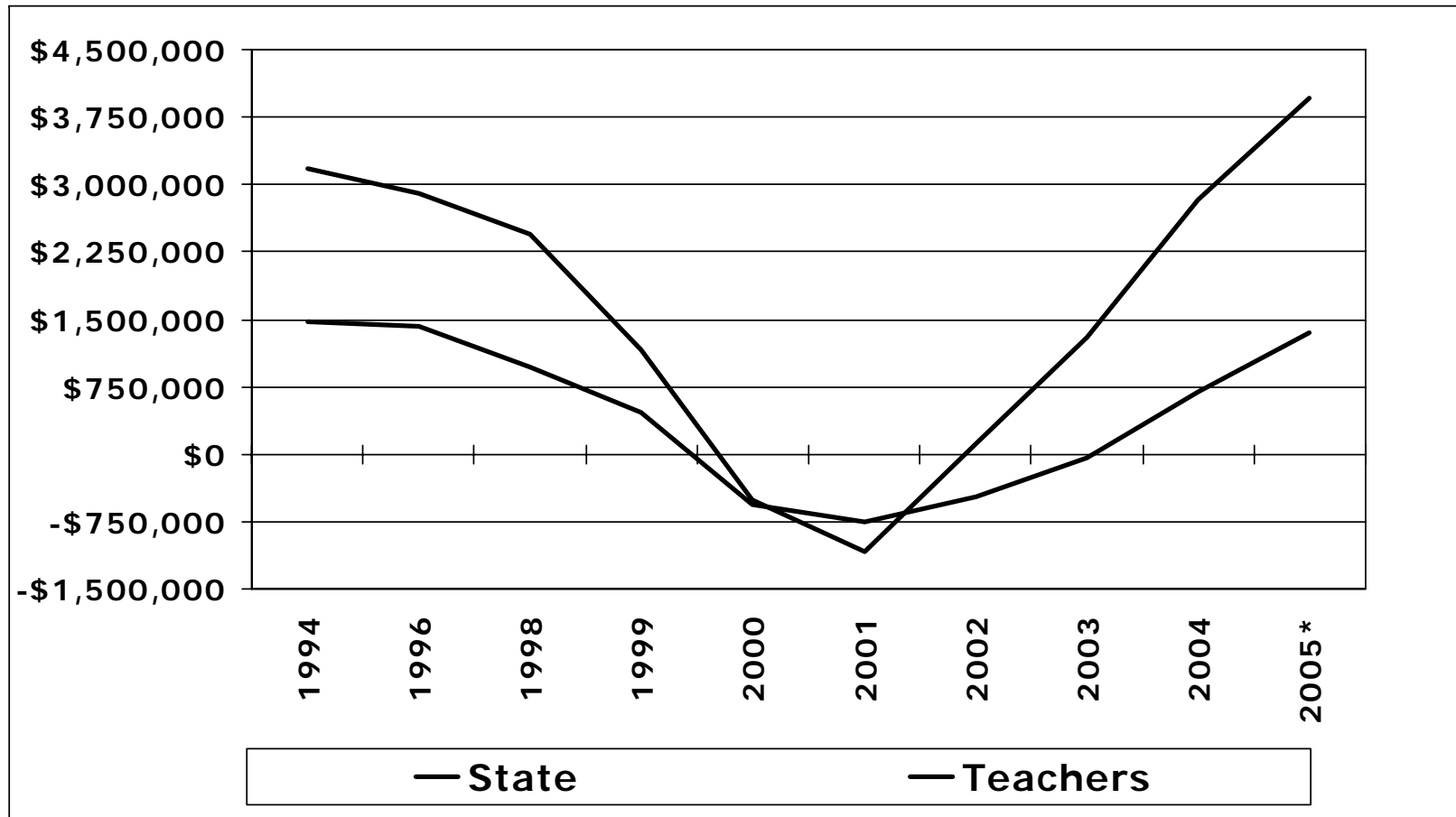
Funded Status: State Employees



Funded Status: Teachers



Unfunded Actuarial Accrued Liability (UAAL) (Dollars in thousands)



2005 Actuarial Valuation

- Actuary will perform 2005 valuation to calculate 2007-2008 contribution rates.
- Factors Affecting New Rates:
 - Weak market environment 2001-2003.
 - Investment gains/losses are smoothed and recognized over 5 years. Weak years are still affecting valuation.
 - Future investment gains are assumed to be lower (7.5% vs. 8.0% annually).
 - Demographic assumptions revised using actual experience:
 - Retirees living longer
 - Salaries rising slower
 - Future COLAs assumed to average 2.5% vs. 3.0%.
 - Board certified rates have not been fully funded in recent years.

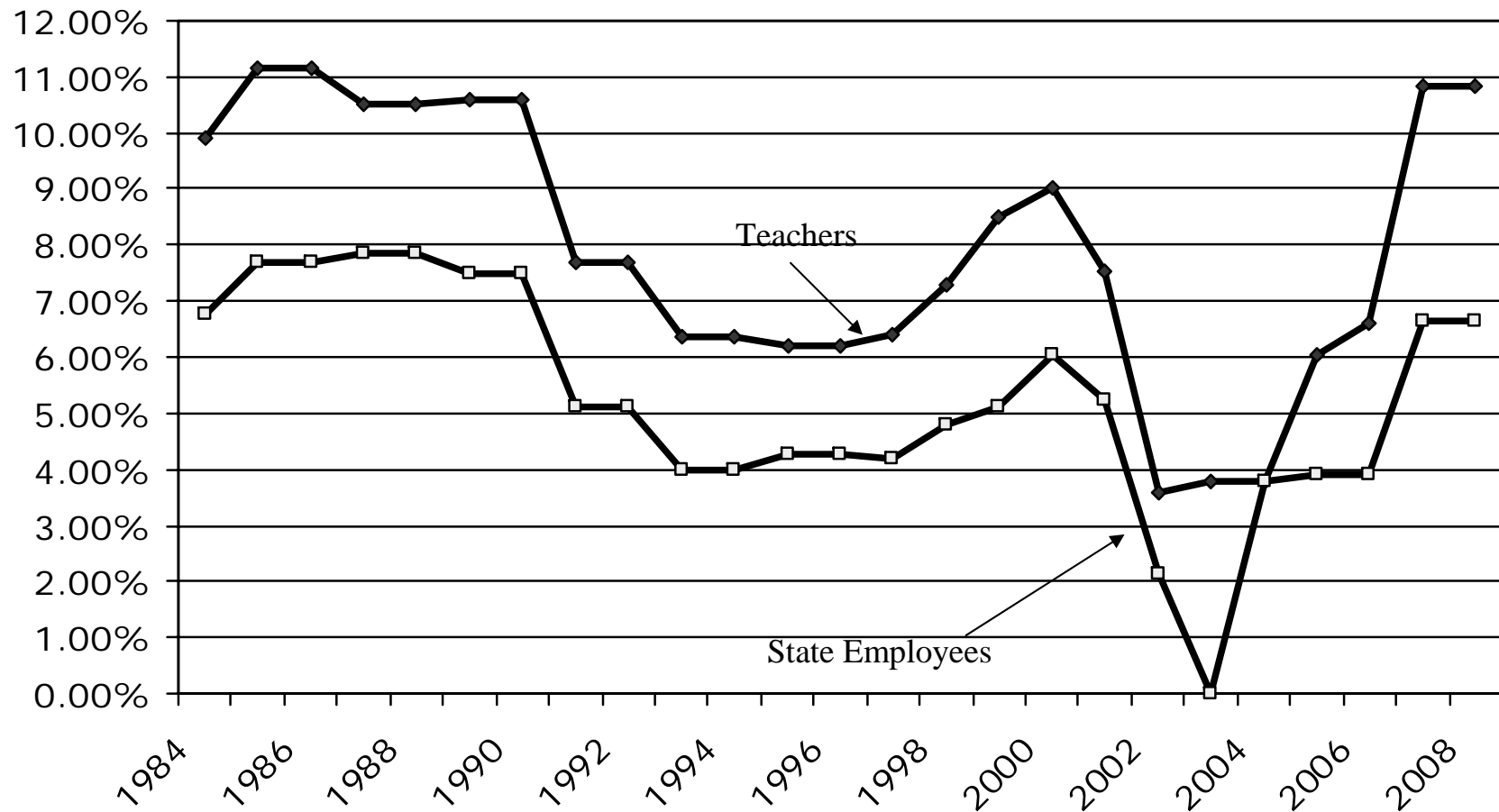
Employer Contribution Rates

	Teacher		State	
	FY '06 Current	FY '07 & '08 Estimated	FY '06 Current	FY '07 & '08 Estimated
Retirement	6.62%	10.83%	3.91% 8.91%*	6.64% 11.64%*
Health Insurance Credit	0.55%	0.59%	1.04%	1.24%
Group Life	0.00%	1.40%	0.00%	1.40%

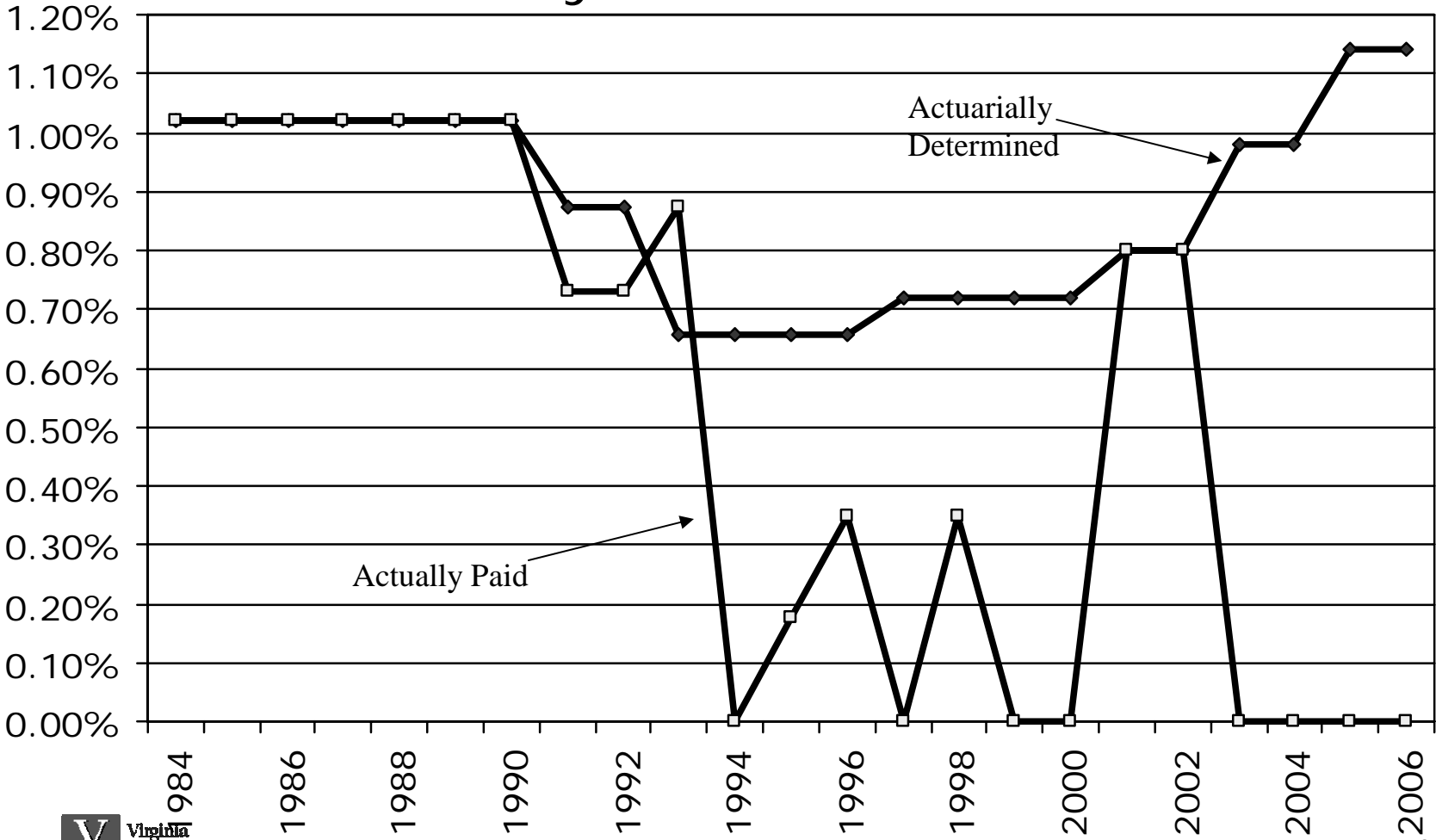
* Includes 5% employee picked-up contribution

Contribution Rates

Teacher and State Employer Contribution Rates Actually Paid, FY 1984 – FY 2008 (Est.)



Schedule of Group Life Insurance Rates Actuarially Determined vs. Paid



➤ 1998

- VSDP established (effective 1/99).

➤ 1999

- Single benefit formula of 1.7% of AFC.
- 50/30 for state and teachers, optional for local governments.
- VaLORS established.
- State and teacher health insurance credit increased.
- Employer match for State employee deferred compensation program authorized (effective 1/00).

Major Benefit Changes

➤ 2000

- Retired local officers receive State funded health insurance credit.

➤ 2001

- Purchase of Service rewritten for clarity and to promote purchases early in employees' careers when less costly to them and to the system (cost neutral).
- Partial Lump-sum Option Payment (cost neutral).

➤ 2003

- Advance Pension Option established (cost neutral).

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Thank You!



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Appendix

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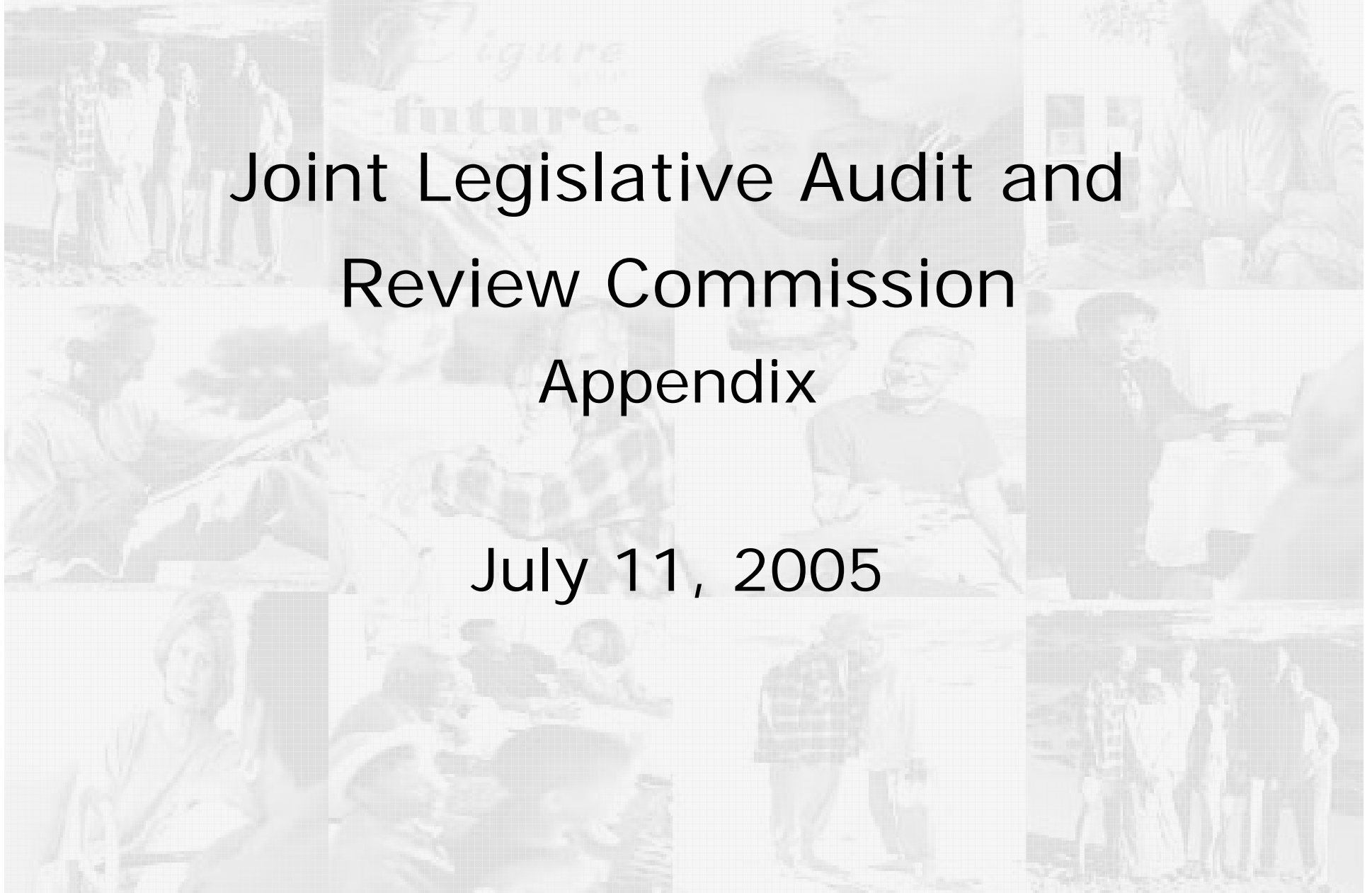


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Cost Effectiveness Measurement Benchmarking

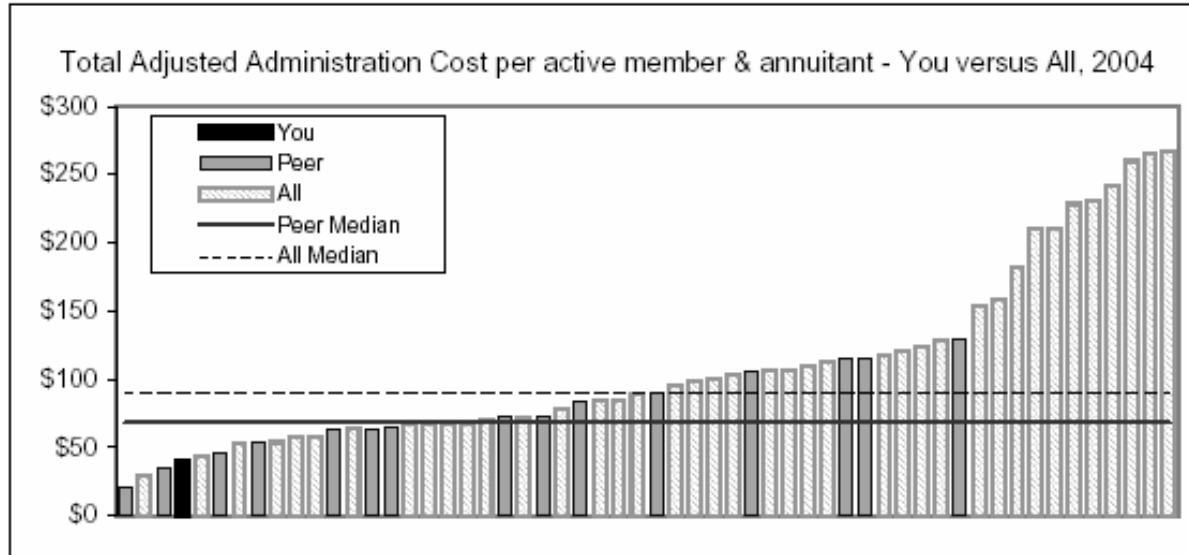
56 leading global pension systems participate in the Service.

Current Participants *		
<u>United States</u>		<u>Canada</u>
Arizona SRS	Nevada PERS	APA
CalPERS	Ohio SERS	BC Pension Corporation
CalSTRS	Orange County ERS	CAAT
Illinois MRF	San Diego County ERA	Defence Canada
Illinois TRS	Texas MRS	LAPP
Indiana PERF	TRS Louisiana	Nova Scotia
Iowa PERS		Ontario Teachers
North Carolina RS		OPTrust
NYSLRS		PWGSC
Ohio PERS		
Oregon PERS	<u>The Netherlands</u>	
Pennsylvania PSERS	ABP	
South Carolina RS	ASW	
STRS Ohio	Bpf Bouw	<u>Australia</u>
Virginia RS	BPF Metalektro	Australia Post
Washington State DRS	Detailhandel	ComSuper
Dallas ERF	KPN	GSO Victoria
ERS of Texas	Pensioenfonds Metaal en Techniek	Pillar DB
Idaho PERS	PGGM	RBF Tasmania DB
Indiana State TRF	SPF	Super SA DB
KPERS	SSPF/ SPB	UniSuper DB
LACERA		
Michigan MERS		
MOSERS		

* Not all of this year's participants are listed. We have not received data for all the clients participating this year. Also, some data is being temporarily excluded because it was not 'clean' enough to include in the comparisons.

Cost Effectiveness Measurement Benchmarking

Your 2004 Total Adjusted Administration cost was \$40 per active member & annuitant. This is below the peer median of \$68.

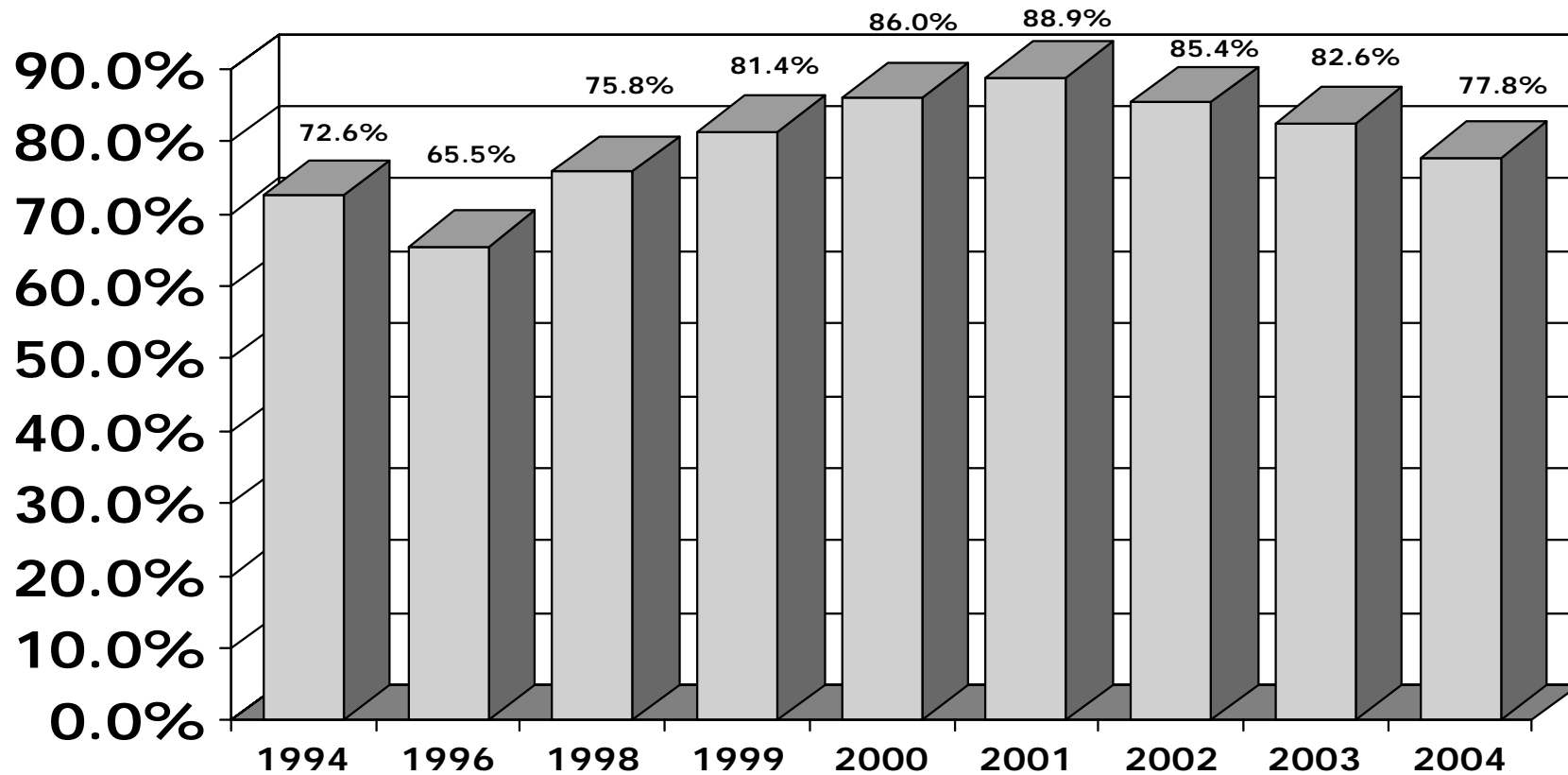


Foreign Currency Conversion: All currency amounts have been converted to USDs using Purchasing Power Parity figures as per the OECD. Appendix B shows the detailed currency conversions.

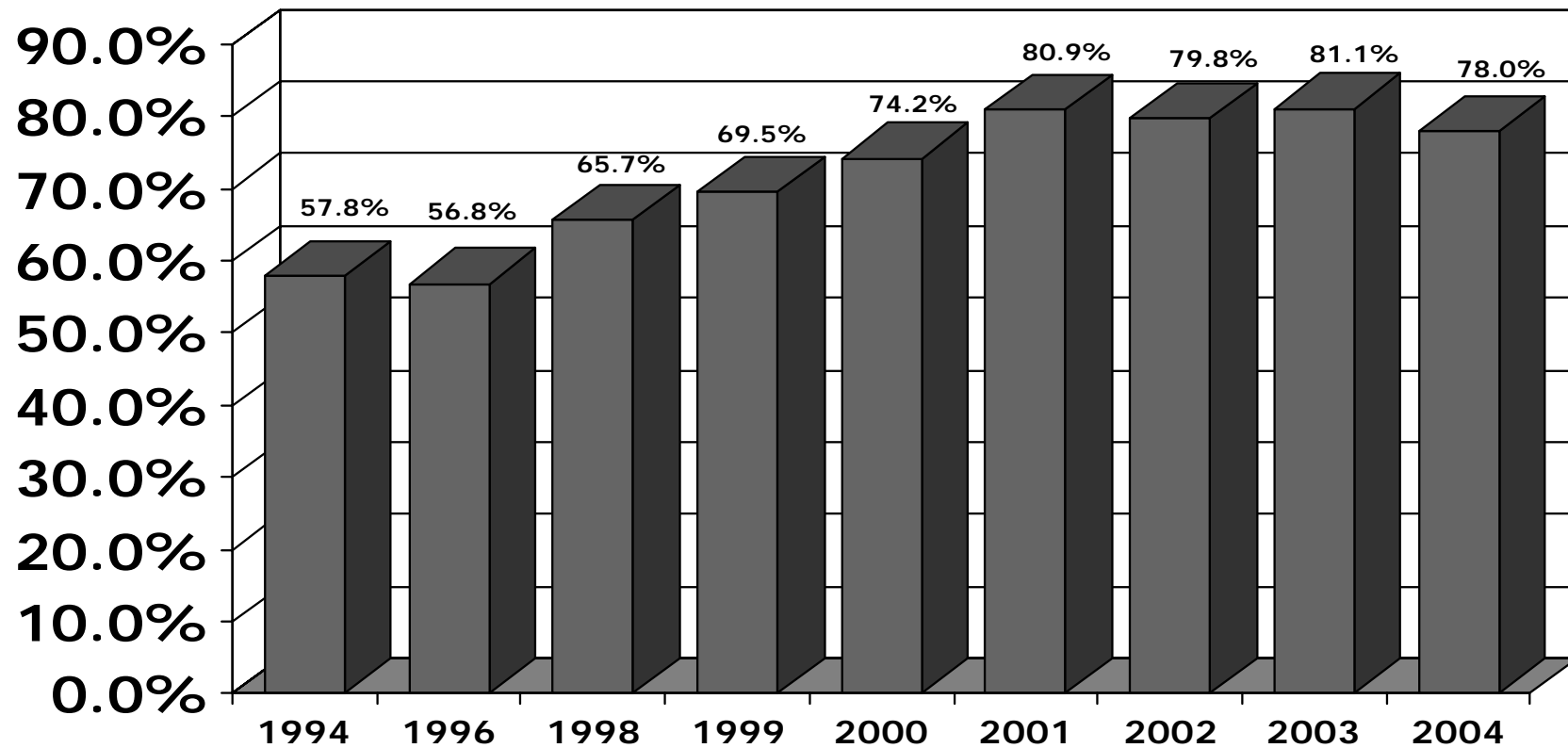
Agency Initiatives

- Telephone System
- Self Service
 - IVR
 - Web
- Allocation of Resources
 - Counseling
 - Customer Contact Center
 - Technology
 - Employer Representatives
- New Facility

Funded Status: State Police



Funded Status: Judicial



Funded Status: Virginia Law Officers

