



**Investment Policy Committee (IPC) Meeting**  
**Virtual via GoToWebinar -**  
**Wednesday, 3/24/2021**  
**1:00 - 3:00 PM ET**

**I. Welcome & Introductions**

**II. Public Comment**

**III. Approval of Prior Meeting Minutes**

• **August 13, 2019**

*IPC Meeting Minutes Aug 13 2019 DRAFT - Page 2*

• **November 20, 2019 (Brown Bag Lunch)**

*IPC BBL Minutes Nov 20 2019 DRAFT - Page 5*

• **February 13, 2020 (Brown Bag Lunch)**

*IPC BBL Minutes Feb 13 2020 DRAFT - Page 6*

• **November 17, 2020 (Brown Bag Lunch)**

*IPC BBL Minutes Nov 17 2020 DRAFT - Page 7*

**IV. Discussion and Review of Investments Beliefs Statement**

*IPC Mtg Mar 24 2021 Meeting Materials - Page 9*

*#1 Current 9-8-2015 VRS Defined Benefit Plan Investment Belief Statements - Page 33*

*#2 VRS DBP Inv Beliefs Statment Proposed Edits REDLINE - Page 37*

*#3 VRS DBP Inv Beliefs Statment Proposed Edits CLEAN - Page 43*

*#4 VRS DBP Inv Beliefs Statment Proposed Reorder REDLINE - Page 46*

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## Minutes

A joint meeting of the Investment Advisory Committee (IAC) and the Investment Policy Committee (IPC) of the Virginia Retirement System was held on August 13, 2019 with the following IPC members present:

Mitchell Nason, Chairperson  
Diana Cantor  
Brandon Bell  
Wallace Harris  
Brett Hayes  
William Leighty  
O'Kelly E. McWilliams, III  
Joseph Montgomery

The following IAC members were present:

Larry Kochard  
Deborah Allen Hewitt  
Michael Beasley  
Theodore Economou  
Thomas Gayner  
Rod Smyth

The following staff members were in attendance:

Trish Bishop, Ron Schmitz, Stephen Adelaar, John Alouf, Rory Badura, Parham Behrooz, Erica Billingslea, Jeanne Chenault, Michael Cooper, Perry Corsello, Sara Denson, Josh Fox, Bryan Gardiner, Brian Goodman, Katie Grawe, JT Grier, Dane Honrado, K.C. Howell, Ross Kasarda, Kristina Koutrakos, Matt Lacy, Chung Ma, Curt Mattson, Jennifer MacKnight, Steve McClelland, Scott Mootz, Laurie Nelson, Walker Noland, Greg Oliff, Steven Peterson, Vera Pleasants, Jennifer Schreck, Lisa Turner, Dan Whitlock.

Also in attendance was Kimberly Sarte of JLARC; Marshall Terry and Rick Fowler of Virginia Governmental Employees Association; Jennifer Schoeller of APA; Adam Rosatelli of the Senate Finance Committee; and John Meier of Verus Investments.

Mr. Nason called the meeting to order at 10:01 a.m.

### Minutes

A motion was made and seconded to approve the Investment Policy Committee minutes from the following Brown Bag Lunch meetings:

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November 14, 2018, December 13, 2018, February 14, 2019, May 13, 2019, and June 13, 2019. The motion was unanimously approved.

**CIO Report**

Mr. Schmitz then gave a brief overview of current economic and market conditions. Mr. Schmitz reviewed plan performance analysis, including asset allocation, risk bucketed asset allocation, investment performance, and tracking error. Mr. Schmitz presented the Performance Summary and the Asset Allocation Report as of June 30, 2019. Mr. Schmitz then reviewed the New Investments and Terminations Report.

**Asset Liability Study**

Dr. Peterson introduced John Meier from Verus, and the Asset Liability Study that Verus has been conducting. Mr. Meier presented details regarding the Asset Liability study, including projections given current VRS risk and return assumptions, projections given changes to current VRS risk and return assumptions and the implications of the change to these assumptions.

Updated possible long-term Defined Benefits Plan asset allocation and allowable ranges were also presented.

The IPC and IAC members then discussed the projections and the implications of the various assumptions.

The IPC agreed that the assumed rate of return could be lowered, however, determined that further discussion at the next Board meeting is warranted before a final decision.

**Recommended Program  
Benchmark Updates**

Mr. Whitlock proposed a change to the VRS Public Equity Benchmark. Details of the current VRS Public Equity Benchmark were presented to the Committees, as well as details regarding the benchmark being proposed for the VRS Public Equity Program.

Mr. McClelland outlined changes to the Credit Strategies program that will be implemented at January 1, 2020. Because of the changes outlined, a change to the benchmark for the program is being proposed.

Mr. Gardiner outlined changes that are ongoing in the Fixed Income program. Because of the changes outlined, a change to the benchmark for the program is being proposed.

Members of both Committees engaged in thorough and detailed discussion throughout all of the reviews provided.

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**Request for Board Action** Based on the results of the asset/liability study and an in-depth discussion, as well as the Investment Advisory Committee’s full support, the Investment Policy Committee recommends the approval of the following actions to the full Board:

**Request for Board Action:** *The Board approves changes to the benchmarks in the Defined Benefit Plan Investment Policy Statement for the following programs: Public Equity; Credit Strategies; and Fixed Income. These changes are effective January 1, 2020. (Upon further review by staff since the last meeting, additional changes to the benchmarks may be necessary. Staff plans to review proposed changes at the November IAC meeting, and will bring revisions to the Board of Trustees at its November 20, 2019 meeting)*

**Request for Board Action:** *The VRS Board of Trustees approves the recommended changes to update the Defined Benefit Plan Strategic Asset Allocation and Allowable Ranges to reflect the new long-term Board target asset mix. The changes are effective January 1, 2020. (Note that the dates in the RBA for the Defined Benefit Plan Asset Allocation have been updated to clarify the inception date of the previous long-term target asset mix.)*

**Adjournment** The meeting was adjourned at 2:52 p.m.

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O’Kelly McWilliams, III, Chairperson

## Minutes

The Investment Policy Committee of the Virginia Retirement System held an informal meeting ("Brown Bag Lunch Session") for the purpose of member education on November 20, 2019 at the Bank of America Building, 1111 East Main Street, Richmond, Virginia with the following members present:

Mitchell Nason  
Diana Cantor  
Wallace "Bo" Harris  
William Leighty  
O'Kelly E. McWilliams, III  
Joe Montgomery  
Troilen Seward

Also present were Trish Bishop, Ron Schmitz, Sylvia Aryeh, Rory Badura, Jeanne Chenault, Michael Cooper, Sara Denson, Barry Faison, Josh Fox, JT Grier, KC Howell, Ross Kasarda, Kristina Koutrakos, Chung Ma, Jennifer MacKnight, Curt Mattson, Jennifer Schreck, Jillian Sherman, Lisa Turner, and Cindy Wilkinson of the VRS staff.

Liz Meyers from OAG; Lauren Axelle and Jamie Bitz from JLARC; and Latasha Johnson from the Virginia Department of Planning and Budget were also present.

The informal meeting convened at 12:03 p.m.

### Meeting Contents

An informal education session, led primarily by Chung Ma, Ross Kasarda, and Kristina Koutrakos was conducted for the purpose of providing general education information on the Multi-Asset Public Strategy. A general discussion was held throughout the presentation.

### Adjournment

The meeting was adjourned at 12:55 p.m.

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O'Kelly McWilliams, III, Chairperson

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## Minutes

The Investment Policy Committee of the Virginia Retirement System held an informal meeting ("Brown Bag Lunch Session") for the purpose of member education on February 13, 2020 at the Bank of America Building, 1111 East Main Street, Richmond, Virginia with the following members present:

Mitchell Nason  
Diana Cantor  
Brandon Bell  
Wallace "Bo" Harris  
William Leighty  
O'Kelly E. McWilliams, III  
Joe Montgomery  
Troilen Seward

Also present were Trish Bishop, Ron Schmitz, Stephen Adelaar, Rory Badura, Jeanne Chenault, Michael Cooper, Sara Denson, Laurie Fennell, Josh Fox, Katie Grawe, JT Grier, KC Howell, Kristina Koutrakos, Matt Lacy, Chung Ma, Jennifer MacKnight, Curt Mattson, Steven Peterson, Dan Schlussler, Jennifer Schreck, Kristy Scott, Lisa Turner, Dan Whitlock, and Cindy Wilkinson of the VRS staff.

Liz Meyers from OAG and Jamie Bitz from JLARC were also present.

The informal meeting convened at 12:00 p.m.

### Meeting Contents

An informal education session, led primarily by Steven Peterson, Matt Lacy, Dan Schlussler, Dan Whitlock, and Stephen Adelaar was conducted for the purpose of providing general education information on Global Equity - Long / Short activities. A general discussion was held throughout the presentation.

### Adjournment

The meeting was adjourned at 1:00 p.m.

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O'Kelly McWilliams, III, Chairperson

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## Minutes

An electronic meeting, held in accordance with Item 4-0.01 of Chapter 1289 of the 2020 Acts of Assembly, of the Investment Policy Committee of the Virginia Retirement System was held on November 17, 2020 with the following members present:

O'Kelly E. McWilliams, III  
Joseph Montgomery  
Michael Disharoon  
William Garrett  
Susan Gooden  
Wallace "Bo" Harris  
Troilen Seward

Also present were Trish Bishop, Ron Schmitz, John Alouf, Rory Badura, Parham Behrooz, Jeanne Chenault, Michael Cooper, Sara Denson, Valerie Disanto, Josh Fox, JT Grier, Dane Honrado, K.C. Howell, Ross Kasarda, Kristina Koutrakos, Matt Lacy, Chung Ma, Jennifer MacKnight, Curt Mattson, Tom Mulvin, Walker Noland, Greg Oliff, Jummai Sarki-Hurd, Dan Schlussler, Jennifer Schreck, Kristy Scott, Michael Scott, Jillian Sherman, Lisa Turner, Dan Whitlock, and Cindy Wilkinson of the VRS staff.

Beth Blandford from Pageant Media, Carlton Byrd from Triple I Partners, and Zack Cziryak from Financial Investment News were also present.

Ms. Turner served as host and walked participants through the logistics of an electronic meeting. Ms. Turner turned the meeting over to Mr. McWilliams to call the meeting to order.

Mr. McWilliams called the meeting to order at 12:05 p.m. Mr. McWilliams noted that given the current circumstances related to COVID-19, the IPC was unable to meet in person. However, utilizing electronic means, the IPC could hold this meeting in accordance with Item 4-0.01 of Chapter 1289 of the 2020 Acts of Assembly as it relates to conducting business during the pandemic.

Mr. McWilliams took a roll call of each IPC member for attendance purposes:

Mr. Bell – not present  
Mr. Disharoon – present  
Mr. Garrett – present  
Dr. Gooden – present

Mr. Harris – present  
Mr. Hayes – not present  
Mr. Montgomery – present  
Ms. Seward – present  
Mr. McWilliams - present

**Meeting Contents**

An information session led by K.C. Howell was conducted for the purpose of providing general information on the VRS Investments Women and Minority Engagement Policy. The presentation included the existing policy, as well as proposed changes to the existing policy that will redefine the diverse community and clarify reporting requirements. An updated policy will be presented through a Request for Board Action to the Board of Trustees at the December 10, 2020 meeting. A general discussion regarding diversity was held throughout the presentation.

**Adjournment**

Mr. Montgomery made a motion to adjourn the meeting. Mr. Harris seconded the motion. Mr. McWilliams asked for each Committee member to vote on the motion:

Mr. Disharoon – Aye  
Mr. Garrett – Aye  
Dr. Gooden – Aye  
Mr. Harris – Aye  
Mr. Hayes – Aye  
Mr. Montgomery – Aye  
Ms. Seward – Aye  
Mr. McWilliams – Aye

The motion to adjourn the meeting passed.

The meeting was adjourned at 12:40 p.m.

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O’Kelly McWilliams, III, Chairperson



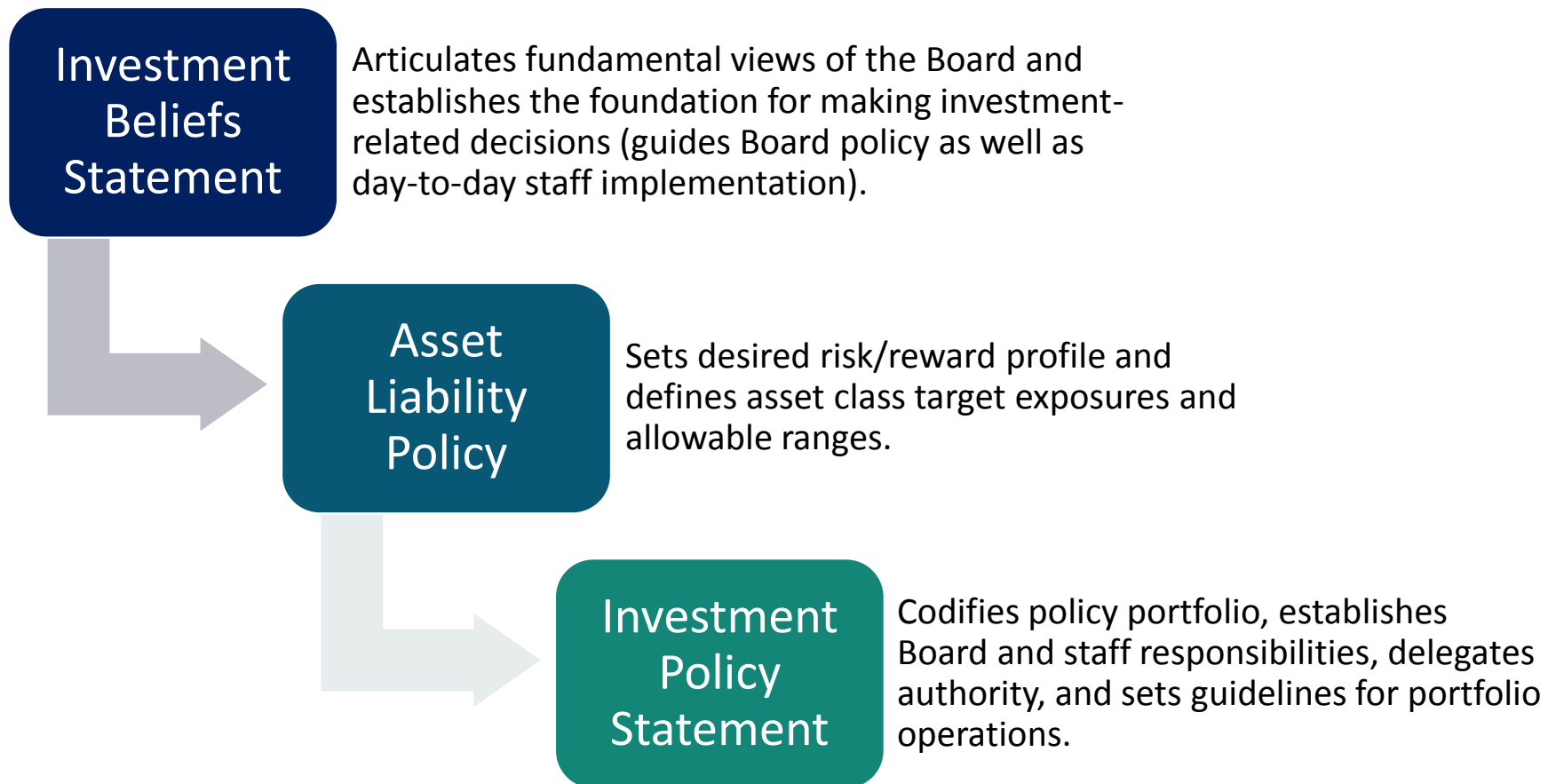
# Investment Policy Committee

## Investment Beliefs Statements Review

March 24, 2021



# Key Investment Portfolio Documents



# Why Review These Now?



## Staff Made Suggested Changes To The Investment Beliefs Statement On Two Levels:

- Initial edits based on grammar and clarity
- Secondary edits to better organize the document
- Possible Board actions today
  - Keep current Investment Beliefs 'as is'
  - Review and approve proposed document
  - Edit the edits (fine-tuning)
  - Enlist a consultant to do a full survey of Board beliefs

## I. Introduction

The VRS Board of Trustees (Board) developed Investment Beliefs to help guide the strategic management of the VRS investment portfolio. These Investment Beliefs represent a high-level framework for making decisions that require balancing multiple, and competing, factors. In addition, the Investment Beliefs provide context for VRS actions and reflect VRS values, with a focus on maintaining the long-term commitment to provide benefits to participants.

## II. VRS Investment Beliefs Statements

With the assistance of an outside expert, the Board developed the following Investment Beliefs Statements to guide the Board's decisions and provide an anchor to the Board's stated goals and objectives.

## Goals and Objectives

- 1) The primary objective of the VRS investment portfolio is to achieve the highest level of return for a given level of risk over the long term.
  
- 2) With respect to VRS' investments, the VRS Board has two key roles:
  - a. Establish the overall level of investment risk for the Fund:
    - i. Total Risk (range of outcomes that the VRS total portfolio is likely to experience). Total risk is determined largely by the Strategic Allocation Policy as set by the Board. Total risk is the larger of the two risks.
    - ii. Relative Risk (range of outcomes in relation to Strategic Allocation Policy benchmark). Once the Board establishes this range, staff is expected to add value over the investment performance policy benchmark by an amount commensurate with that amount of relative risk allowed. While material, relative risk is typically a fraction of total risk.
  
  - b. Establish and monitor investment guidelines that are then delegated to staff to implement consistent with the risks above.

- 3) As VRS conducts its investment activities, it seeks to strike a balance among three competing objectives:
- a. Achieving Long Term Funding Progress – In order to achieve long term funding goals, VRS must allocate to asset classes and strategies that take advantage of equity and illiquidity risk factors. Such allocations introduce volatility into the Fund.
  - b. Avoiding Short Term Drawdown Risk – Higher exposures to equity and liquidity risk increase the probability of large short-term mark-to-market declines in the Fund’s value. However, investment strategies to avoid shortfall risk may lead to a reduced long-term investment return, increasing the likelihood of falling short of long-term funding goals.
  - c. Avoiding Contribution Volatility – Short term mark-to-market declines in the Fund’s value can cause intermediate term increases in required contribution rates. However, investment strategies that seek to reduce volatility may lead to a reduced long-term investment return, thus requiring higher overall contribution rates and raising long term costs for employers.

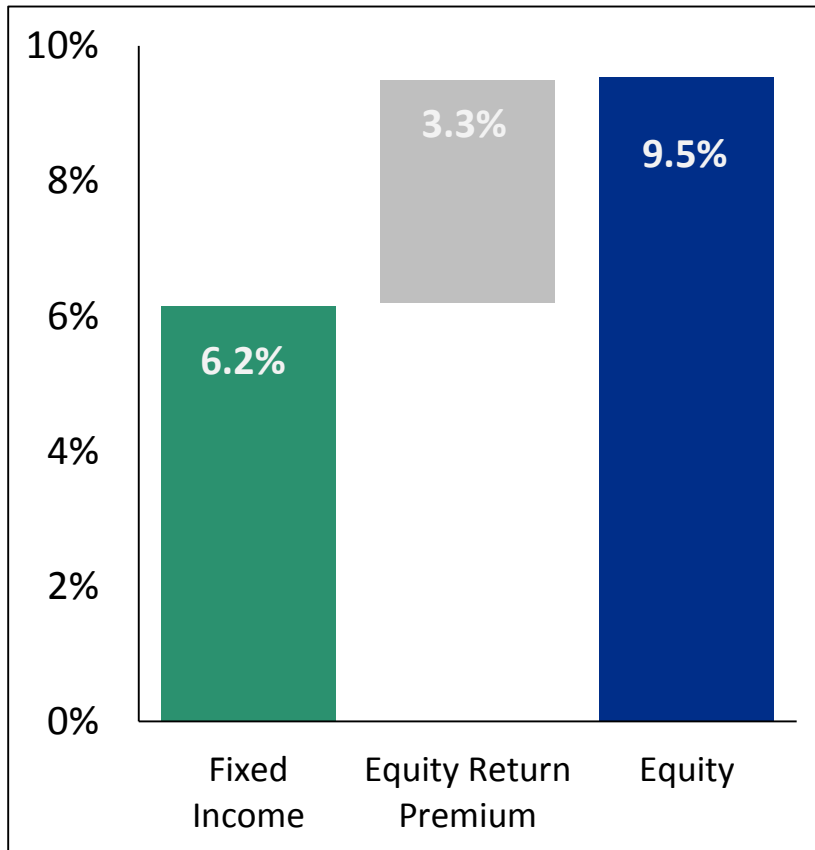
## **VRS Access and Structural Advantages**

- 4) In order to achieve the necessary long-term returns, VRS focuses on two premiums that typically reward long-term investors: the equity risk premium and the illiquidity risk premium. Both risk premiums vary over short to intermediate periods; however, over longer horizons, both risk premiums have historically produced positive returns.

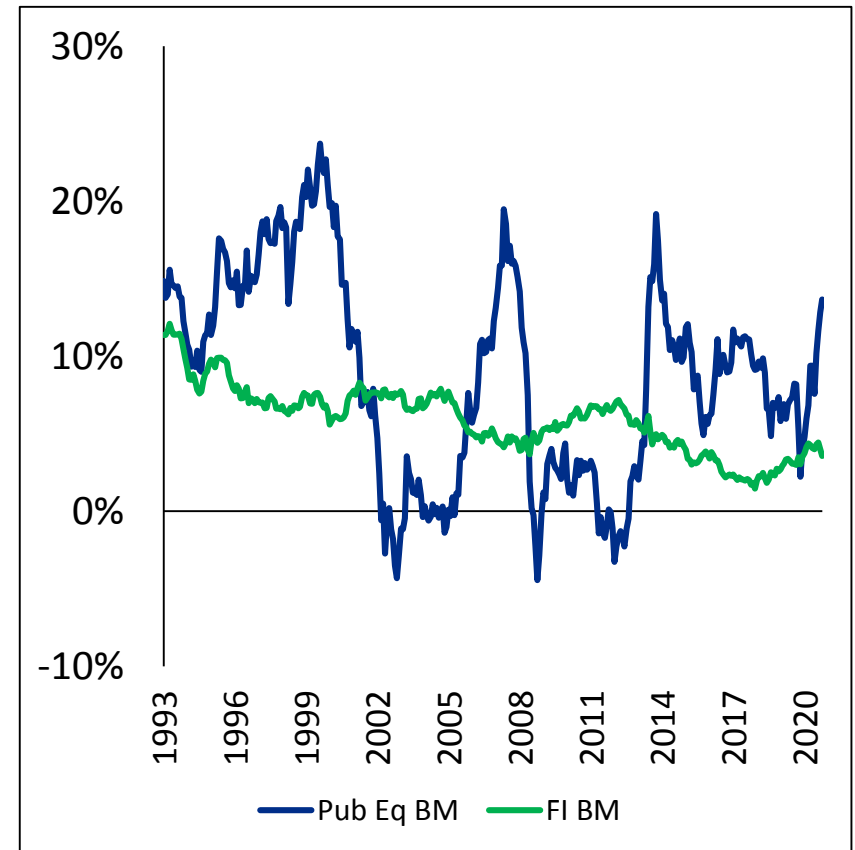


# Equity Return Premium (to Fixed Income)

## Equity Return Premium To Fixed Income June 1988 – February 2021



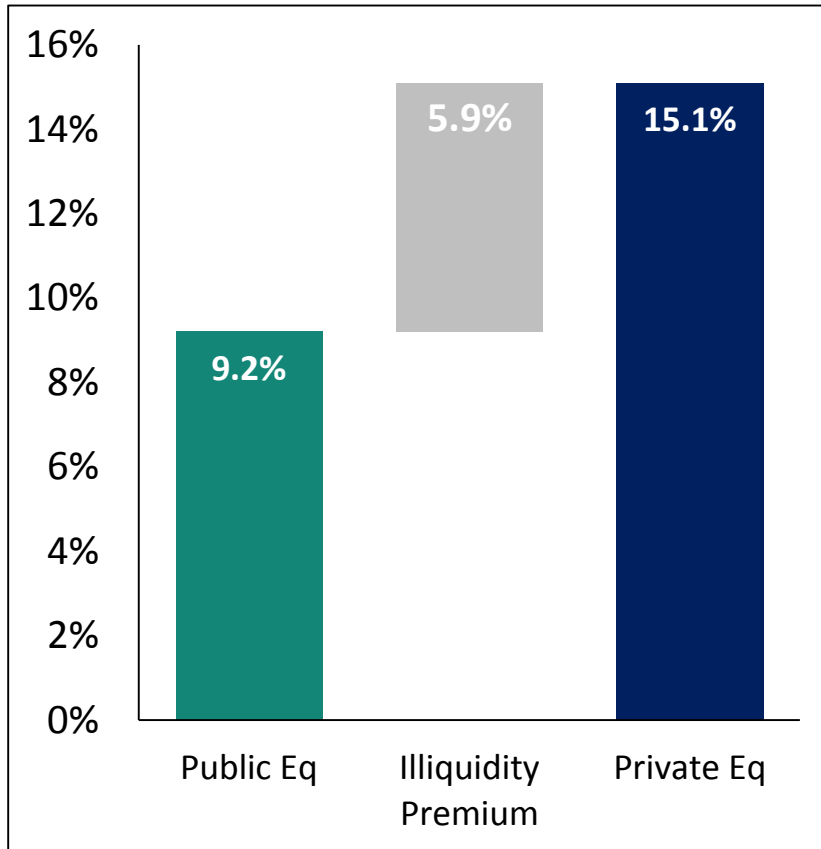
## Public Equity vs. Fixed Income 5-Year Rolling Returns



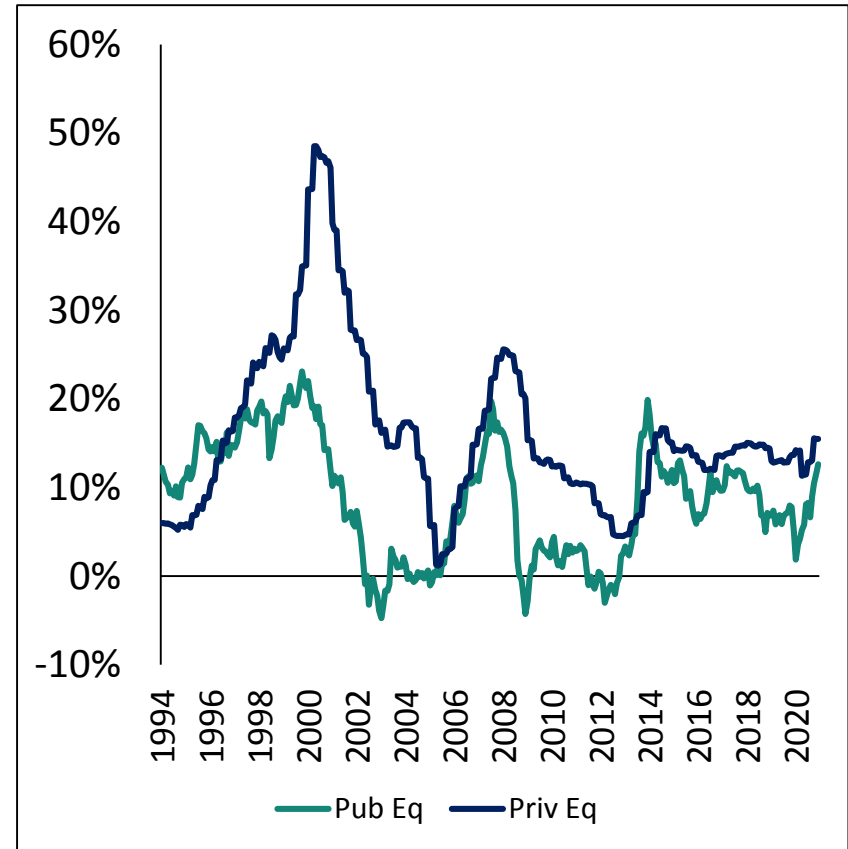
Source: BNY Mellon, using VRS program benchmark returns

# Illiquidity Premium

### Illiquidity Premium April 1989 – February 2021



### Public vs. Private Equity 5-Year Rolling Returns

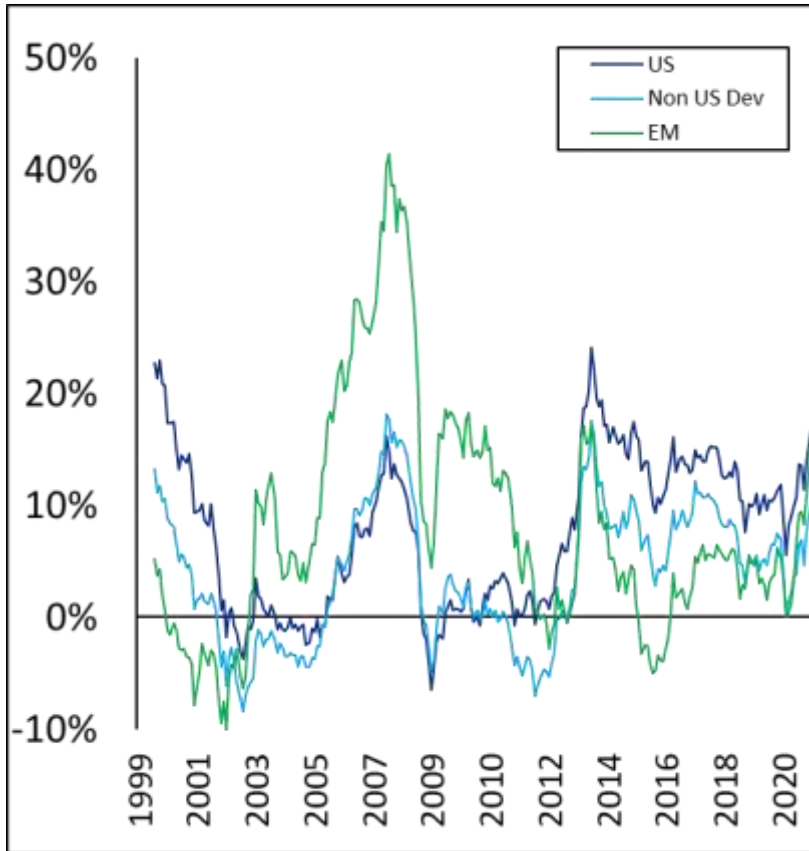


Source: BNY Mellon, using VRS program returns

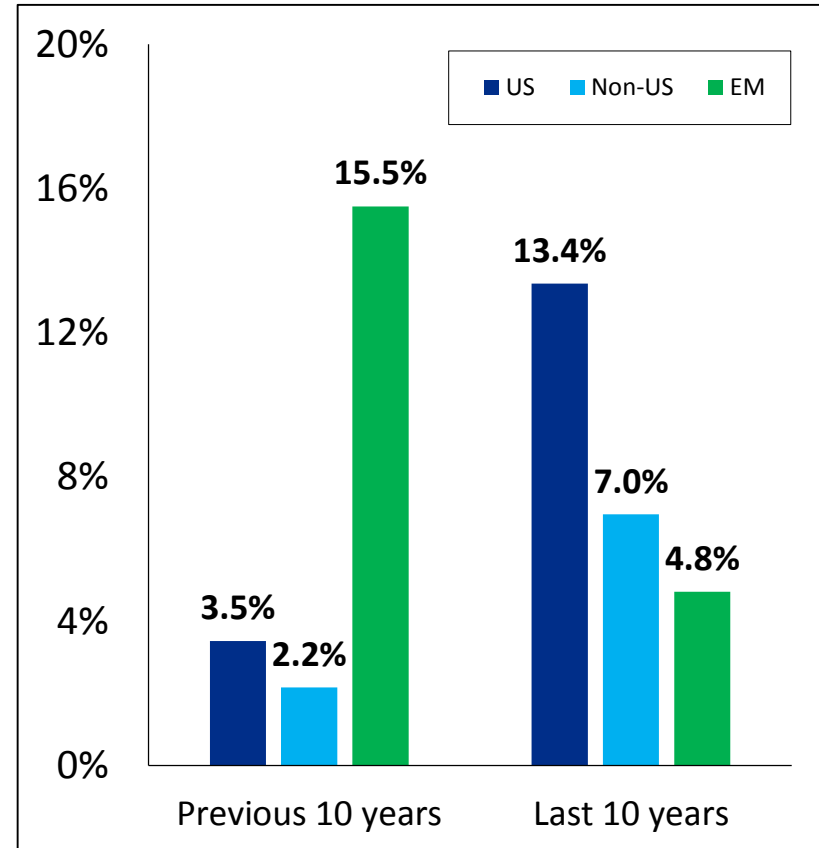
- 5) VRS has the size and capabilities to pursue global opportunities, which offer a vast array of investments across a wide spectrum of domestic and international markets.

# Regional Differences In Returns

### 5-Year Rolling Equity Performance



### Regional Equity Returns Through February 2021

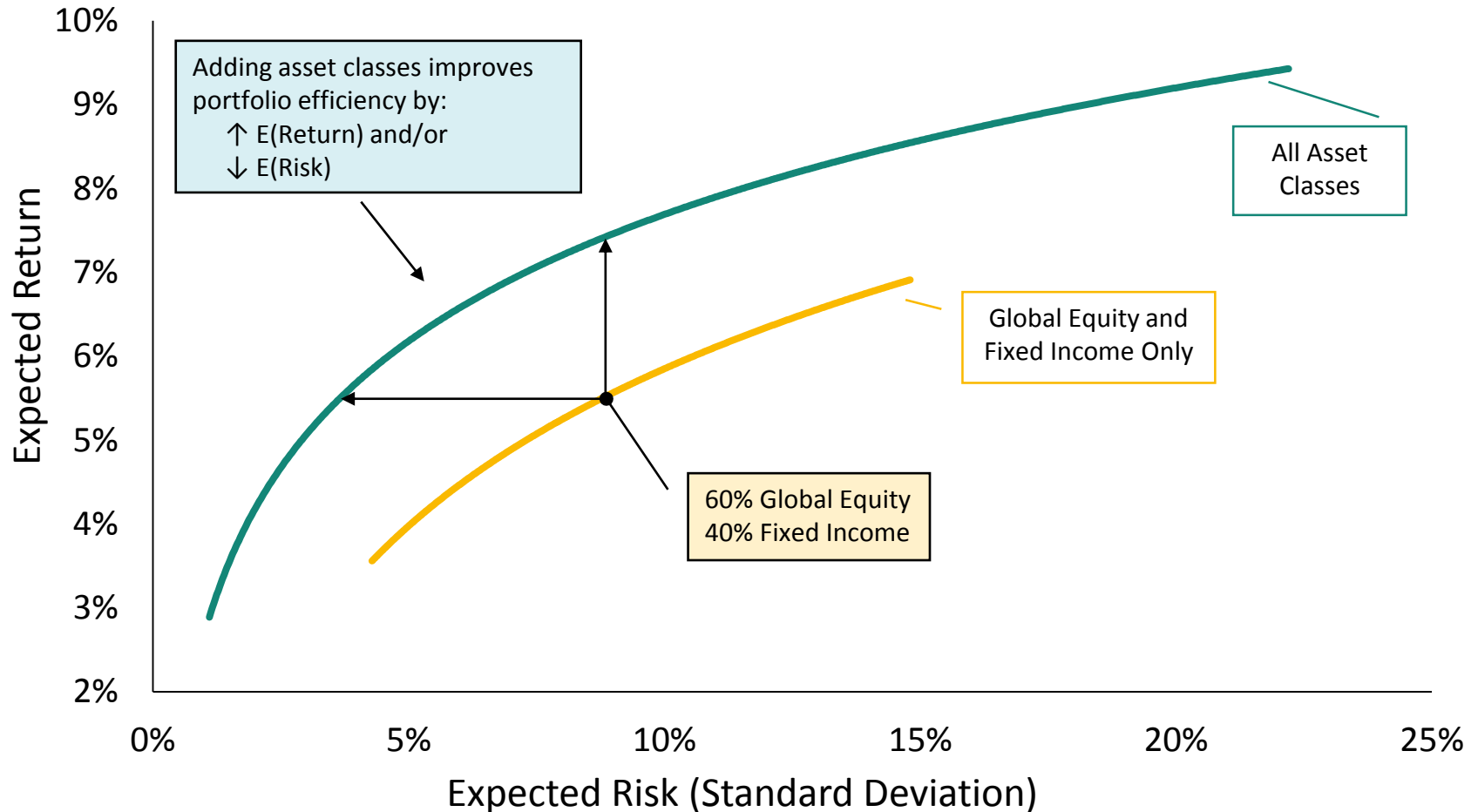


Source: BNY Mellon, using VRS program benchmarks

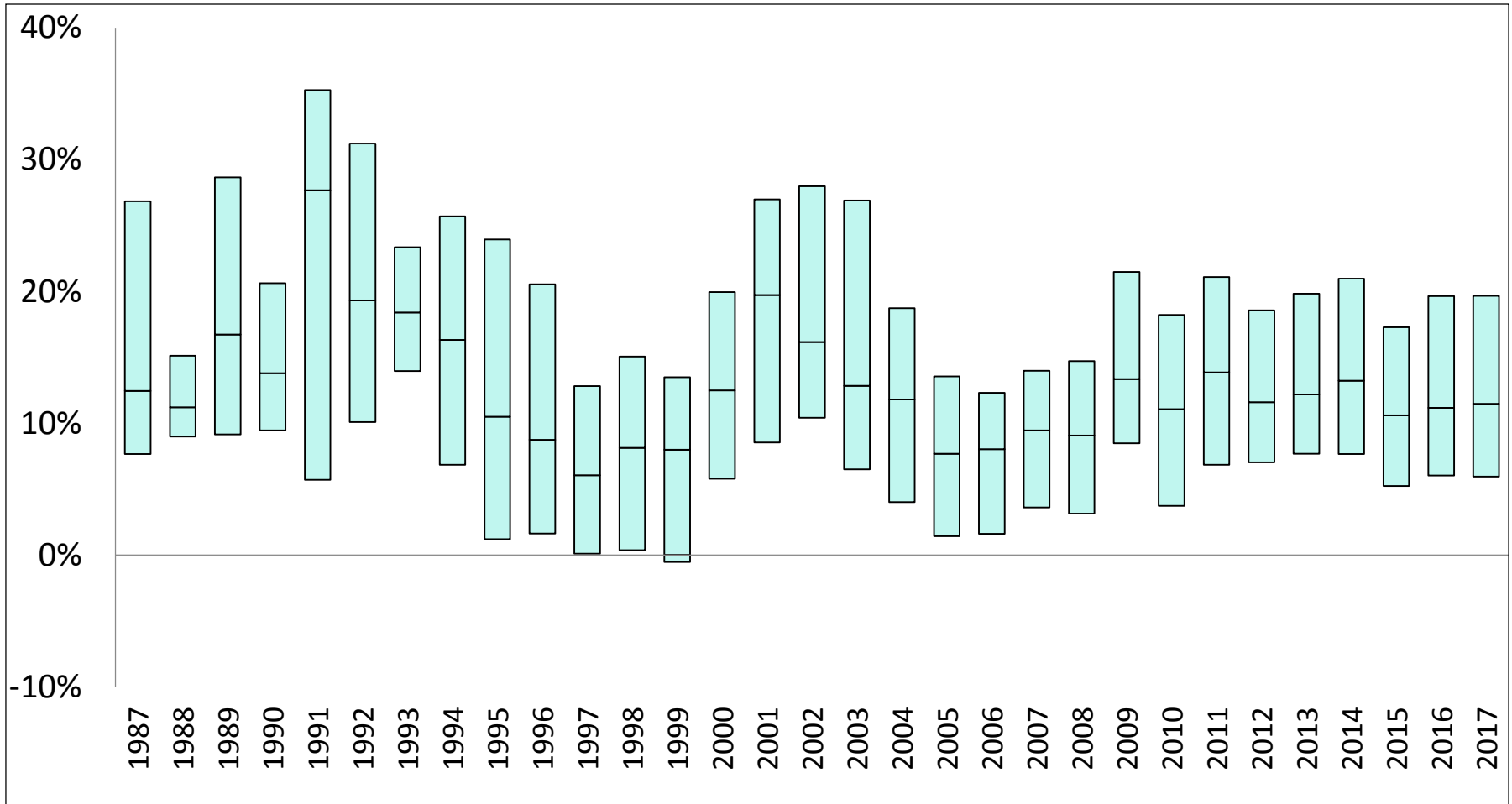
- 6) Diversification can take the form of exposure or time:
  - a) Multiple asset classes/risk premiums enhance the return-risk tradeoff of VRS' investment portfolio, particularly over short-to-intermediate horizons.
  - b) Vintage year diversification, as well as dollar-cost averaging, in and out of investments helps mitigate the impact of market volatility.

# Benefits of Diversification

## Stylized Efficient Frontiers



# Private Equity Median Returns By Vintage Year



Source: Burgiss Vintage Year Global Private Equity Return Universe, Upper = 75th percentile, Lower = 25th Percentile and Line = Median

- 7) Portfolio management is an active and dynamic process. Market inefficiencies exist in varying degrees across and within all asset classes in which VRS invests. Using both internal and external management capabilities, VRS can add value exploiting these inefficiencies.



## **Opportunities Vary By Asset Class, Geographic Region, Capitalization, etc.**

- Passive investing in the purest sense doesn't exist.
- Private market investments require significant resource commitments and are highly active because there are no index alternatives.
- In the Public Markets, investment opportunity sets must be identified and portfolios need rebalancing.
- Opportunities to enhance risk and return due to others' systematic mistakes, liquidity demands, and market frictions exist.

# Opportunities Vary By Market Segment and Time



Asset Class	Market Efficiency	Benchmarking Options	Indexing Options	Expected Tracking Error
Private Equity	Low	Limited	None	High
Real Estate	Low	Limited	None	High
Credit Strategies	Low – Med	Limited	None	High – Med
Fixed Income	Med – High	Many	Many	Med – Low
Public Equity	Med – High	Many	Many	Med – Low
Total Fund	Mixed	Reference	Limited	Med

# Best Environments for Active and Passive



<b>Conducive to Active</b>	<b>Conducive to Passive</b>
Higher Interest Rates	Lower Interest Rates
Average to Below-Average Equity Returns	Above-Average Equity Returns
Higher Volatility	Lower Volatility
Higher Dispersion, Lower Correlation	Lower Dispersion, Higher Correlation
More Passive Investors	More Active Investors

Source: AllianceBernstein

## VRS Has A Long History Of Successful Active Management In Public Equity

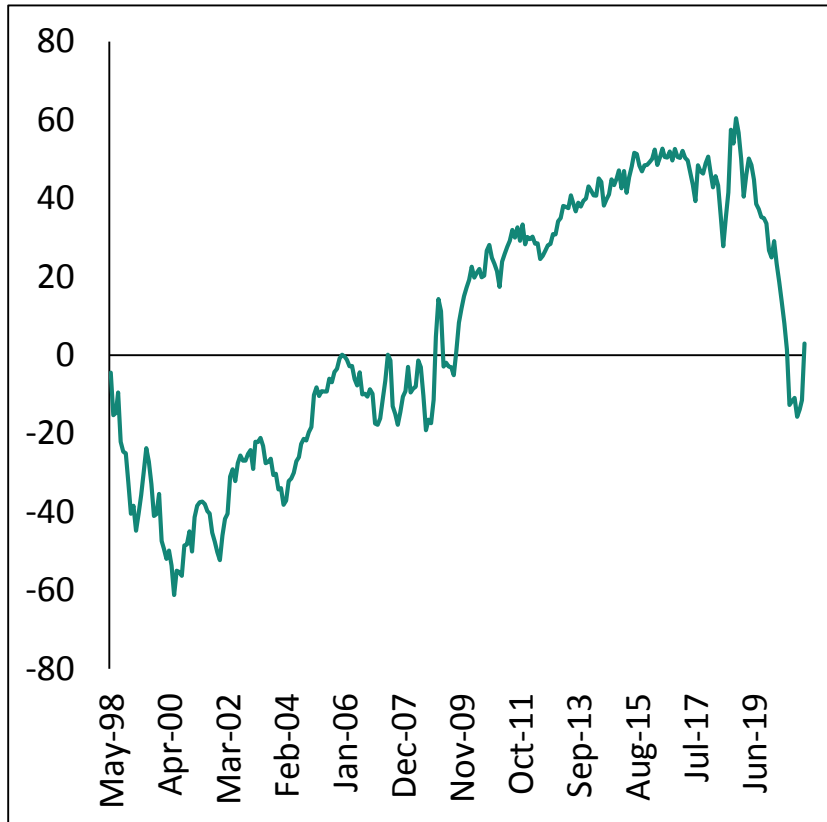
- Since January 2010, 128 of 134 performance reports (96%) have printed positive 10-year excess returns for Public Equity
- Since 2000, staff has focused on internal management, fees, risk control and somewhat defensive strategies.
- Total history going back to 1988 is less consistent, but still has a good batting average over long time periods
- The recent drawdown in 2020 and recovery was an astonishing lack of breadth and public equity printed 6 months of negative 10-year excess returns. We have had good performance subsequently and are positive again through February (and continued in March).

# Active Equity Management At VRS



**VRS Has A Long History Of Successful Active Management In Public Equity, But Success Is Somewhat Cyclical.**

**10-year Rolling Excess (basis points)**



**Batting Averages**

	From 1988-1999	Beginning 2000
Monthly	50%	56%
Quarterly	43%	58%
Fiscal Year	45%	62%
Calendar Year	45%	71%

- Relative to cumulative excess returns (left-hand graph), the recent dislocation has been unusually long and severe.
- Beginning in 2000, the overall public equity strategy became more risk-conscious (right-hand table).

## Staff Implementation Parameters

- 8) VRS has the governance structure, staffing and resources to leverage the cost savings associated with managing assets in-house. Given these attributes, staff should continue to explore further expansion of internal capabilities in areas that leverage staff's expertise in a cost-effective manner.
- 9) VRS has a long history of investment innovation and the Board encourages staff to continue to explore, access and implement creative investment approaches and strategies. Staff is expected to monitor new initiatives closely, and the Board recognizes that not all may develop into permanent strategies.
- 10) Costs (management fees, commissions, transaction costs, etc.) related to managing the VRS investment program are significant and have a material impact upon long-term performance. As an experienced, large-scale investor, VRS will seek to maximize its negotiating leverage to manage its assets in a cost-effective manner.

- 11) VRS believes it is difficult to successfully add value by making frequent, large scale shifts between major asset classes; however, smaller-scale shifts and tilts across asset class segments can add incremental value when based on sound relative value judgments.
  
- 12) Leverage is a financial tool that can be utilized in a prudent and thoughtful manner to help balance risk exposures, and in turn, enhance the risk/return profile of a portfolio.

# Investment Policy Committee

## Investment Beliefs Statement Review

March 24, 2021



## VRS Defined Benefit Plan Investment Belief Statements

Approved by the Board of Trustees: September 8, 2015

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### 1. Introduction

The VRS Board of Trustees developed a set of thirteen Investment Beliefs intended to help guide the strategic management of the VRS investment portfolio. These Investment Beliefs represent a high-level framework for making decisions that often require balancing multiple, often competing, factors and issues. In addition, the Investment Beliefs provide context for VRS actions and reflect VRS values, with a focus on VRS maintaining its long-term commitment to provide benefits to its participants.

### 2. VRS Investment Belief Statements

With the assistance of an outside expert, the Board developed the following thirteen Investment Belief Statements to guide the Board in future decisions and provide an anchor to the Board's stated goals and objectives.

- 1) The primary objective of the VRS investment portfolio is to achieve the highest level of return for a given level of risk over the long term.
- 2) In order to achieve the necessary long-term returns, the VRS relies heavily upon two premiums that have rewarded long-term investors above risk-free investments: the equity risk premium and the illiquidity risk premium.

Both risk premiums can vary over short-to-intermediate periods. Over relatively long investment horizons, both risk premiums produce positive real returns.

- 3) The VRS is a global investor, having access to a vast array of investment opportunities across a wide spectrum of domestic and international markets.

Across this broad opportunity set, several avenues exist to add value through actively managing portfolio assets rather than holding market-replicating passive exposures.

- 4) While relying on the equity and illiquidity risk premiums produces favorable long-term outcomes, diversifying into other asset classes/risk premiums can enhance the return-risk tradeoff of VRS' investment portfolio, particularly over short-to-intermediate horizons.

- a. VRS' Fixed Income class is the primary diversifier and is expected to (1) provide liquidity across all environments and (2) provide principal protection when risk assets suffer sharp price declines and/or liquidity shortages. VRS also invests in Credit, Real Estate, and other Real Assets to increase income and improve the return/risk profile of the overall portfolio.
  - b. Time diversification is also critical. Dollar-cost averaging in and out of investments helps mitigate the impact of market volatility, particularly in the private markets, which are considered high-risk.
- 5) With respect to VRS' investments, the VRS Board of Trustees has two key roles:
- a. Establishing the overall level of investment risk that VRS' assets can endure:
    - i. Total Risk (range of outcomes that the VRS total portfolio is likely to experience). Total Risk is determined largely by the Board setting the strategic allocation policy. Total Risk is the larger of the two risks.
    - ii. Relative Risk (range of outcomes in relation to VRS' strategic allocation policy benchmark). Once the Board establishes this range, staff is expected to add value over the investment performance policy benchmark by an amount commensurate with that amount of Relative Risk allowed. While material, Relative Risk is typically a fraction of Total Risk.
  - b. Establish and monitor investment guidelines that are then delegated to staff to implement consistent with the risks above.
- 6) VRS' investment staff has the capability to:
- a. Translate the strategic allocation policy into the appropriate market exposures within the portfolio.
  - b. Deliver added value commensurate with the amount of allowable relative risk.

Given these capabilities, staff should continue to explore further expansion of internal management in areas that leverage staff's expertise in a cost effective manner.

- 7) VRS' staff investment management capabilities, the Board and staff's governance structure, and VRS' global orientation allow it to explore, access, and implement innovative investment approaches and strategies.
- 8) Costs (management fees, commissions, transaction costs, etc.) of managing the VRS investment program are significant and have material impact upon long-term performance.

As an experienced, large-scale investor, VRS will seek to maximize its negotiating leverage to manage its assets in a cost-effective manner and minimize investment costs where feasible.

- 9) Active management can be a value added proposition for the VRS.
  - a. Market inefficiencies exist in varying degrees across and within all asset classes in which VRS invests.
  - b. Using both internal and external management capabilities, VRS can add value exploiting these inefficiencies.
- 10) As VRS conducts its investment activities, it seeks to strike a balance among three sometimes competing objectives:
  - a. Achieving Long Term Funding Progress – In order to achieve long term funding goals, VRS must allocate heavily to asset classes and strategies that take advantage of equity and illiquidity risk factors. Such allocations introduce significant volatility into the System.
  - b. Avoiding Short Term Drawdown Risk – Higher exposures to equity and liquidity risk increase the probability of large short term mark to market declines in the fund's value. However, investment strategies to avoid shortfall risk may lead to a reduced long-term investment return, increasing the likelihood of falling short of long-term funding goals.
  - c. Avoiding Contribution Volatility – Short term mark to market declines in the fund's value can cause intermediate term increases in required contribution rates. However, investment strategies that seek to reduce volatility may lead to a reduced long-term investment return, and thus, would require higher overall contribution rates, raising long term costs for employers.

- 11) VRS believes it is difficult to successfully add value by making frequent, large scale shifts between major asset classes. However, smaller-scale shifts and tilts

across asset class segments can add incremental value if based on sound relative value judgments. While it is impossible to perfectly predict what markets will do, there is evidence that markets, in some environments, are more conducive to generating expected returns than others. Investors may improve their risk and reward profiles by identifying these market environments and rotating assets accordingly.

- 12) Leverage is a financial tool. When leverage is used to pursue higher expected returns, expected risk also is likely to rise. However, leverage can also be utilized in a prudent and thoughtful manner to better balance risk exposures and, in turn, enhance the risk/return profile of a portfolio.
- 13) Recognizing that investment scalability is an important issue, the CIO and staff have the authority to consider and pursue smaller/capital constrained opportunities if significant value-added potential exists.

## Virginia Retirement System (VRS) Defined Benefit Plan

### Investment Beliefs Statements

-Approved by the Board of Trustees: September 8, 2015

#### I. Introduction

The VRS Board of Trustees (Board) developed ~~a set of thirteen~~ Investment Beliefs ~~to intended to~~ help guide the strategic management of the VRS investment portfolio. These Investment Beliefs represent a high-level framework for making decisions that ~~often~~ require balancing multiple, ~~and often~~ competing, factors ~~and issues~~. In addition, the Investment Beliefs provide context for VRS actions and reflect VRS values, with a focus on ~~VRS~~ maintaining its ~~the~~ long-term commitment to provide benefits to ~~its~~ participants.

#### II. VRS Investment Beliefs Statements

~~With the assistance of an outside expert, the Board developed the following~~ thirteen ~~Investment Beliefs~~ Statements to guide the Board's ~~in future~~ decisions and provide an anchor to the Board's stated goals and objectives.

~~1)~~ The primary objective of the VRS investment portfolio is to achieve the highest level of return for a given level of risk over the long term.

1)

~~2)~~

In order to achieve the necessary long-term returns, the VRS ~~relies heavily upon~~ focuses on two premiums that ~~have rewarded~~ typically reward long-term ~~investors~~ investors above ~~risk-free investments~~:- the equity risk premium and the illiquidity risk premium.

Both risk premiums ~~can~~ vary over short ~~to~~ intermediate periods; ~~however,~~ over ~~relatively~~ longer ~~investment~~ horizons, both risk premiums have historically produced positive ~~real~~ returns.

2)

3) VRS has the size and capabilities to pursue global opportunities, which offer a vast array of investments across a wide spectrum of domestic and international markets.

- 3) —
- 4) ~~The VRS is a global investor, having access to a vast array of investment opportunities across a wide spectrum of domestic and international markets.~~
- 5) —
- 6) ~~Across this broad opportunity set, several avenues exist to add value through actively managing portfolio assets rather than holding market-replicating passive exposures.~~
- 7) —
- 4) Diversification can take the form of exposure or time:
  - a. ~~While relying on the equity and illiquidity risk premiums produces favorable long-term outcomes, diversifying into Multiple other~~ asset classes/risk premiums ~~can~~ enhance the return-risk tradeoff of VRS' investment portfolio, particularly over short-to-intermediate horizons.
  - a. \_\_\_\_\_
  - b. Vintage year diversification, as well as dollar-cost averaging, in and out of investments helps mitigate the impact of market volatility.

- a. ~~VRS' Fixed Income class is the primary diversifier and is expected to (1) provide liquidity across all environments and (2) provide principal protection when risk assets suffer sharp price declines and/or liquidity shortages. VRS also invests in Credit, Real Estate, and other Real Assets to increase income and improve the return/risk profile of the overall portfolio.~~
- b. ~~Time diversification is also critical. Dollar-cost averaging in and out of investments helps mitigate the impact of market volatility, particularly in the private markets, which are considered high-risk.~~

6) With respect to VRS' investments, the VRS Board ~~of Trustees~~ has two key roles:

- a. Establishing the overall level of investment risk ~~that for VRS' assets the Fund can endure~~:
  - i. Total Risk (range of outcomes that the VRS total portfolio is likely to experience). Total ~~r~~Risk is determined largely by the ~~Board setting the~~ Strategic Allocation Policy as set by the Board. -Total ~~r~~Risk is the larger of the two risks.
  - ii. Relative Risk (range of outcomes in relation to ~~VRS'~~ Strategic Allocation Policy benchmark). Once the Board establishes this range, staff is expected to add value over the investment performance policy benchmark by an amount commensurate with that amount of ~~r~~Relative ~~r~~Risk allowed. While material, ~~r~~Relative ~~r~~Risk is typically a fraction of ~~t~~Total ~~r~~Risk.
- b. Establish and monitor investment guidelines that are then delegated to staff to implement consistent with the risks above.

7) ~~VRS has the governance structure, staffing and resources to leverage the cost savings associated with managing assets in-house. VRS' investment staff has the capability to:~~

- 8)
- 9) ~~Translate the Strategic Allocation Policy into the appropriate market exposures within the portfolio.~~
- 10)
- 11) ~~Deliver added value commensurate with the amount of allowable relative risk.~~

12) ~~6~~ Given these ~~attributes~~ capabilities, staff should continue to explore further expansion of internal capabilities management in areas that leverage staff's expertise in a cost-effective manner.

7) VRS has a long history of investment innovation and the Board encourages staff to continue to<sup>2</sup>staff investment management capabilities, the Board and staff's governance structure, and VRS' global orientation allow it to explore, access, and implement innovative creative investment approaches and strategies. Staff is expected to monitor new initiatives closely, and the Board recognizes that not all may develop into permanent strategies.

13)8) Costs (management fees, commissions, transaction costs, etc.) related to managing the VRS investment program are significant and have a material impact upon long-term performance. As an experienced, large-scale investor, VRS will seek to maximize its negotiating leverage to manage its assets in a cost-effective manner.

~~14) Costs (management fees, commissions, transaction costs, etc.) of managing the VRS investment program are significant and have material impact upon long-term performance.~~

~~15) As an experienced, large-scale investor, VRS will seek to maximize its negotiating leverage to manage its assets in a cost-effective manner and minimize investment costs where feasible.~~

~~16) Portfolio management is an active and dynamic process. Market inefficiencies exist in varying degrees across and within all asset classes in which VRS invests. Using both internal and external management capabilities, VRS can add value exploiting these inefficiencies. Active management can be a value added proposition for the VRS.~~

17)9) a. Market inefficiencies exist in varying degrees across and within all asset classes in which VRS invests.

b. Using both internal and external management capabilities, VRS can add value exploiting these inefficiencies.



18)10) As VRS conducts its investment activities, it seeks to strike a balance among three ~~sometimes~~ competing objectives:

- a. Achieving Long Term Funding Progress – In order to achieve long term funding goals, VRS must allocate ~~heavily~~ to asset classes and strategies that take advantage of equity and illiquidity risk factors. Such allocations introduce ~~significant~~ volatility into the SystemFund.
- b. Avoiding Short Term Drawdown Risk – Higher exposures to equity and liquidity risk increase the probability of large short-term mark-to-market declines in the ~~fund's~~ Fund's value. However, investment strategies to avoid shortfall risk may lead to a reduced long-term investment return, increasing the likelihood of falling short of long-term funding goals.
- c. Avoiding Contribution Volatility – Short term mark-to-market declines in the Fund's value can cause intermediate term increases in required contribution rates. However, investment strategies that seek to reduce volatility may lead to a reduced long-term investment return, ~~and thus,~~ ~~would~~ require higher overall contribution rates and, raising long term costs for employers.

19)11) VRS believes it is difficult to successfully add value by making frequent, large scale shifts between major asset classes; ~~h-~~ However, smaller-scale shifts and tilts across asset class segments can add incremental value when based on sound relative value judgments.

~~across asset class segments can add incremental value if based on sound relative value judgments. While it is impossible to perfectly predict what markets will do, there is evidence that markets, in some environments, are more conducive to generating expected returns than others. Investors may improve their risk and reward profiles by identifying these market environments and rotating assets accordingly.~~

~~20)12) Leverage is a financial tool that can be. ~~When leverage is used to pursue higher expected returns, expected risk also is likely to rise. However, leverage can also be~~ utilized in a prudent and thoughtful manner to help better balance risk exposures, and, in turn, enhance the risk/return profile of a portfolio.~~

~~Recognizing that investment scalability is an important issue, the CIO and staff have the authority to consider and pursue smaller/capital-constrained opportunities if significant value-added potential exists.~~

**Virginia Retirement System (VRS) Defined Benefit Plan****Investment Beliefs Statements****Approved by the Board of Trustees: September 8, 2015**

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**I. Introduction**

The VRS Board of Trustees (Board) developed Investment Beliefs to help guide the strategic management of the VRS investment portfolio. These Investment Beliefs represent a high-level framework for making decisions that require balancing multiple, and competing, factors. In addition, the Investment Beliefs provide context for VRS actions and reflect VRS values, with a focus on maintaining the long-term commitment to provide benefits to participants.

**II. VRS Investment Beliefs Statements**

With the assistance of an outside expert, the Board developed the following Investment Beliefs Statements to guide the Board's decisions and provide an anchor to the Board's stated goals and objectives.

- 1) The primary objective of the VRS investment portfolio is to achieve the highest level of return for a given level of risk over the long term.
- 2) In order to achieve the necessary long-term returns, VRS focuses on two premiums that typically reward long-term investors: the equity risk premium and the illiquidity risk premium. Both risk premiums vary over short to intermediate periods; however, over longer horizons, both risk premiums have historically produced positive returns.
- 3) VRS has the size and capabilities to pursue global opportunities, which offer a vast array of investments across a wide spectrum of domestic and international markets.
- 4) Diversification can take the form of exposure or time:
  - a. Multiple asset classes/risk premiums enhance the return-risk tradeoff of VRS' investment portfolio, particularly over short-to-intermediate horizons.
  - b. Vintage year diversification, as well as dollar-cost averaging, in and out of investments helps mitigate the impact of market volatility.

- 5) With respect to VRS' investments, the VRS Board has two key roles:
  - a. Establish the overall level of investment risk for the Fund:
    - i. Total Risk (range of outcomes that the VRS total portfolio is likely to experience). Total risk is determined largely by the Strategic Allocation Policy as set by the Board. Total risk is the larger of the two risks.
    - ii. Relative Risk (range of outcomes in relation to Strategic Allocation Policy benchmark). Once the Board establishes this range, staff is expected to add value over the investment performance policy benchmark by an amount commensurate with that amount of relative risk allowed. While material, relative risk is typically a fraction of total risk.
  - b. Establish and monitor investment guidelines that are then delegated to staff to implement consistent with the risks above.
- 6) VRS has the governance structure, staffing and resources to leverage the cost savings associated with managing assets in-house. Given these attributes, staff should continue to explore further expansion of internal capabilities in areas that leverage staff's expertise in a cost-effective manner.
- 7) VRS has a long history of investment innovation and the Board encourages staff to continue to explore, access and implement creative investment approaches and strategies. Staff is expected to monitor new initiatives closely, and the Board recognizes that not all may develop into permanent strategies.
- 8) Costs (management fees, commissions, transaction costs, etc.) related to managing the VRS investment program are significant and have a material impact upon long-term performance. As an experienced, large-scale investor, VRS will seek to maximize its negotiating leverage to manage its assets in a cost-effective manner.
- 9) Portfolio management is an active and dynamic process. Market inefficiencies exist in varying degrees across and within all asset classes in which VRS invests. Using both internal and external management capabilities, VRS can add value exploiting these inefficiencies.

- 10) As VRS conducts its investment activities, it seeks to strike a balance among three competing objectives:
- a. Achieving Long Term Funding Progress – In order to achieve long term funding goals, VRS must allocate to asset classes and strategies that take advantage of equity and illiquidity risk factors. Such allocations introduce volatility into the Fund.
  - b. Avoiding Short Term Drawdown Risk – Higher exposures to equity and liquidity risk increase the probability of large short-term mark-to-market declines in the Fund’s value. However, investment strategies to avoid shortfall risk may lead to a reduced long-term investment return, increasing the likelihood of falling short of long-term funding goals.
  - c. Avoiding Contribution Volatility – Short term mark-to-market declines in the Fund’s value can cause intermediate term increases in required contribution rates. However, investment strategies that seek to reduce volatility may lead to a reduced long-term investment return, thus requiring higher overall contribution rates and raising long term costs for employers.
- 11) VRS believes it is difficult to successfully add value by making frequent, large scale shifts between major asset classes; however, smaller-scale shifts and tilts across asset class segments can add incremental value when based on sound relative value judgments.
- 12) Leverage is a financial tool that can be utilized in a prudent and thoughtful manner to help balance risk exposures, and in turn, enhance the risk/return profile of a portfolio.

## Virginia Retirement System (VRS) Defined Benefit Plan Investment Beliefs Statements

Approved by the Board of Trustees: September 8, 2015

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### I. Introduction

The VRS Board of Trustees (Board) developed a set of Investment Beliefs intended to help guide the strategic management of the VRS investment portfolio. These Investment Beliefs represent a high-level framework for making decisions that require balancing multiple, and competing, factors. In addition, the Investment Beliefs provide context for VRS actions and reflect VRS values, with a focus on maintaining the long-term commitment to provide benefits to participants.

### II. VRS Investment Beliefs Statements

With the assistance of an outside expert, the Board developed the following Investment Beliefs Statements to guide the Board's decisions and provide an anchor to the Board's stated goals and objectives.

#### Goals and Objectives

- 1) The primary objective of the VRS investment portfolio is to achieve the highest level of return for a given level of risk over the long term.
- 2) With respect to VRS' investments, the VRS Board has two key roles:
  - a. Establish the overall level of investment risk for the Fund:
    - i. Total Risk (range of outcomes that the VRS total portfolio is likely to experience). Total risk is determined largely by the Strategic Allocation Policy as set by the Board. Total risk is the larger of the two risks.
    - ii. Relative Risk (range of outcomes in relation to Strategic Allocation Policy benchmark). Once the Board establishes this range, staff is expected to add value over the investment performance policy benchmark by an amount commensurate with that amount of relative risk allowed. While material, relative risk is typically a fraction of total risk.

a. Establish and monitor investment guidelines that are then delegated to staff to implement consistent with the risks above.

b.

3) As VRS conducts its investment activities, it seeks to strike a balance among three competing objectives:

a. Achieving Long Term Funding Progress – In order to achieve long term funding goals, VRS must allocate to asset classes and strategies that take advantage of equity and illiquidity risk factors. Such allocations introduce volatility into the Fund.

b. Avoiding Short Term Drawdown Risk – Higher exposures to equity and liquidity risk increase the probability of large short-term mark-to-market declines in the Fund’s value. However, investment strategies to avoid shortfall risk may lead to a reduced long-term investment return, increasing the likelihood of falling short of long-term funding goals.

c. Avoiding Contribution Volatility – Short term mark-to-market declines in the Fund’s value can cause intermediate term increases in required contribution rates. However, investment strategies that seek to reduce volatility may lead to a reduced long-term investment return, thus requiring higher overall contribution rates and raising long term costs for employers.

### **VRS Access and Structural Advantages**

~~2)~~

3)4) In order to achieve the necessary long-term returns, VRS focuses on two premiums that typically reward long-term investors: the equity risk premium and the illiquidity risk premium. Both risk premiums vary over short-to-intermediate periods; however, over longer horizons, both risk premiums have historically produced positive returns.

4)5) VRS has the size and capabilities to pursue global opportunities, which offer a vast array of investments across a wide spectrum of domestic and international markets.

5)6) Diversification can take the form of exposure or time:

a. ~~M~~ultiple asset classes/risk premiums enhance the return-risk tradeoff of VRS' investment portfolio, particularly over short-to-intermediate horizons.

b. ~~V~~intage year diversification, as well as dollar-cost averaging, in and out of investments helps mitigate the impact of market volatility.

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~~Avoiding Contribution Volatility — Short term mark to market declines in the fund's value can cause intermediate term increases in required contribution rates. However, investment strategies that seek to reduce volatility may lead to a reduced long term investment return, thus requiring higher overall contribution rates and raising long term costs for employers.~~



7) Portfolio management is an active and dynamic process. Market inefficiencies exist in varying degrees across and within all asset classes in which VRS invests. Using both internal and external management capabilities, VRS can add value exploiting these inefficiencies.-

### Staff Implementation Parameters

~~7) With respect to VRS' investments, the VRS Board has two key roles:~~

~~8)-~~

~~9) Establish the overall level of investment risk for the Fund:~~

~~10)-~~

~~11) Total Risk (range of outcomes that the VRS total portfolio is likely to experience). Total Risk is determined largely by the Strategic Allocation Policy as set by the Board. Total Risk is the larger of the two risks.~~

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~~13) Relative Risk (range of outcomes in relation to Strategic Allocation Policy benchmark). Once the Board establishes this range, staff is expected to add value over the investment performance policy benchmark by an amount commensurate with that amount of Relative Risk allowed. While material, Relative Risk is typically a fraction of Total Risk.~~

~~14)-~~

~~15) Establish and monitor investment guidelines that are then delegated to staff to implement consistent with the risks above.~~

~~16)8) VRS has the governance structure, staffing, and resources to leverage the cost savings associated with managing assets in-house. Given these attributes, staff should continue to explore further expansion of internal capabilities in areas that leverage staff's expertise in a cost-effective manner.~~

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5)11) VRS believes it is difficult to successfully add value by making frequent, large scale shifts between major asset classes; however, smaller-scale shifts and tilts across asset class segments can add incremental value when based on sound relative value judgments.

~~As VRS conducts its investment activities, it seeks to strike a balance among three competing objectives:~~

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**Virginia Retirement System (VRS) Defined Benefit Plan**  
**Investment Beliefs Statements**  
Approved by the Board of Trustees: September 8, 2015

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