VRS Defined Benefit Plan Investment Belief Statements

APPROVED BY THE BOARD OF TRUSTEES: SEPTEMBER 8, 2015
UPDATED: NOVEMBER 16, 2023

I. Introduction

VRS strives to be consistent with the fiduciary obligations outlined in the *Code of Virginia,* which require the Virginia Retirement System Board of Trustees (Board) to invest the assets of the VRS Trust Fund with care, skill, prudence and diligence, while diversifying investments to minimize the risk of large losses. The Board, therefore, developed these Investment Beliefs to 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 Belief Statements

The Board developed the following Investment Belief Statements to guide its decisions and provide an anchor to the 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.

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.

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.

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

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. Portfolio 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. Plan leverage can also help balance risk exposures and appear in multiple forms, including asset allocation leverage and rebalancing leverage.

13. VRS' Investment Staff develops, strengthens and retains its intellectual capital, so that it can remain successful through industry leadership and innovation. This is primarily advanced by collaboration among asset class and functional area teams. Secondly, external relationships with like-minded global partners are identified and cultivated to broaden investment reach. With both internal and external personnel, success is based on cooperation, trust and transparency.