

**VIRGINIA RETIREMENT SYSTEM  
DEFINED CONTRIBUTION PLANS**

**INVESTMENT POLICY STATEMENT**

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# **VIRGINIA RETIREMENT SYSTEM DEFINED CONTRIBUTION PLANS**

## **INVESTMENT POLICY STATEMENT**

### ***INTRODUCTION***

The Virginia Retirement System (VRS) has been established for the purpose of providing retirement benefits to teachers, state employees, and employees of participating political subdivisions. VRS administers several Defined Contribution Plans in addition to the VRS Defined Benefit Plan. This Investment Policy Statement has been adopted by the VRS Board of Trustees (Board) to provide guidelines for the investment management of funds held in trust for the participants and beneficiaries of the Deferred Compensation Plan of the Commonwealth of Virginia, the Virginia Cash Match Plan, the Optional Retirement Plan of the Commonwealth of Virginia for Political Appointees, the Optional Retirement Plan of the Commonwealth of Virginia for Public School Superintendents, and the Virginia Supplemental Retirement Plan. The purposes of the Plans are set forth in the Plan Documents and Master Trusts.

The Board is appointed as the Trustee of the Defined Contribution Plans and appoints the Investment Advisory Committee (IAC) to assist in fulfilling its fiduciary duty. The funds of the Defined Contribution Plans shall be deemed separate and independent trust funds, shall be segregated from all other funds of the Commonwealth, and shall be invested and administered solely in the interests of the participants and beneficiaries thereof.

### ***RESPONSIBILITIES AND AUTHORITY***

The attached matrix (Exhibit 1) outlines the responsibilities of the Board of Trustees and sets forth areas under which the Investment Advisory Committee and Investment Department staff have the authority to act as it relates to the investment management of Defined Contribution Plans trust assets. In general, the Board of Trustees, as the fiduciaries of the Plans, sets out guidelines under which these responsibilities will be carried out. The Investment Advisory Committee reviews the actions and recommendations of the Chief Investment Officer relating to the Plans' investments and reports the results of their review and any resulting recommendations to the Board. In all cases, the Board will not act on the recommendation of the Chief Investment Officer without considering the recommendation of the Investment Advisory Committee.

The responsibilities of the investment managers are set forth in their respective Investment Advisory Agreements.

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### ***INVESTMENT OBJECTIVE***

The Board and IAC recognize that participants in the Defined Contribution Plans are responsible for their own investment decisions relative to the Plans and that each participant has his or her own risk tolerance, time horizon, and investment objectives in anticipation of achieving retirement income goals.

The objectives in determining the Plans' core investment options are:

- Provide participants with an array of investment choices across a range of risk levels, asset classes, and investment strategies to allow participants to construct portfolios tailored to meet their particular retirement income goals;
- Provide investments that offer competitive risk adjusted returns; and
- Provide investments at a reasonable cost.

Furthermore, the Board and IAC recognize that participants who are knowledgeable investors may desire additional investment alternatives other than those offered as part of the core options. Therefore, to meet this need the Board shall make available a self-directed brokerage account ("SDB") to those participants who have identified themselves as knowledgeable investors and are willing to accept all risks and costs related to participating in the SDB. The Board, IAC, and VRS staff shall not have any fiduciary oversight duties relating to the particular investment options available through the SDB.

### ***CORE INVESTMENT OPTIONS***

To the extent possible, the core investment options shall represent the major asset classes. From time to time additional investment categories may be added or existing investment categories may be deleted in order to maintain an array of investment options that address participants' changing needs or changes in the investment industry. Whenever practical, investment options may exhibit a growth, value or blended style orientation. The Board shall maintain core investment options that incorporate passively and actively managed funds.

Core options shall be comprised of options from the following categories:

1. Cash or Cash Equivalents
2. Stable Value
3. Asset Allocation

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4. Core Bonds
5. Inflation-Protected Bonds
6. High-Yield Bonds
7. Domestic Large Capitalization Stocks
8. Domestic Large Capitalization Value Stocks
9. Domestic Large Capitalization Growth Stocks
10. Domestic Small/Mid Capitalization Stocks
11. Real Estate Investment Trusts
12. International Stocks
13. Global Stocks

### ***CORE INVESTMENT PERFORMANCE OBJECTIVES***

Performance objectives for specific investment options will be tied to appropriate benchmarks for each investment option as determined by the Chief Investment Officer subject to review by the IAC.

Passively managed investment options should approximate the risk and total return of their respective benchmark indexes annually, with a reasonable allowance for costs.

Actively managed investment options should exceed the total return of their respective benchmark indexes over rolling 3-year periods net of all costs. Additional measurements of performance such as style indexes and universe comparisons may also be used.

The attached table (Exhibit 2) outlines the authorized investment funds and performance benchmarks.

### ***HIRING INVESTMENT MANAGERS***

Core investment options shall be selected with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

When hiring investment managers, the Chief Investment Officer will ensure that the most efficient utilization of resources is accomplished. Whenever practical, Investment staff will choose funds that have at least three years of investment history.

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The determination to hire a manager is based on the following situations:

- A current manager is terminated;
- A new asset class is added; and
- It is determined that further diversification is warranted.

It is anticipated that in certain circumstances a manager search will not be conducted. Usually this will be the case when Investment staff determines that either a current defined benefit or defined contribution investment manager can fulfill the needs of a certain investment mandate. If a manager search is deemed necessary, the following procedures will be followed:

Under the direction of the Chief Investment Officer, staff delineates the purposes and context of the manager search including:

- The overall objectives of the investment program;
- The description of the type or style of the manager(s) to be hired; and
- The determination of an appropriate benchmark and performance objective.

Staff then performs the following:

- Determines the number of managers to be hired;
- Develops a list of potential candidates;
- Creates a questionnaire;
- Determines screening criteria to include:
  - a well defined investment philosophy;
  - a verifiable performance record;
  - a reasonable amount of assets under management utilizing the strategy and proposed product;
  - a strong business plan including provisions for retention of key professionals;
  - risk management;
  - stability of the firm;
  - depth of staff;
  - fees; and
  - compatibility with the Plans' record keeper;
- Selects finalists;
- Interviews finalists;
- Recommends final decision to Chief Investment Officer;

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- Chief Investment Officer reviews the process, makes the hiring decision, and authorizes staff to proceed with contract and fee negotiations; and
- Chief Investment Officer informs the IAC and the Board.

The following documentation shall be maintained:

- The statement of objectives of the search;
- The list of potential candidates;
- Responses to questionnaires;
- Screening criteria of application of such screens;
- Documentation of interviews; and
- Other pertinent information.

### ***MONITORING INVESTMENT MANAGERS***

#### **Objective**

The primary objective of monitoring investment managers is to ensure that each manager is providing satisfactory information/performance and is in compliance with the objectives and constraints of their contracts. This section provides guidelines for performing the monitoring and covers: 1) annual requests for information; 2) periodic reviews of performance; 3) visits with each manager; and 4) documentation of the process and interaction.

#### **Annual Requests for Information and Contract Review**

Each manager is requested to provide a copy of Part II of Form ADV and most recent prospectus, if applicable.

In addition, an annual supplemental questionnaire is sent to each manager. The objective of the questionnaire is to provide staff with updated information regarding changes in qualitative and quantitative areas of the manager's operations. Investment contracts are reviewed annually by the Investment Officer and the Investment Administrator.

#### **Review of Performance Data and Other Pertinent Correspondence**

Manager performance is reviewed with the IAC and Board quarterly. Monthly reports are provided in the interim. However, abnormal performance or other

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items of a serious nature receive immediate attention and are brought to the attention of the IAC and/or Board as soon as possible.

### **Periodic Visits with Managers**

Staff will visit each manager periodically. Once a year is recommended. Preferably, every other year the visit will be held at the manager's office.

### **Documentation/Maintenance of Manager Files**

The manager file shall contain:

- A list of the significant items contained in the contract (such as investment guidelines, investment objectives, the performance benchmark, and fee structure);
- ADV's (where applicable) for the last three years;
- Prospectuses (where applicable) for the last three years;
- Responses to annual questionnaires for the last three years;
- Performance reports for the last five years;
- Pre-Visit Checklist forms for the last three years;
- Manager Visit forms for the last three years; and
- Correspondence deemed pertinent.

## ***TERMINATION OF INVESTMENT MANAGERS***

### **Procedures**

Staff monitors investment performance and maintains communications with investment managers in order to quickly identify problems such as:

- Changes in style not approved by VRS;
- Failure to meet defined performance objectives over a reasonable time horizon;
- Changes in personnel or ownership that might adversely affect the manager's ability to provide the level of performance and/or services required; and
- Change in the manager's ability to handle the amount of assets committed.

Staff will recommend termination of investment managers to the Chief Investment Officer. If in agreement, the Chief Investment Officer authorizes the

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termination. If a manager underperforms its specific benchmark for a period of three years, the manager will automatically be considered for termination.

If it is determined that an investment option is no longer acceptable for continued offering, staff initiates the process, subject to approval by the Chief Investment Officer, to phase out the option, require participants to move balances to an alternative choice, and establish an alternative default option for those participants who do not make an alternative choice. The timing of such a transfer shall depend upon the facts of each case.

The termination and transition process will be presented to the IAC and Board for their review.

### ***CONSULTANTS***

The employment of consultants shall be considered on a prudent basis when it is determined that neither the Investment staff nor the existing investment managers have the expertise necessary for assisting in a specific project. The selection and termination of consultants for the investment program will be approved by the Chief Investment Officer at the recommendation of staff.

### ***PROXY VOTING***

All proxy matters shall be handled in accordance with the policy and guidelines set forth in the Board of Trustee's Corporate Governance Policy then in effect.

### ***BROKERAGE FOR SEPARATE ACCOUNTS***

It is the policy of the Virginia Retirement System that all trades executed on its behalf meet the test of "best execution". Separate account asset managers may execute trades that generate soft dollars to be utilized by them on behalf of VRS. Once, again, these trades must meet the test of "best execution" and any services purchased must fall under Section 28(e) of the Securities and Exchange Act of 1934.

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### ***ETHICS***

The Board of Trustees, its advisory committees, and the Investment Department staff have adopted the Association for Investment Management and Research (AIMR) Code of Ethics and Standards of Professional Conduct (Exhibit 3).

#### **Additional Guidelines:**

##### **I. Disclosure of Conflicts**

In compliance with Virginia law, annually, each trustee, committee member, and investment department professional must complete a Statement of Economic Interest to disclose all potential investment and business conflicts for himself/herself and immediate family.

##### **II. Travel on Official VRS Business**

When traveling on official VRS business, the VRS Policies and Procedures for Travel and Reimbursement apply.

##### **III. Gifts**

Any gift, ticket, etc. that is related to a position with VRS, received by a Trustee, committee member, or staff member valued in excess of fifty dollars (\$50) must be reported on the annual Statement of Economic Interest.

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**Exhibit 1  
Investment Program Allocation of Authority to Act**

	<b><u>CIO</u></b>	<b><u>IAC</u></b>	<b><u>BOARD</u></b>
<b>X = Review</b>			
<b>R = Recommends</b>			
<b>A = Approves</b>			
<b><u>Policy &amp; Guidelines</u></b>			
Approval of Proposed Policy/Guidelines	R	R	A
Approve New Asset Classes	R	R	A
<b><u>Program Structure</u></b>			
Approval of Proposed Structure	A	R	X
<b><u>Core Manager Strategy</u></b>			
Screenings & Interviews	X		
Manager Hiring Decision	A	X	X
Fee Negotiation	A		
Ongoing Monitoring	X		
Quarterly Performance	X	X	X
Manager Dismissals	A	X	X
<b><u>Consultants</u></b>			
Selection of Consultants	A	X	X
Termination of Consultants	A	X	X

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**Exhibit 2**

**Authorized Investment Funds and Performance Benchmarks**

**Funds**

**Benchmarks**

**Tier I: Asset Allocation Funds**

Income & Growth Fund

Custom (75% Lehman Aggregate, 22% Russell 3000,  
3% MSCI EAFE)

Balanced Growth Fund

Custom (50% Lehman Aggregate, 43% Russell 3000,  
7% MSCI EAFE)

Long-Term Growth Fund

Custom (25% Lehman Aggregate, 64% Russell 3000,  
11% MSCI EAFE)

**Tier II: Passively Managed Funds**

Bond Index Fund

Lehman Brothers Aggregate Bond Index

Russell 3000 Index Fund

Russell 3000 Index

S&P 500 Index Fund

S&P 500 Index

Russell 1000 Value Index Fund

Russell 1000 Value Index

Russell 1000 Growth Index Fund

Russell 1000 Growth Index

Small/Mid Cap Equity Index Fund

Russell Small Cap Completeness Index

Real Estate Investment Trust Index Fund

Wilshire REIT Index

International Equity Index Fund

MSCI EAFE Index

**Tier III: Actively Managed Funds**

Money Market Fund

91-Day Treasury Bill

Active Inflation-Protected Bond Fund

Lehman Brothers U.S. Treasury Inflation  
Notes Index

Active Bond Fund

Lehman Brothers Aggregate Bond Index

Active High-Yield Bond Fund

Custom (95% Lehman Brothers High-Yield ex CCC, 5%  
Lehman Brothers 1-3 Year Treasury)

Active Small/Mid Cap Equity Fund

Russell Small Cap Completeness Index

Active Global Equity Fund

MSCI World Index

Stable Value Fund

3 Year Constant Maturity Treasury (CMT)

Yield plus 0.50%

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**EXHIBIT 3**

Attach AIMR Code of Ethics & Standards of Professional Conduct (two pages)