

# Employee and Retiree Benefits

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LOB #310:

## **RETIREMENT PLAN INVESTMENT AND FINANCIAL MANAGEMENT**

### **Purpose**

The Retirement Plan Investment and Financial Management Line of Business includes the provision of investment consulting advice to the three Boards of Trustees and implementation of investment strategies and decisions; oversight of and coordination with the systems' custodial bank; accounting for fund assets, income and disbursements; preparation of financial statements; and coordination with external investment consultants. Investment advice and support includes development of an Investment Policy Statement for each system that details investment strategy, policy and guidelines. Investment support consists of strategic and tactical asset allocation advice, identification and selection of external investment managers and oversight, compliance and due diligence reviews of investment managers and portfolios. Other functions include investment performance monitoring and reporting, risk allocation and management, monitoring capital market trends, and asset allocation re-balancing.

### **Description**

The Retirement Plan Investment and Financial Management LOB acts as an agent of the Boards of Trustees of the Employees', Uniformed, and Police Officers Retirement Systems. Its mission is to manage the three retirement systems according to the terms established by the County and to do so in a manner that:

- Safeguards and invests the assets of the systems in accordance with the standard of care required in making such investments as stated in the Virginia Code § 51.1-803 and in compliance with each Board's stated objectives and investment policies;
- Maximizes cost effectiveness of the retirement programs by optimizing long-term investment returns within an acceptable level of variation in required funding and by maintaining efficient investment operations; and
- Fulfills the obligations of the systems to participants.

To accomplish its specific mission, the Retirement Agency focuses on portfolio construction to optimize investment return and control risk; supporting the information needs of the Boards of Trustees; accurate accounting, control, and reporting of plan assets; and monitoring the cost efficiency of processes.

The Uniformed Board of Trustees employs an outside investment consulting firm. For this system, agency staff works with the consulting firm to provide advice to the Board on investment strategy and implementation. For the Employees' system and the Police Officers system, all investment consulting services are provided internally by professional agency staff.

With the exception of balances in the County's pooled cash account, all investment portfolios are managed by outside investment management firms. Staff monitors the activities of the investment managers. Staff and external consultants assist with the identification of managers to be hired or fired and with reporting and analysis of performance. All securities are held for the systems by external custodians.

Each system has adopted a formal investment policy statement. The investments and investment risks of the systems are well diversified by asset class, investment strategy and number of investment positions. Asset allocation strategies reflect each Board's desired balance of return and risk. Disciplined re-balancing processes have been adopted by each Board as a means of maintaining the desired exposure to each segment of the capital markets. Trustees and staff closely monitor the performance of the individual portfolios to ensure that established investment guidelines are followed and that the manager is producing the expected returns over market cycles.

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Staff works with each Board of Trustees in an ongoing review of the entire investment strategy and implementation with a focus on maintaining an investment structure and complement of investment managers and styles that optimizes risk-adjusted returns and takes advantage of best practices in portfolio management as they develop over time. Over the past few years, changes have been initiated to focus on increased diversification of market risk exposures and to include diversified active management strategies with low correlations to create a total portfolio with greater risk/return efficiency.

The systems implement portfolio investment strategies that better balance exposures to multiple asset classes than traditional asset portfolio models. As a result, each system utilizes derivatives at the portfolio level to increase and decrease exposure to certain asset classes to balance the portfolio risk and return profiles. Trustees are advised at every meeting about the economic exposures of the various asset classes.

## Benefits

The Retirement Plan Investment and Financial Management LOB provides the Retirement Boards with expert advice on the investment of retirement assets and produces accurate and reliable audited financial reports presenting the financial statements of each retirement system. The highly-competitive returns generated based on the advice of this LOB have significantly reduced the level of employer contributions required by the County.

## Mandates

The Commonwealth of Virginia requires that jurisdictions either participate in the Virginia Retirement System (VRS) or establish their own retirement system. Jurisdictions that establish their own retirement system must provide benefits that are at least two-thirds of the benefits provided by VRS.

## Trends and Challenges

Each of the retirement systems targets a 7.5 percent investment return net of fees, which is near the midpoint of a peer group of comparable public pension systems. Over the last 10 years ending June 2015, the average annual investment results achieved were 7.2 percent for the Employees' system, 6.6 percent for the Uniformed system, and 7.0 percent for the Police Officers system. These returns compare very favorably to returns of a peer group of other large public pension systems and are commendable considering the steep market losses incurred during the financial crisis of 2008. Based on current assumptions and the strategic asset allocation policies of each system, the 7.5 percent target return remains realistic. However, there is no guarantee as to what future returns will be for well-diversified portfolios that have a reasonable level of investment risk and complexity. Target investment returns and high funding ratios may be a challenge to achieve in the current low interest rate environment with low return expectations for most asset classes.

In addition, changes in accounting reporting standards from implementation of Governmental Accounting Standards Board (GASB) Statement No. 67, Financial Reporting for Pension Systems, and GASB Statement No. 68, Accounting and Financial Reporting for Pensions, will bring increased visibility to the volatility and magnitude of the pension liability shortfall as the smoothing of asset values has been eliminated in the reporting of funding ratios for GASB purposes. The County continues to use smoothed asset values in the determination of required employer contributions. This change in reporting also brings the pension liability for employees covered under the Supplemental Retirement System of Fairfax County (ERFC) and the Virginia Retirement System onto the County balance sheet.

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## Resources

Category	FY 2014 Actual	FY 2015 Actual	FY 2016 Adopted
<b>LOB #310: Retirement Plan Investment and Financial Management</b>			
<b>FUNDING</b>			
<u>Expenditures:</u>			
Compensation	\$710,058	\$703,289	\$820,649
Benefits	290,340	297,432	362,299
Operating Expenses	19,941,402	19,321,758	32,755,667
<b>Total Expenditures</b>	<b>\$20,941,800</b>	<b>\$20,322,479</b>	<b>\$33,938,615</b>
<u>Revenue:</u>			
Return on Investments <sup>1</sup>	\$462,562,658	\$392,927,230	\$503,163,082
Unrealized Gain/(Loss) <sup>1</sup>	435,515,774	(161,724,925)	0
<b>Total Revenue</b>	<b>\$898,078,432</b>	<b>\$231,202,305</b>	<b>\$503,163,082</b>
<b>POSITIONS</b>			
Authorized Positions/Full-Time Equivalents (FTEs)			
<u>Positions:</u>			
Regular	5 / 5	5 / 5	5 / 5
<b>Total Positions</b>	<b>5 / 5</b>	<b>5 / 5</b>	<b>5 / 5</b>

(1) The FY 2015 actual revenue figures only reflect investment returns through May 2015. Final revenue figures will be included in the [FY 2017 Advertised Budget Plan](#) as audit adjustments to FY 2015.

## Metrics

Metric Indicator	FY 2013 Actual	FY 2014 Actual	FY 2015 Actual	FY 2016 Estimate	FY 2017 Estimate
Employees' Retirement System Net Return	7.60%	14.86%	0.45%	7.50%	7.50%
Uniformed Retirement System Net Return	10.03%	16.09%	1.47%	7.50%	7.50%
Police Officers Retirement System Net Return	9.53%	16.22%	3.35%	7.50%	7.50%

This LOB serves the three Retirement Boards and the participants in the Employees', Uniformed, and Police Officers Retirement Systems by providing expert investment advice to achieve each system's investment policy goals. Over the last 35 years, all three systems have achieved returns that have exceeded the targeted 7.5 percent actuarial assumption with average annual net returns by system ranging from 9.2 percent to 10.1 percent. Returns over the past three years have fluctuated, with strong returns in all three systems in FY 2013 and FY 2014 that exceeded the 7.5 percent target and returns that fell short of the target in FY 2015. Looking forward, the 7.5 percent target is expected to be attainable over the long term based on each system's strategic asset allocation policies. However, market returns can and will vary significantly from period to period. By retaining focus on risk diversification, both in terms of market exposures and active strategies, the agency seeks to attain the necessary returns while limiting the fluctuation in required employer funding rates on a year-to-year basis. However, in the current low interest rate environment with low return expectations for most asset classes, future portfolio returns may come under pressure.