



## **Investment Policy Committee (IPC) Meeting**

[VRS Boardroom - 3rd floor](#)  
[Pavilion Building](#)

**Thursday, 2/9/2023**  
**11:45 AM - 12:45 PM ET**

- 1. Welcome & Introductions**
- 2. Approval of Minutes (March 24, 2021 Meeting)**  
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- 3. Asset Liability Management (ALM) Process Education**  
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## Minutes

An electronic meeting, held in accordance with § 2.2-3700 et seq. of the Code of Virginia and Chapter 1289 of the 2020 Acts of Assembly, of the Investment Policy Committee (IPC) of the Virginia Retirement System was held on March 24, 2021 with the following members present:

O'Kelly McWilliams, III  
Joseph Montgomery  
Brandon Bell  
Michael Disharoon (joined the meeting at 1:32 p.m.)  
William Garrett  
Wallace "Bo" Harris  
Brett Hayes  
Troilen Seward

Also present were Trish Bishop, Ron Schmitz, Stephen Adelaar, John Alouf, Advait Apte, Rory Badura, Parham Behrooz, Jeanne Chenault, Sara Denson, Valerie Disanto, Josh Fox, Katie Grawe, JT Grier, Dane Honrado, K.C. Howell, Kristina Koutrakos, Matt Lacy, Chung Ma, Jennifer MacKnight, Curt Mattson, Steve McClelland, Walker Noland, Greg Oliff, Steven Peterson, Dan Schlusser, Jennifer Schreck, Kristy Scott, Jillian Sherman, Corey Turner, Lisa Turner, Grace Wheaton, Dan Whitlock, and Steve Woodall of the VRS staff.

Jeremy Bennett from VACO; Steve Chavez from Mandate Wire; Rachel Furash from MAC; Latosha Johnson from the Virginia Department of Planning and Budget; James Rosatelli from Virginia Senate Finance Committee; and Adam Rees from Pageant Media 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 1:08 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 § 2.2-3700 et seq. of the Code of Virginia and 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 – present  
Mr. Disharoon – joined the meeting at 1:32 p.m.  
Mr. Garrett – present  
Dr. Gooden – unable to attend due to a prior commitment  
Mr. Harris – present  
Mr. Hayes – present  
Mr. Montgomery – present  
Ms. Seward – present  
Mr. McWilliams - present

**Public Comment**

Mr. McWilliams noted that there was no public comment to introduce at this meeting.

**Approval of Minutes**

Mr. McWilliams made a motion to approve the minutes from the August and November 2019 meetings, as well as the February and November 2020 meetings. Mr. Montgomery seconded the motion. Mr. McWilliams asked for each Committee member to vote on the motion:

Mr. Bell – aye  
Mr. Garrett – aye  
Mr. Harris – aye  
Mr. Hayes – aye  
Mr. Montgomery – aye  
Ms. Seward – aye  
Mr. McWilliams - aye

The motion to approve the minutes passed.

**Review of Defined  
Benefit Plan Investment  
Beliefs Statements**

Mr. Schmitz conducted a review of updates being proposed to the Defined Benefit Plan Investment Beliefs Statements previously adopted in 2015. Staff made minor edits to the original document to improve grammar and clarity as well as to better organize the document for cohesive flow. A general discussion was held throughout the presentation. Consensus of the Committee was to share the updated draft with the Investment Advisory Committee and present it to the Board of Trustees for approval. An updated Defined Benefit Plan Investment Beliefs Statements will be presented through a Request for Board Action to the Board of Trustees at the April 20, 2021 meeting.

**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. Bell – Aye

Mr. Disharoon – Aye  
Mr. Garrett – 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 2:30 p.m.

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A. Scott Andrews, Chairperson

# Linking Investment Beliefs to the Asset Allocation Decision

Investment Policy Committee

February 9, 2023

Steven Peterson

Director of Research



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

- **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.
- **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.
- **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.

## The Asset Allocation that the Board chooses balances these 3 objectives

- **Achieving Long-Term Funding Progress** – requires growth which will involve increasing exposure to risky asset classes.
- **Avoiding Short-Term Drawdown Risk** – pulls the asset allocation away from risk assets and in the direction of safer, less volatile assets.
- **Avoiding Contribution Volatility** – contribution rates change as the unfunded liability changes. Short-fall losses will contribute most to contribution rate volatility.

## Progress toward ALL 3 objectives will in general depend upon the path of returns & Board's collective Risk Tolerance which, in turn, depends upon:

- The degree of aversion to risk/loss
- How risky opportunities are framed
- How we react to losses

# (A Few) Interactions Between Behavior and Beliefs



## **Risk Aversion: (Too much risks Long Term Funding objective. Too little risks greater Short Fall risks)**

1. You have been given a large sum of money to invest.  
You are now asked to choose between  
A: (50:50 chance of either 8% or -4% return) and B: (a certain 2%)

A risk averse person will opt for a safe 2% Treasury return than a risky bet on stocks that could return either 8% or lose -4%.

2. You have been given a large sum of money to invest.  
You are now asked to choose between  
A: (50:50 chance of either 8% or -4% return) and B: (a certain 0%)

This person is even more risk averse, preferring to lose nothing rather than take a risky bet that could lose something (-4%).



# (A Few) Interactions Between Behavior and Beliefs



## **Loss Aversion: Losses hurt more than an equivalent gain feels “good”. (Too much loss aversion can lead to higher Short Fall risk)**

3. You have been given a large sum of money to invest.

You are now asked to choose between

A: (a 50:50 chance of -4% or 0%) and B: (a certain -2%)

Why write down your assets by a certain -2% when there's a chance to not lose anything at all?

4. You have been given a large sum of money to invest.

You are now asked to choose between

A: (50:50 chance of -6% or 0%) and B: (a certain -2%)

Loss aversion is a strong impulse which could lead us to risk greater loss rather than accept a much smaller certain loss. We sometimes seek to avoid regret only to expose ourselves to much greater risk.

## **Disposition Effect: Tendency to hold losing positions too long.**

### **(Impacts both Short-Fall risk and Contribution Rate Volatility)**

5. After an initial run-up in value, a streak of losses over the past year has reduced the market value of a particular asset you own by almost one-half. As a result, you feel disposed to
  - A. Sell the balance of this asset to stem the losses and invest the balance in a safe account.
  - B. *Hold your current balance in the hope the stock's price will recover.*

*(This is called regret avoidance – people dislike losses more than they like gains. Our disposition to hold losing positions too long is very strong amongst investors in general).*

## Narrow Framing: Not seeing the “forest for the trees” (Can slow Long-Term Funding Progress)

1. You are asked to contemplate an investment decision that will result in one of two equally likely outcomes: a gain of 12% or a loss of -6%. Are you willing to take on this investment.

A: No B: Yes

2. You are asked to contemplate an investment decision that will result in one of two equally likely outcomes: a gain of 12% or a loss of -6%. Are you willing to take on this investment if it could be repeated a number of times in sequence?

Yes: Repeat twice: {HH, TT, HT, TH} = {24%, -12%, 6%, 6%} which is successful  $\frac{3}{4}$  of the time.

In general, people prefer a sure thing over a fair bet that may result in a loss. The greater the aversion to risk, the smaller the sure thing needs to be. As a result -

- *The Asset Allocation (AA) would be tilted more heavily toward safe assets.*

A loss hurts more than an equivalent gain. The more loss averse, the greater the risks we are willing to take to avoid loss. As a result -

- *The AA doesn't reduce exposure to risk in the presence of expected loss.*

Many people are “disposed” to hold onto losers too long in the hopes of avoiding the regret of a bad decision.

- *Perversely, there is a tendency to hold “losers” and sell “winners”.*

Framing can lead us to avoid constructive risky opportunities.

- *Risky opportunities should not be evaluated in isolation.*

# Know the Origins of Your Risk Tolerance

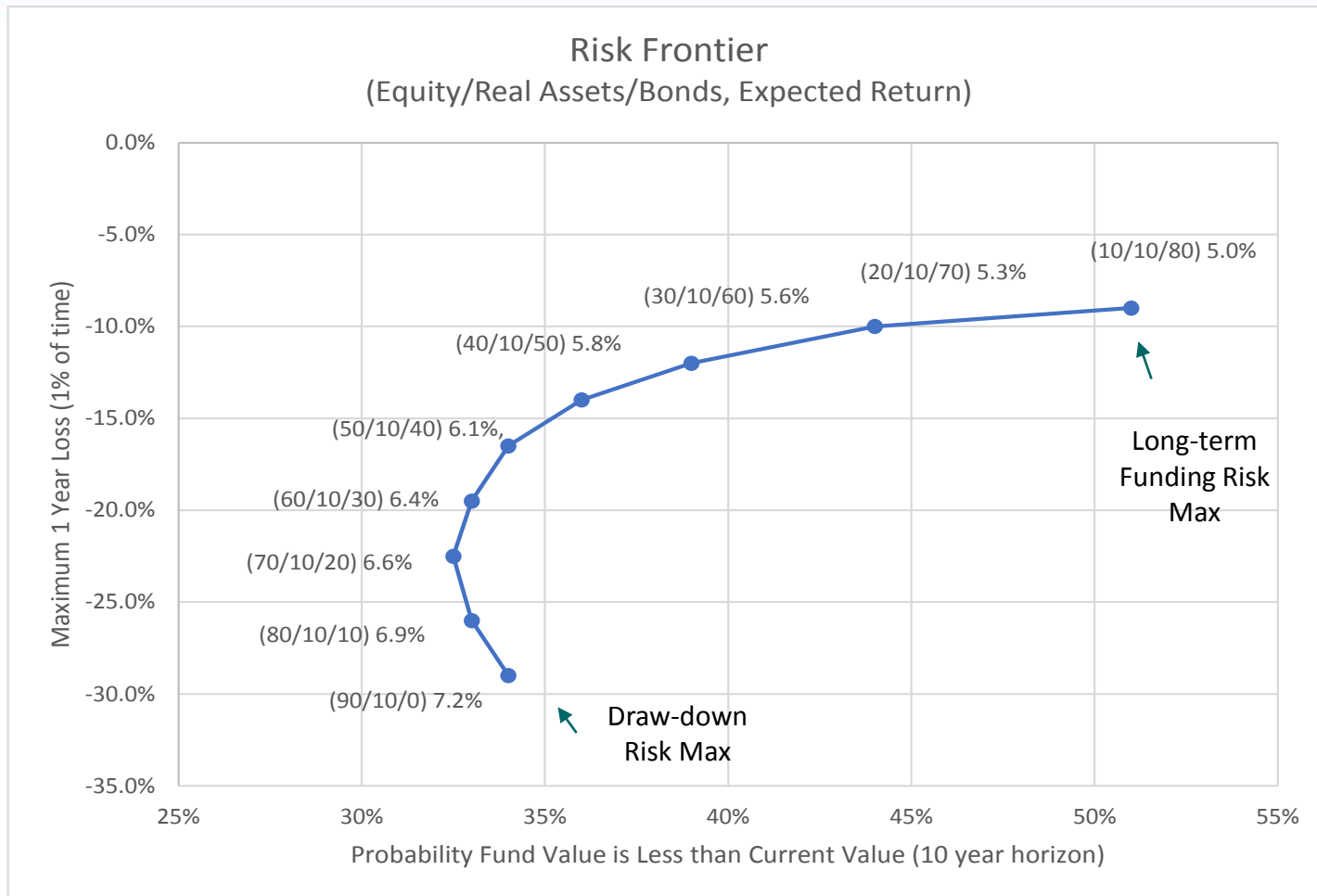
Long-Term Funding Progress

Short-Term Drawdown Risks

Contribution Volatility



# What Is Our Risk Tolerance?



# Expanding the Asset Mix Allows for Diversification Opportunities

