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September 24, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia
1111 East Broad Street
Richmond, Virginia 23219

The Honorable Charles J. Colgan
Co-Chairman, Senate Finance Committee
Senate of Virginia
10660 Aviation Lane
Manassas, Virginia 20110

The Honorable Walter A. Stosch
Co-Chairman, Senate Finance Committee
Senate of Virginia
Innsbrook Center
4551 Cox Road, Suite 110
Glen Allen, Virginia 23060

The Honorable S. Chris Jones
House of Delegates
Chairman, House Appropriations Committee
P.O. Box 5059
Suffolk, Virginia 23435

Re: Report on Virginia Retirement System Internal Asset Management

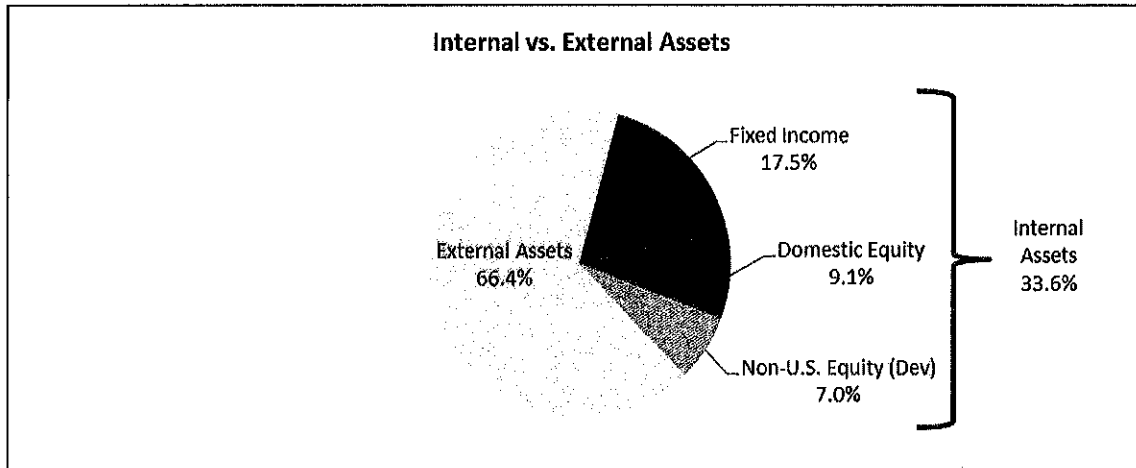
Dear Governor McAuliffe, Co-Chairman Colgan, Co-Chairman Stosch and Chairman Jones:

Pursuant to Item 483 of Chapter 2, 2014 Special Session I Acts of Assembly (The "Appropriations Act"), I am pleased to provide a report on the fiscal 2014 results obtained by the internal investment management program at the Virginia Retirement System ("VRS").

The VRS internal investment management program continues to make an important contribution to the total fund. As of June 30, 2014, the internal investment management team managed a total of \$22.2 billion in assets (excludes the Currency Hedge Account), representing approximately 33.6% of the fund. This amount consisted of \$10.6 billion managed in equity related strategies, and \$11.6 billion managed in fixed income strategies. The following pie chart provides the breakdown between internally and externally managed assets as of June 30, 2014. In addition, I am attaching, as a supplementary exhibit, a schedule that shows the various investment mandates being managed internally by VRS staff at fiscal year end.

Board of Trustees

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The VRS Board of Trustees has established certain external benchmarks for evaluating portfolio managers and believes that intermediate time frames of 3 to 5 years are most useful for evaluating performance. I am pleased to report that the internally managed funds continued to demonstrate outstanding performance across both the 3 and 5 year periods ending on June 30, 2014, as demonstrated in the following table. We estimate that the value added to the total fund from these excess returns over the last 5 years is approximately \$717 million.

IAMI Track Records as of June 30, 2014			
		3 Years	5 Years
Equity Mandates	Portfolio	15.5 %	19.4 %
	Benchmark	13.3 %	17.3 %
	Excess	2.2 %	2.1 %
Fixed Income Mandates	Portfolio	4.1 %	5.1 %
	Benchmark	3.7 %	4.7 %
	Excess	0.4 %	0.4 %

In addition to outstanding performance, the internal asset management team continues to operate at a low level of cost when compared to fees that would be charged by outside managers who offer similar strategies. We estimate that by managing these strategies internally the VRS is saving approximately \$21 million annually based on an outside consultant's data.

The Board of Trustees is proud of the efforts and results of the internal asset management team at VRS, and we are confident that the fund will continue to benefit from their work in the years ahead.

Sincerely,

Diana F. Cantor
Chairman, VRS Board of Trustees

EXHIBIT A

VRS Internal Mandates as of June 30, 2014			
Asset Class	Objective	Assets (MM)	
Equity	Passive U.S. Large	\$376.4	
	Passive Non-U.S. Large	\$736.8	
	Active U.S. Large	\$3,549.5	
	Active Non-U.S. Large	\$2,005.7	
	Active U.S. Small	\$342.1	
	Active U.S. Small Synthetic	\$161.6	
	Active U.S. REIT	\$86.8	
	Active U.S. Large Low Volatility	\$803.8	
	Active Non-U.S. Large Low Volatility	\$1,869.6	
	Rebalancing Account	\$677.0	
	Currency Hedge (Overlay)	\$3,604.1	
		Subtotal	\$14,213.4
	Fixed Income	Securitized	\$3,393.3
Credit		\$3,803.7	
Government Related		\$4,357.9	
Rate Overlay		\$13.6	
		Subtotal	\$11,568.5
	Total	\$25,781.9	