

**Virginia Retirement System
2026 General Assembly Session
Fiscal Impact Statement**

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ORIGINAL

Bill Number: SB 507

Patron: McPike

Bill Title: Virginia retirement system; investments in companies with elected official interests

Bill Summary: Prohibits investments by the Virginia Retirement System and local retirement systems in (i) companies with a majority ownership interest held by those holding elected federal positions or (ii) in investment funds with holdings of such companies in their portfolios on and after January 1, 2027, unless such investments or holdings are held in a blind trust established pursuant to federal law.

Budget Amendment Necessary: Yes

Items Impacted: 484

Explanation: VRS would need a NGF appropriation of approximately \$250,000 for FY 2027 and each subsequent year for implementation of the bill. This appropriation would include funding for contracting with an outside firm to monitor the investment mandate set forth in the bill. It would also include an additional part-time employee to oversee the activities of the outside firm, although the full scope of resources needed is not clear at this time. These costs are based on the assumption that the defined term “covered official” in the bill only applies to the Virginia Congressional delegation and the President and Vice-President (i.e., those federal officials either elected by the voters of the Commonwealth or by the United States as a whole including voters in the Commonwealth). If, instead, the bill were to apply to all members of Congress, the costs to implement the bill would increase substantially.

This does not include costs that any of the independent retirement systems will incur to comply with the bill.

General Fund Expenditure Impact:

<u>Agency</u>	<u>FY2026</u>	<u>FY2027</u>	<u>FY2028</u>	<u>FY2029</u>	<u>FY2030</u>	<u>FY2031</u>
TOTAL						

Nongeneral Fund Expenditure Impact:*

<u>Agency</u>	<u>FY2026</u>	<u>FY2027</u>	<u>FY2028</u>	<u>FY2029</u>	<u>FY2030</u>	<u>FY2031</u>
VRS		\$200,000	\$200,000	\$200,00	\$200,000	\$200,000
TOTAL		\$200,000	\$200,000	\$200,000	\$200,000	\$200,000

Position Impact:

<u>Agency</u>	<u>FY2026</u>	<u>FY2027</u>	<u>FY2028</u>	<u>FY2029</u>	<u>FY2030</u>	<u>FY2031</u>
VRS		\$50,000	\$50,000	\$50,000	\$50,000	\$50,000
TOTAL						

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**Note: This table does not include potential costs for independent retirement systems in the Commonwealth.*

Fiscal Analysis: Historically, VRS investment earnings fund approximately 2/3rds of benefit payments. Accordingly, when VRS was reconstituted in the 1990s, significant focus by JLARC and the legislature was placed on developing robust governance structures focused on fiduciary duty and insulating VRS from influence. Limiting access to the broadest opportunity set possible constrains VRS as an investor, is contrary to long-standing legislative history and practice, does not align with Constitutional and legal requirements, and may contravene VRS' fiduciary obligations. Consistent with its governance structure and applicable law and regulation, VRS has long maintained that efforts to constrain access to investment opportunities conflict with its fiduciary duty.

In order to implement the provisions of this bill, VRS will need to engage an outside firm or firms to monitor the public and private markers holdings of the VRS Trust Fund for compliance with the requirement not to invest in certain assets held or controlled by covered officials as well as completing any reporting requirement under the bill.

In addition to implementation and personnel and system costs for VRS and the independent local retirement systems, the bill's limitation on investments may result in a substantial, albeit unquantifiable, negative financial impact on the Trust Fund and VRS members, beneficiaries, retirees, and employers in the form of increased unfunded liabilities and increased employer contributions resulting from lost investment opportunities and other investment losses. As a fiduciary, VRS is required by state and federal law, including Article X, § 11 of the *Constitution of Virginia*, to act only in the interest of the system's more than 860,000 members, retirees, and beneficiaries. In furtherance of its fiduciary duty, the VRS Investment Policy Statement expressly provides that VRS acts to maximize investment returns while managing risk within an acceptable range.

The bill would prohibit VRS and asset managers used by VRS from making an investment (either through the public or private markets) on or after January 1, 2027 in any assets in which the President, Vice-President, or member of the Virginia Congressional delegation holds, owns, and controls a majority interest. In addition, the bill would require VRS and asset managers used by VRS to divest from an erroneous or unintentional investment in any assets in which one of these officials held, owned, and controlled a majority interest that was not previously identified as a prohibited investment at the time it was made. The bill has the potential to retroactively render certain investments as prohibited because it applies to all investments made on or after January 1, 2027, and to all individuals holding one of the listed offices regardless of when elected. Given the election cycle for the elected officials (every four years for the President and Vice President, every two years for an U.S. Representative, and every six years for an U.S. Senator), VRS may be forced to divest from an investment when an individual is elected after 2027 who holds a majority share in the investment. Specifically, this means that if VRS invests in any holding on

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or after January 1, 2027 that at the time is not prohibited and then a majority owner becomes an elected official, VRS would be required to divest because the investment has become one owned by a covered official. In addition, market action (such as corporate actions, acquisitions, mergers, sales) may impact whether such elected official continues to hold a majority share in a public or private asset.

VRS is an investor in both public and private markets. This bill would require VRS to divest from investments in publicly traded individual stocks or bonds. This means VRS would have to divest from entire private equity, real assets, credit strategies funds and hedge funds since VRS does not have the ability to select from among the individual investment holdings within private market assets. VRS would have to divest from an entire fund and be forced to sell its ownership portion of the fund on the secondary market, likely below its market value. Divestment from public and private markets would likely generate a larger negative impact on the fund than the relative size of the applicable prohibited investments themselves.

Further, it is likely not possible to successfully implement the provisions of the bill. Sufficient public information regarding the investment holdings of the elected officials covered by the bill, especially their ownership of private market assets, may not be available or sufficiently detailed to permit VRS to determine which investments are prohibited under the bill.

Other:

As VRS attempts to operationalize the bill's provisions, available data and information may pose a challenge to full compliance. The bill's language requires review and monitoring of a broad universe of publicly traded companies, private market assets and investment managers.

More important, though, is the precedent that the bill could set for future legislation further dictating or restricting VRS's ability to make investments.

If passed, the bill would be the first legislative control over the VRS Board of Trustees' ability to invest in over 30 years since the system's reconstitution as an independent agency. The decision to make VRS an independent agency stemmed from concerns about the ability of VRS to act in the best interests of its members and beneficiaries as an executive branch agency. The history behind and reasoning underlying the decision to insulate VRS from the influence of the other branches of government can be seen in the 1994 report from the Joint Legislative Audit and Review Commission (JLARC). JLARC was tasked with reviewing how to assure VRS' independence as a public trust and, based on JLARC's recommendations, VRS became an independent agency and art. 10, § 11 was added to the Virginia Constitution. VRS's governance structure contains best-in-class provisions.

Finally, the limitations contained in the bill necessarily affect VRS's ability to comply with its fiduciary duties to its members, retirees, and beneficiaries. While the bill provides that compliance with its provisions satisfies VRS's statutory duty of care, VRS's fiduciary duties are governed by multiple bodies of

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law and are set out in federal law and the Constitution of Virginia, as well as the Code of Virginia. Federal law, 26 U.S.C. § 401(a)(2), expressly provides that government retirement plans must be maintained “for the exclusive benefit” of the beneficiaries of the plans. Likewise, art. X, § 11 of the Virginia Constitution provides that the VRS Trust Fund “shall be invested and administered solely in the interests of the members and beneficiaries thereof.” See also Va. Code § 51.1-124.30(C) (“The Board shall discharge its duties with respect to the Retirement System solely in the interest of the beneficiaries thereof[.]”). Although the bill states that the Board’s compliance with the new divestment requirements satisfies the standard of care described in Va. Code § 51.1-124.30(C), the Board’s fiduciary duties extend beyond the Virginia Code, and such a statement in the law does not ensure that the Board is meeting all fiduciary obligations.

VRS’ investment policy is a function of the Board’s fiduciary duties. As the fiduciary of the Trust Fund, the VRS Board of Trustees seeks prudent investments in line with the Board’s asset allocation and risk tolerances. In addition, the VRS Defined Benefit Plan Investment Policy Statement includes the following: “The investment objective of the VRS defined benefit plan portfolio is to maximize return while managing risk within an acceptable range.” Further, VRS’ strict adherence to the prudent investor rule is statutorily required by Va. Code § 51.1-124.30(C), which provides as follows:

The Board shall discharge its duties with respect to the Retirement System solely in the interest of the beneficiaries thereof and shall invest the assets of the Retirement System 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. The Board shall also diversify such investments so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.

VRS’ investment policy is based solidly on its fiduciary duty to act in the best interests of its members, retirees, and beneficiaries, and to maximize its investments’ rate of return for a given risk level. To meet its fiduciary duty, VRS carefully analyzes economic factors and assesses pecuniary risk. This does not include reviewing factors that do not relate directly to the alignment of the investment with the aims of the VRS Trust Fund. Any external constraints imposed on VRS’ discretion to make investments, such as the ones in this bill, could impair VRS’ fiduciary responsibility to act solely in the best interests of plan members and beneficiaries.

A blanket prohibition on investing in the applicable prohibited investments may contradict the fiduciary requirements set out in the Constitution of Virginia, the Internal Revenue Code, and the Code of Virginia, as it may require VRS to forego certain investments or preclude VRS from investing in the applicable prohibited investments. Moreover, it could potentially result in a negative financial impact on the Trust Fund and VRS members, beneficiaries, retirees, and employers in the form of increased unfunded liabilities

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and increased employer contributions resulting from lost investment opportunities and other investment losses.