

Governance and Policy Review Committee

Thursday, April 21, 2022, 11:00a.m.
Peace Garden Room, State Capitol
Teleconferencing – 701.328.0950 Participant Code – 317 099 102#
600 E Boulevard Ave. Bismarck, ND

AGENDA

- I. CALL TO ORDER AND ACCEPTANCE OF AGENDA**
- II. ELECTION OF OFFICERS (CHAIR/VICE CHAIR) – MS. MURTHA**
- III. OPERATING STATISTICS & INVESTMENT COMMITTEE STRUCTURES – MR. ANDERSON**
- IV. REVIEW OF COMMITTEE CHARTER & TOPICS FOR FUTURE DISCUSSION – MS. MURTHA**
- V. PROPOSED MEETING SCHEDULE – MS. MURTHA**
- VI. ADJOURNMENT**

MEMORANDUM

TO: SIB – Governance & Policy Review (GPR) Committee
FROM: Jan Murtha, Executive Director
DATE: April 20, 2022
RE: GPR Committee Election of Officers

At its February meeting, the SIB approved the creation of a Governance & Policy Review (GPR) standing committee at the recommendation of the Audit Committee.

An amendment to Policy B-6 and proposed committee charter were approved for 2nd reading and final adoption in accordance with Policy B-10. The initial committee charter states:

GOVERNANCE & POLICY REVIEW COMMITTEE COMPOSITION AND TERM LIMITS The Committee shall be composed of at least three members. They will be nominated and approved by a majority vote of the SIB. This is a standing committee with no term limits. The Executive Director will be responsible for meeting preparation.

Similar to the Audit Committee, membership on the GPR Committee is by nomination and approval of a majority of the SIB.

A copy of the approved charter for the GPR committee is included for your reference. The GPR committee may make recommendations to the SIB for changes to the charter. Currently the approved charter does not contain any requirements regarding election of officers for the committee itself. Staff is requesting that the committee elect a Chair and Vice Chair for the committee to facilitate administration of committee business.


COMMITTEE ACTION REQUESTED: Motion to nominate and approve Committee Chair and Vice Chair.

Operating Statistics and Investment Committee Structures

Scott M Anderson, CFA
April 21, 2022

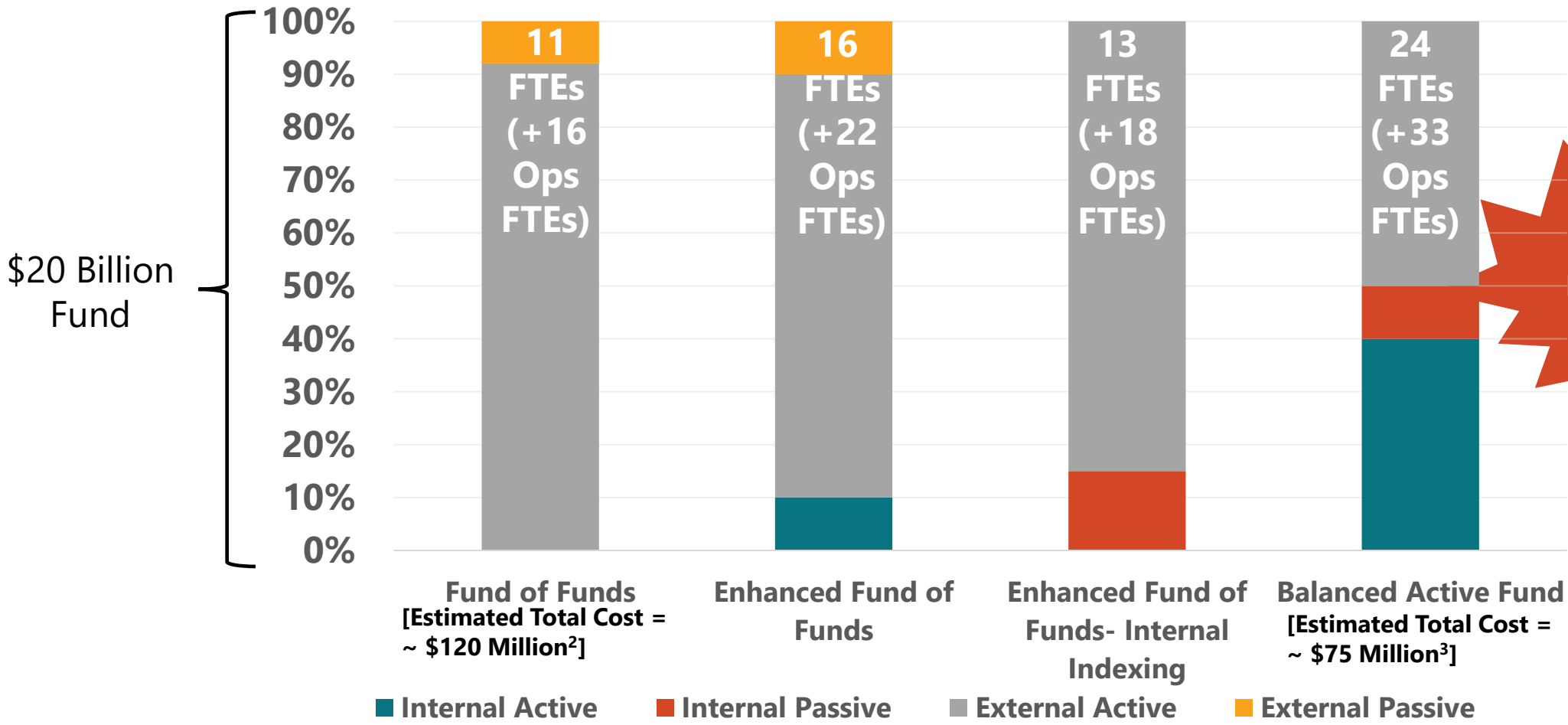
PEERS HAVE MORE INVESTMENT FTES¹

FTE Count Peer Group

Metric	75%	Median	25%	RIO
Total FTE	44	40 	26	8
Total Assets Under Management	\$33 Billion	\$21 Billion	\$17 Billion	\$20 Billion

1. Based on CEM proprietary database of US public fund managers and based on a peer group of similar size plans. Average funds have some internal investment management

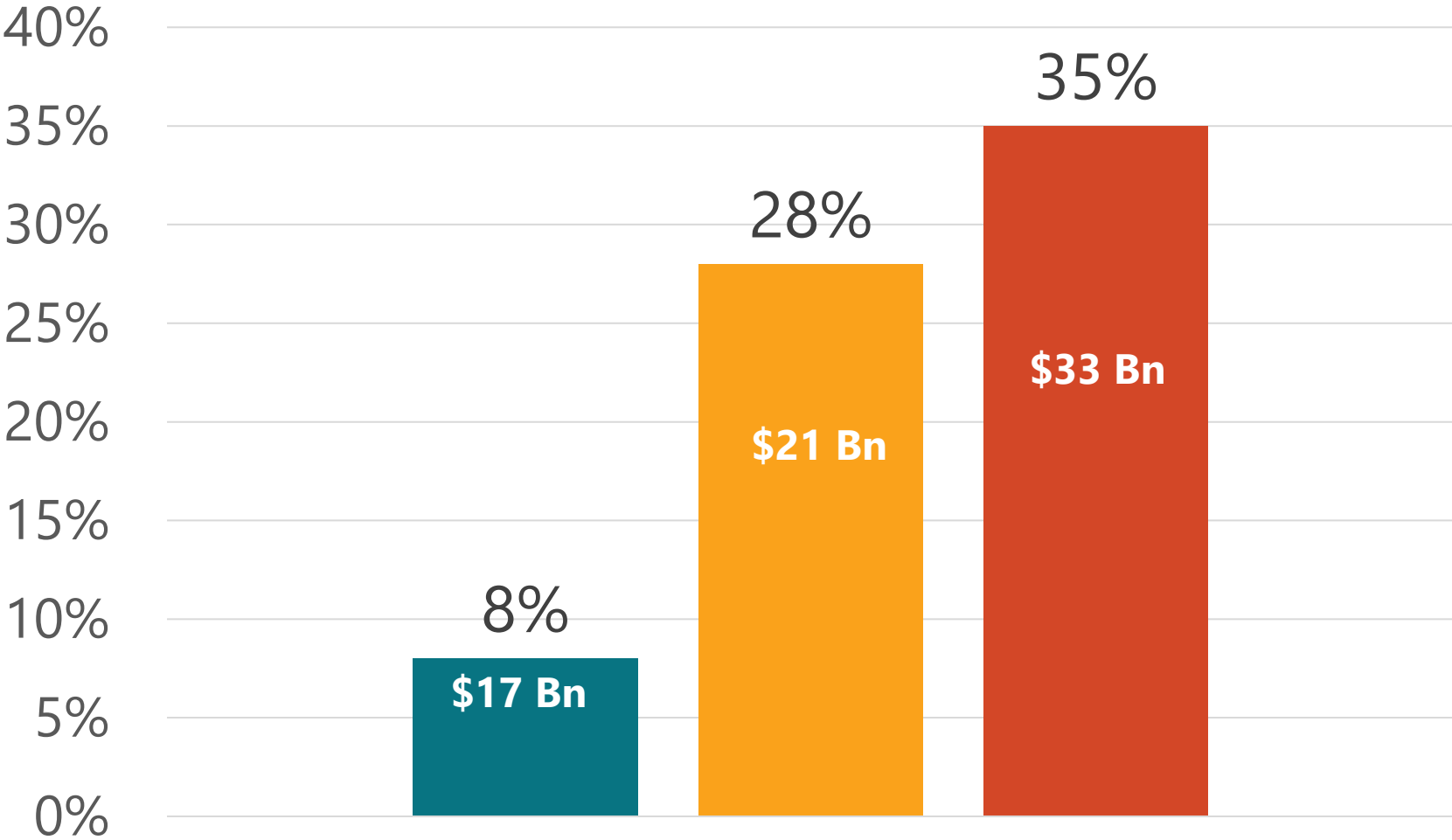
INVESTMENT STRATEGY IMPACTS FTE COUNT¹



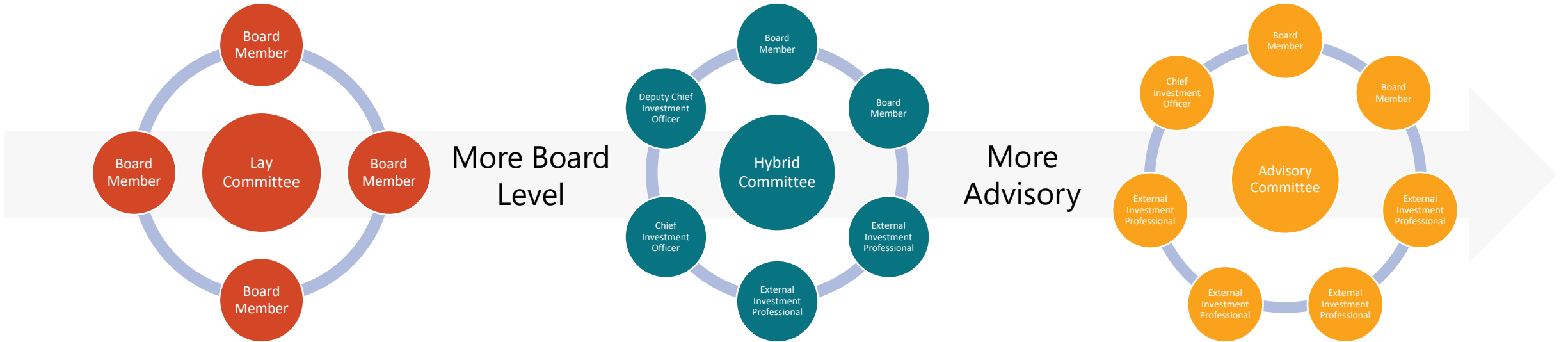
1. Based on CEM proprietary database of US public fund managers and based on a peer group of similar size plans
 2. Assumes 0.60% fees and expenses (not including performance fees) on \$20 billion of AUM
 3. Assumes 0.60% fees and expenses on the portion of investment with external managers; 13 incremental investment professionals, 13 operating staff and associated expenses as well as additional infrastructure spend (\$40 million total) -> \$120 million less \$60 million of fees plus \$20 million of costs (\$10 million labor and \$5 million operating costs) = \$75 million of cost

MORE INTERNALLY MANAGED WITH SCALE

% Internally Managed By AUM



THREE INVESTMENT COMMITTEE ARCHETYPES



- Operates like the board but can meet more frequently or more quickly
- Able to have focused and in-depth investment conversations
- Able to summarize for full board approval
- Lacks investment expertise
- Most investment decisions are at the board level with little delegation to staff

- Able to meet more frequently or more quickly
- Able to have focused and in-depth investment conversations
- Able to summarize for full board approval when necessary but also can delegate decisions to staff
- Staff participation enables delegation, quick decision and better implementation
- Outside and independent investment expertise
- Most investment decisions are at the investment committee or staff level

- Can meet more frequently or more quickly
- Able to have focused and in-depth investment conversations
- Able to summarize for full board approval
- Outside and independent investment expertise but need to ensure shared decision making
- Most investment decisions are at the board level
- Less delegation and associated benefits

IMPORTANT COMMITTEE CAPABILITIES

- INVESTMENT STRATEGY
 - How investment philosophy, asset allocation, fund structure, talent management and operations influence results
- ASSET ALLOCATION
- PERFORMANCE MEASUREMENT AND MANAGEMENT
- RISK MANAGEMENT
- FUND OPERATIONS
- CHARACTERISTICS OF ASSET CLASSES AND INVESTMENT STRATEGIES
- INVESTMENT MANAGER SELECTION
- INVESTMENT TALENT MANAGEMENT
- INVESTMENT POLICY AND GUIDELINE DESIGN
- INVESTMENT FEE MANAGEMENT
- LIQUIDITY MANAGEMENT AND REBALANCING
- EXPOSURE MANAGEMENT

APPENDIX- Callan Governance Survey

Name	Type	AUM	ED/CEO	CIO	Investment Staff	Board Authority	Staff Authority	Investment Committee	ED Investment Role	ED Veto	ED responsibilities
Texas Teachers	Public Pension	\$ 186	Reports to Board	Reports to Board	Reports to CIO	Asset allocation, investments over \$1 billion	Manager/investment selection under \$1 billion	Internal - Minimum of 5 members including CIO, Chief Risk Officer. At least two members must be Investment Division Senior Managing Directors ("SMDs")	Oversight, limited direct involvement	Yes	Infrastructure, staffing, external communication
New York State Teachers	Public Pension	\$ 148	Reports to Board	ED/CIO combined	Reports to ED/CIO	Asset allocation, manager/investment selection	Recommends asset allocation and manager/investment selection	Internal - advisory committee to the ED/CIO. Includes ED/CIO; Managing Director of Private Equity; Managing Director Fixed Income; Managing Director of Public Equities; and Managing Director of Real Estate	Oversight and approval of all investment recommendations to Board	Can choose not to recommend	Infrastructure, staffing, risk management, external communication, retirement system administration
State of Wisconsin	Public Pension	\$ 144	Reports to Board	CEO/CIO combined	Report to CEO/CIO	Asset allocation	Manager/investment selection	Internal - ED/CIO and at least four (4) other senior leaders from investment management and investment services	Oversight and approval of all substantive investment decisions	Yes	Infrastructure and staffing of investment division, investment strategy, risk management, investment implementation, Board communication
Minnesota State Board	Public Treasury	\$ 128	ED/CIO Reports to Board	Reports to Board	Reports to ED/CIO	Policies and procedures, includes Governor, State Auditor, Secretary of State other directors of State. Employs ED-CIO, Advisors and consultants. Sets Comp plan. Approves hiring /termination of managers	Recommends asset allocation and manager/investment selection	Advise the board and staff on general policy and matters of investment. Advise on methods to improve returns..		Yes	ED/CIO Execute administrative and investment functions in conformity with policies and directive of State Board. Budget, Planning, management oversight.
Oregon State treasury	Public Treasury	\$ 113	No ED but depute treasurer with this and CIO role	Reports to Treasurer	Reports to CIO	Oregon Investment Council oversees investment and allocation. Policy, AA, Risk	Recommends asset allocation, manager/investment selection up to \$ 100mm new funds and \$250mm reups, rebalance.	IC discretion up to \$250 mm composed of Treasurer, CIO, deputy. Unanimous decision. Any other decision went to the Board	Oversight and CIO role through staff for all assets of the State	Yes	Infrastructure, staffing, external communication, retirement system administration, state credit rating, sits on the Oregon Investment Council and State land Board, oversees all public investing, banking, bonding and financial programs.
Ohio State Teachers	Public Pension	\$ 80	Reports to Board	Reports to ED	Reports to CIO	Asset allocation	Manager/investment selection	Internal - CIO, investment staff	Oversight	No	Infrastructure, staffing, risk management, external communication, retirement system administration
Colorado PERA	Public Pension	\$ 60	Reports to Board	Reports to ED	Report to CIO	Asset allocation	Manager/investment selection, internal management	Internal - CIO, investment staff	Oversight	No	Infrastructure, staffing, external communication, retirement system administration
Texas Permanent School	SWF	\$ 48	Administrator/CC CIO combined Reports to Board	Reports to Committee and Board	Reports to Administrator/CIO	Ratifies transactions, appoints members to IC advisory board, Approves selection of managers, advisors and counsel, consultants. Policy and guidelines. Proposal to create corp modeled after UTIMCO	Makes recommendations regarding investments and policy to IC	Approves rebalancing and investments	Execute directives, policies of the Board thru committee on investment matters.	Unknown	Management oversight, establish procedures
UTIMCO	Endowment	\$ 44	President/CEO Reports to Board/Regents	Reports to CEO. Only CEO/CIO position prior to Jan 1 for succession planning	Reports to CIO	AA, Policy. Fiduciary responsibility lies with Regents	UTIMCO recommends AA, targets and ranges, rebalance management and execution	Portfolio managers up to \$30mm in small coinvestments with approval of Investment Committees	oversight	Yes	Planning, Strategic direction, management oversight, public relations, operating management
Utah Retirement system	Public Pension, Quasi government status	\$ 43	Reports to Board	Reports to ED	Reports to CIO	Strategic plans and Asset allocation. Does not make investment decisions.	Recommends asset allocation and manager/investment selection	Internal-chaired by the ED. Includes CIO, Deputy CIO Real Estate. Unanimous decision. Makes all investment decisions.	Oversight, chairs investment committee	Yes	Infrastructure, staffing, external communication, retirement system administration, liabilities of the plan. ED controls the budget and Board approves.
South Carolina	Public Pension	\$ 40	Reports to Board	Reports to ED		Asset allocation	Manager/investment selection subject to size limitations	CIO, no formal committee structure	Oversight, limited direct involvement	Yes	Infrastructure, staffing, external communication, retirement system administration
Mississippi Public Employees Retirement System	Public Pension	\$ 36	Reports to Board	Reports to ED	Reports to CIO	Asset allocation, manager/investment selection	Recommends asset allocation and manager/investment selection	Sub-committee of Board, makes recommendations to Board for approval	Oversight and approval of all investment recommendations to Board	Can choose not to recommend	Infrastructure, staffing, external communication, retirement system administration
Pennsylvania State Employees Retirement System	Public Pension	\$ 35	Reports to Board	Reports to Board	Reports to CIO	Asset allocation, manager/investment selection	Recommends asset allocation and manager/investment selection	Sub-committee of Board, makes recommendations to Board for approval	Limited	No	Infrastructure, staffing, external communication, retirement system administration

APPENDIX – Callan Governance Survey

Name	Type	AUM	ED/CEO	CIO	Investment Staff	Board Authority	Staff Authority	Investment Committee	ED Investment Role	ED Veto	ED responsibilities
Texas Employees Retirement System	Public Pension	\$	29 Reports to Board	Reports to ED	Reports to CIO	Investment policy, Asset Allocation and limits. Approves alternative investments over 0.6% of trust	Rebalancing, overlays, funding and defunding managers, risk management and proxy voting with ED oversight	IC review investment strategies and policies, provide comments and recommendations to Board. Asset Class committees include members of the IC to review prospective investments. Includes CIO, ED, and IC member plus staff. Can approve up to 0.6% of total value.	oversight, participates in IC, approves short term timing recommendations from CIO then reports to Board	Unknown	Establish procedures and controls, hires CIO and staff, with CIO selects additions to IC. Planning and Strategic direction, oversight.
SF City and County	Public Pension	\$	27 Reports to Board	Reports to ED	Report to CIO	Asset allocation	Manager/investment selection, internal management	Internal - CIO, investment staff	Oversight	No	Infrastructure, staffing, external communication, retirement system administration
North Dakota State Investment Board	Public Pension, SWF	\$	26 Reports to Board	Reports to ED	Report to ED	Asset allocation, manager/investment selection	Recommends asset allocation and manager/investment selection with consultant	Sub-committee of Board, makes recommendations to Board for approval	Oversight and approval of all investment recommendations to Board	Can choose not to recommend	Infrastructure, staffing, external communication, retirement system administration
New Mexico Land Grant Permanent Fund	SWF	\$	25 State Treasurer	Reports to State Treasurer	Reports to CIO	Strategic direction, Asset Allocation, policies, guidelines and benchmarks. Appoints Council IC	monitor performance, recommend and implements policy. Rebalance within limits CIO works with consultant to review AA, Structure, performance, mgr selection	IC and IC subcommittees Search and selection process. Review and make recommendations on investments. Composed of investment professionals. Review retention or termination of consultants ,funds, managers		Unknown	Duties under Treasurer
Public Employee Retirement System of Idaho	Public Pension	\$	24 Reports to Board	Reports to ED	Reports to CIO	Asset Allocation, investment policy	Recommends asset allocation, manager/investment selection,tactical rebalance, short term consequence decisions (tilts, tactical AA)	no formal committee structure	CIO must coordinate with ED to implement investment decisions	No	Infrastructure, staffing, external communication, retirement system administration
Cook County	Public Pension	\$	13 Reports to Board	Reports to ED	Report to ED	Asset allocation, manager/investment selection	Recommends asset allocation and manager/investment selection with consultant	Sub-committee of Board, makes recommendations to Board for approval	Oversight and approval of all investment recommendations to Board	Can choose not to recommend	Infrastructure, staffing, external communication, retirement system administration
Wyoming Permanent Mineral Trust Fund	SWF	\$	8 State Treasurer	Reports to State Treasurer	Reports to CIO	Investment policy, structure, creates Investment Fund Committee	Investment recommendations of policy, asset allocation and portfolio structure, research, Monitoring,	Monitors investment program, advise on manager selection, policy asset allocation. Establish benchmarks, review propose alternative investments and recommends to Board. Review policies and procedures , recommends changes to Board		Unknown	Duties under Treasurer responsible for State Funds, designates CIO, establishes system of internal controls

RETURN AND RISK – Appendix

Scott M Anderson, CFA
April 22, 2022

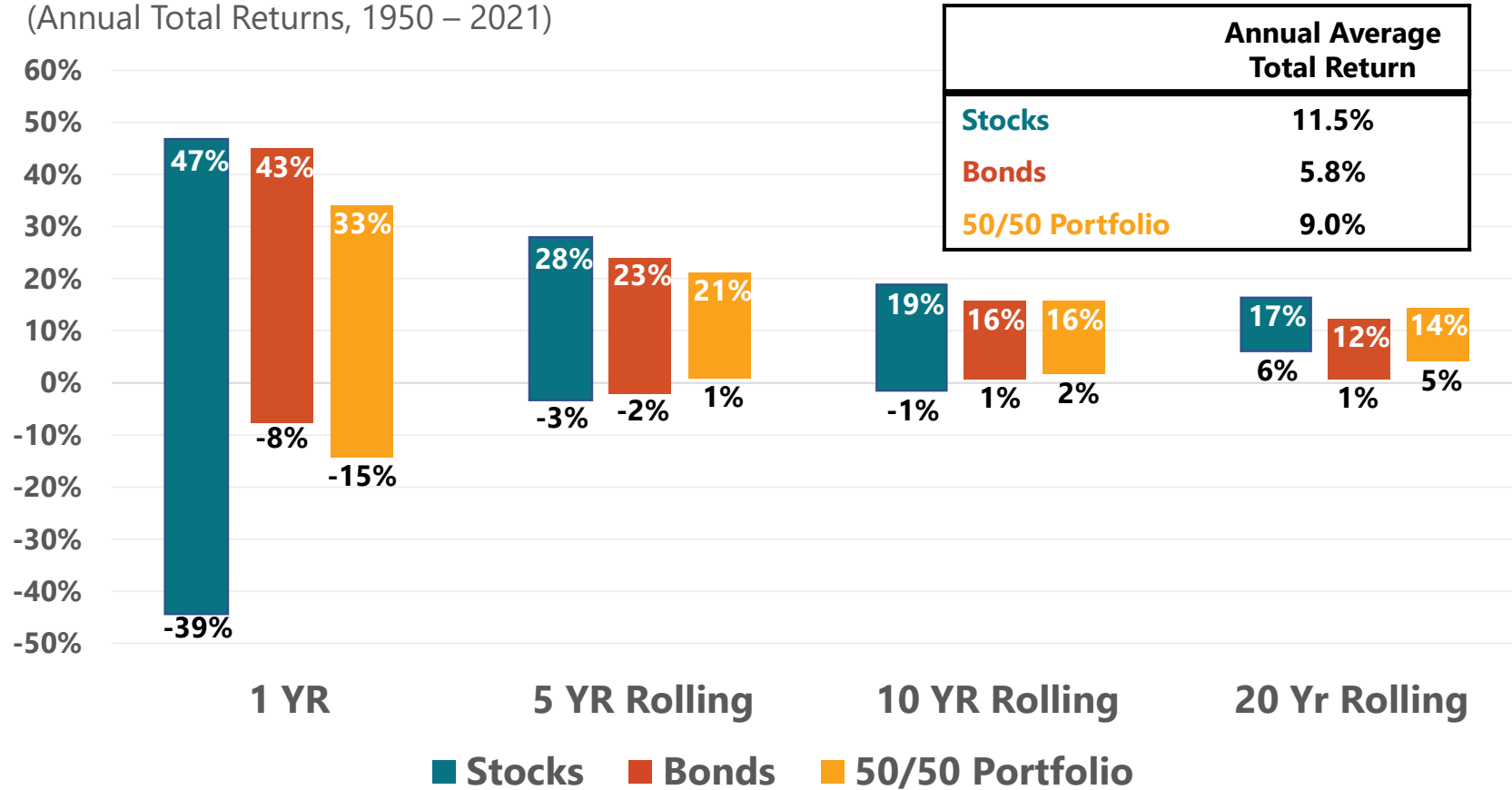
RETURN AND RISK

- WHAT IS RETURN?
- WHAT IS RISK?
- COMPENSATED RISK IS GOOD BUT ALSO IS CONTROLLED
- THERE ARE WAYS TO OPTIMIZE THE CONSTRUCTION OF A FUND
- THERE ARE OTHER COMPENSATED RISKS TO TALK ABOUT

TIME, DIVERIFICATION AND UNCERTAINTY

Range of Stock, Bond and Blended Returns¹

(Annual Total Returns, 1950 – 2021)



1. JPM Guide to Markets – Factset, Bloomberg, Federal Reserve, Robert Shiller and Strategis/Ibbotson

VALUE OF AN INVESTMENT¹ - Formula

$$\text{Value} = \frac{\text{CASH FLOW (Year 1)}}{\text{COST OF CAPITAL} - \text{GROWTH RATE}}$$

CASH FLOW(Year 1)

Investable cash after expenses and maintenance expenditures each Year

COST OF CAPTAL

Required return for an equal risk Investment

GROWTH RATE

Growth rate of the cash flow in time

1. Assumes cashflow flows at growth rate into the future as a perpetuity

VALUE OF AN INVESTMENT - Example

Value of \$225 of Cash Flow (Year 1) That Grows at the Growth of Cashflow Rate

Cost of Capital	Growth of Cashflow	Value
10%	0%	\$2250
11%	6%	\$4500
5%	0%	\$4500
20%	10%	\$2250

Example Cash Flow Growing at a 6% Rate

YR 1	YR 2	YR 3	YR 4	YR 5
\$225	\$236	\$248	\$260 (forever)

RETURN IS THE CHANGE IN VALUE

$$\text{Return} = \frac{\text{Value Before} - \text{Value After}}{\text{Value Before}}$$

Example		Cash Flow	Cost of Capital	Growth of Cashflow	Value	Return
1	Value Before	225 ↓	10%	5%	\$4500	11%
	Value After	250 ↓	10%	5%	\$5000	
2	Value Before	225	10% ↓	0%	\$2250	100%
	Value After	225	5% ↓	0%	\$4500	
3	Value Before	225	10%	0% ↓	\$2250	100%
	Value After	225	10%	5% ↓	\$4500	

100% = $\frac{\$4500 - \$2250}{\$2250}$

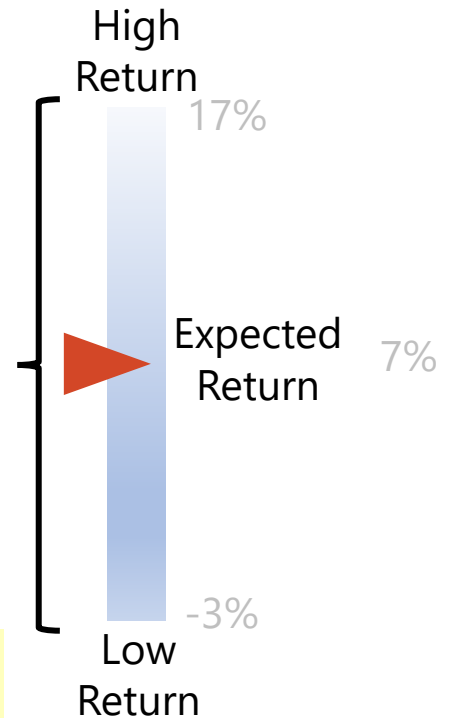
MARKET RISK - UNCERTAINTY OF RETURN¹

**Valuation
Uncertainty Drives
Return
Uncertainty!**

$$\text{Return} = \frac{\text{Value After} - \text{Value Before}}{\text{Value Before}}$$



Uncertainty of
Return Outcome
or Risk



$$\frac{\text{CASH FLOW (Year 1) After ?}}{\text{COST OF CAPITAL After ? - GROWTH RATE After ?}}$$

1. Market Risk is the uncertainty of the actual return compared to what is expected. Investment returns have a higher probability of being near the expectation and lower probabilities away from expectation, like a normal distribution.

RETURN EFFICIENCY

-a lower risk for a given return is better than a higher risk

Return Efficiency = $\frac{\text{Return}}{\text{Risk (Range if Returns)}}$  $\frac{5\%}{10\%}$ is better than $\frac{5\%}{20\%}$

Example:

1 Year Expected Return	Risk	Return/Risk	Average Compound Return (Many Years)
5%	10%	.5	4.5%
5%	20%	.25	3.0%

33% lower long-term return because of the doubling of risk!

RISK IS AN INVESTMENT

-risk is not bad if it is compensated. A given dollar value can be invested in a range of risks



Return on Investment or Cost

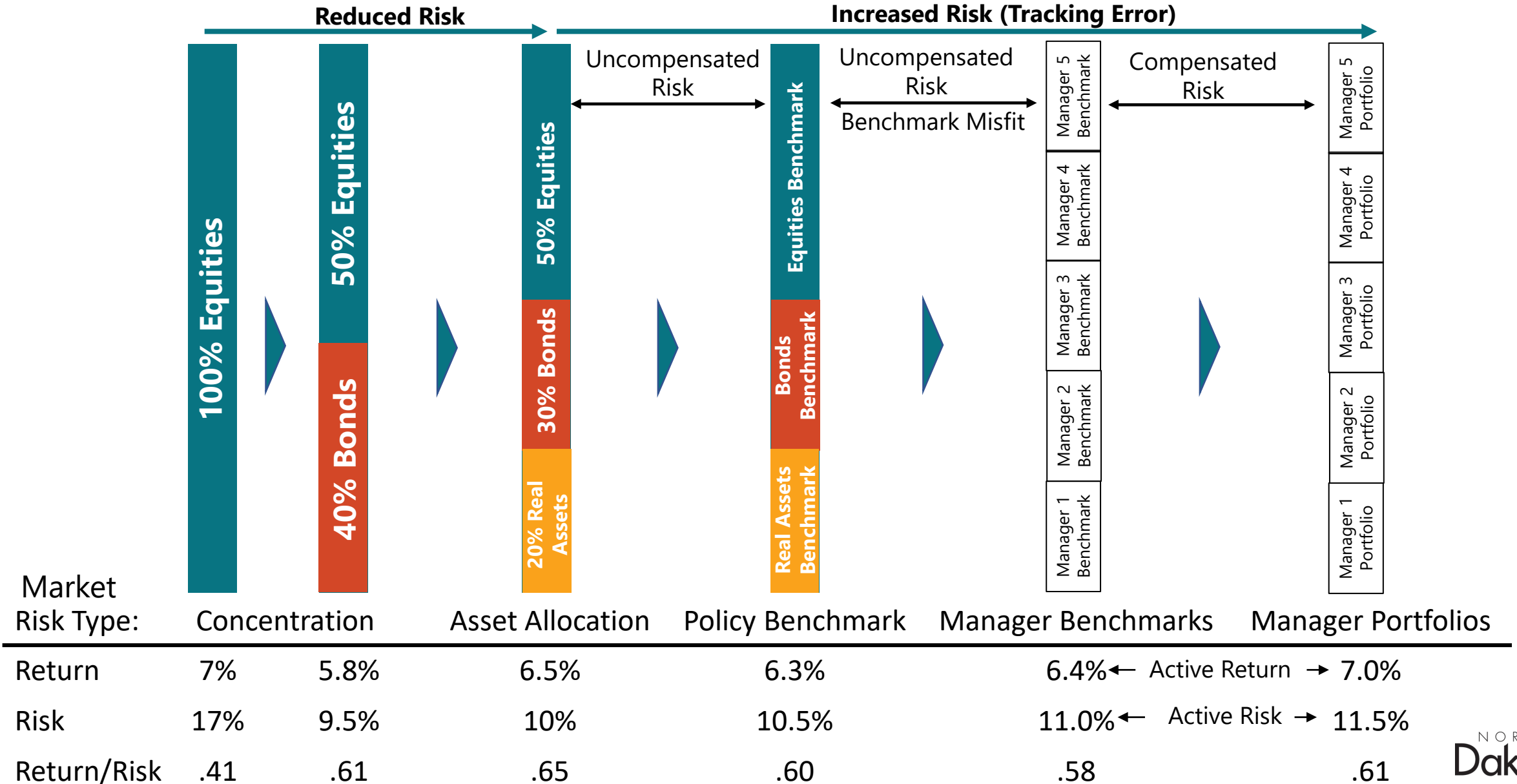
Return

Risk (Range if Returns)

Investment or Cost

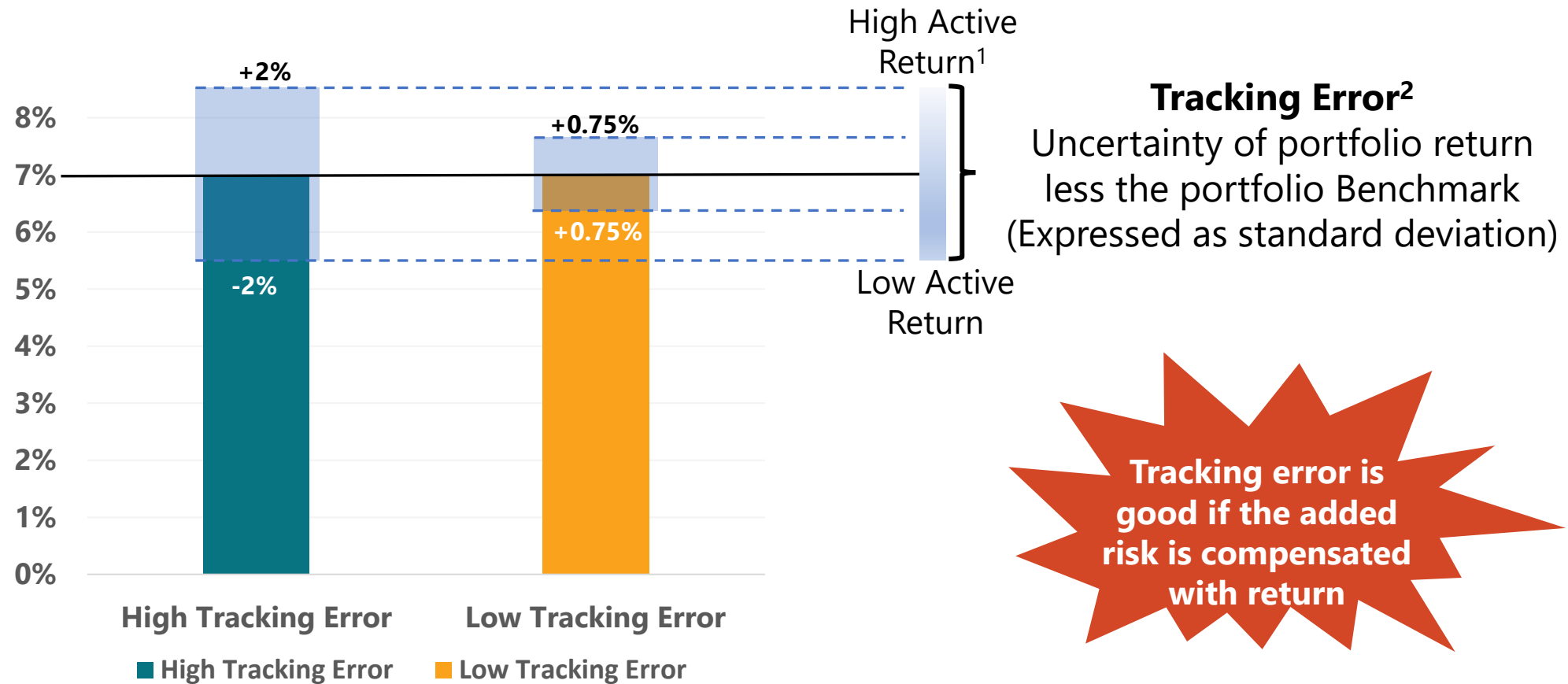
SOURCES OF RISK

Illustration



TRACKING ERROR

-manager active return¹ is good tracking error², benchmark mis fit is bad tracking error (Unintended and uncompensated)



1. Active return is the portfolio return less the benchmark return or how much does the portfolio earn above the benchmark.

2. Tracking error is the variation or uncertainty of active return

ACTIVE RETURN EFFICIENCY

-a lower tracking error for a given active return is better than a higher tracking error

$$\text{Active Return Efficiency} = \frac{\text{Active Return}}{\text{Tracking Error}} \quad \triangleright \quad \frac{0.7\%}{1.5\%} \text{ is better than } \frac{0.7\%}{3.0\%}$$

1 Year Active Return	Tracking Error	Active Return/ Risk	Level of Skill
0.5%	1%	0.5	Top Quartile
0.25%	1%	0.25	Upper Mid Quartile
0.0%	1%	0.0	Average

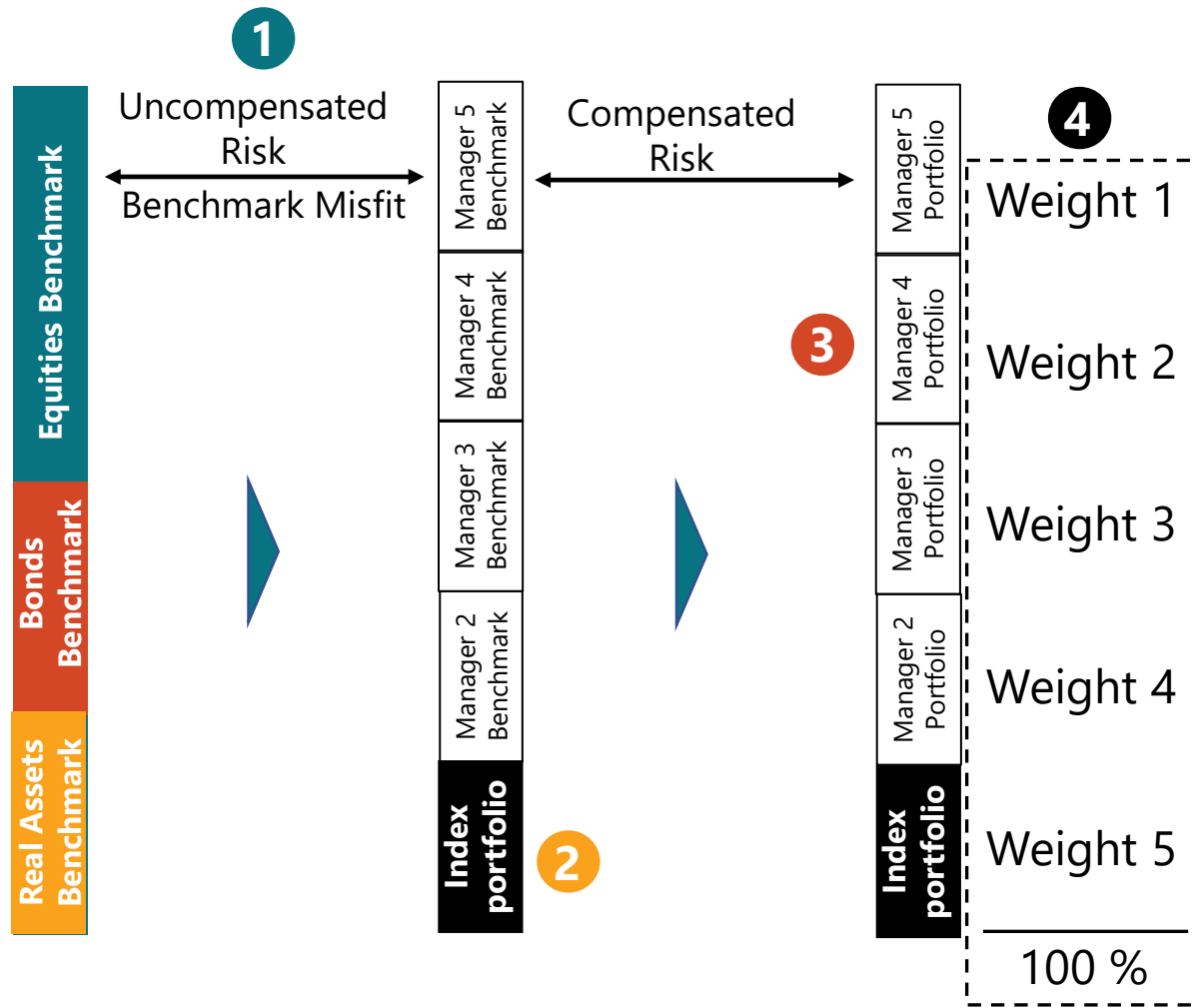
Skill to create active return is rare but a valuable investment!

TRACKING ERROR IS A GOOD INVESTMENT

-Tracking error risk is a good investment if compensated but active return is rare

Tracking Error	Active Return/Risk	Mean Return	Total Risk	Total Return/Risk	Average Compound Return
0%	0.0	6.3%	10.5%	.60	5.8%
1%	0.5	6.8%	10.8%	.65	6.2%
1%	0.25	6.6%	10.8%	.61	6.0%
1%	0.0	6.3%	10.8%	.58	5.7%
3%	0.5	7.8%	11.8%	.66	7.1%
3%	0.25	7.0%	11.8%	.59	6.3%
3%	0.0	6.3%	11.8%	.53	5.6%

FUNDS MANAGEMENT OPPORTUNITIES



- 1 Align Manager Benchmarks to policy benchmark series and benchmark series weight
- 2 Include index portfolios by benchmark to enable more efficient rebalancing, liquidity management and to control the tracking error
- 3 Terminate underperforming managers and index that portion of funds or replace it with performing managers
- 4 Optimize manager weights to achieve a targeted active return (based on assumptions) and tracking error. The optimization eliminates systematic risk¹ and optimizes optimal tracking error at the asset class level.

1. Risk that active returns change in lockstep with the benchmark vs idiosyncratic risk that active returns move randomly with the benchmark

OTHER RISKS AS FUTURE TOPICS TO DISCUSS

-In addition to the high-level market and tracking error risks there are several topics that would be helpful to discuss at future meetings

- LIQUIDITY RISK
- CONCENTRATION RISK
- INFLATION RISK
- CURRENCY RISK
- INTEREST RATE AND CREDIT RISK

MEMORANDUM

TO: SIB – Governance & Policy Review (GPR) Committee
FROM: Jan Murtha, Executive Director
DATE: April 20, 2022
RE: GPR Committee Charter Review & Topics for Future Discussion

At its February meeting, the SIB approved the creation of a Governance & Policy Review (GPR) standing committee at the recommendation of the Audit Committee.

An amendment to Policy B-6 and proposed committee charter were approved for 2nd reading and final adoption in accordance with Policy B-10.

Policy B-6 of the SIB Governance Manual was amended to include the following policy statement for the GPR Committee:

POLICY OF THE STATE INVESTMENT BOARD – Governance & Policy Review Committee

The Governance & Policy Review Committee is authorized to:

- Review and recommend policies for the governance manual.
- Ensure the governance manual reflects best practices and good governance.
- As directed by the board, review specific governance concerns, and make recommendations for improvement.
- Request RIO staff for specific topics for training or education

A copy of the approved charter for the GPR committee was included in the meeting materials for your reference.

Staff recommends that the GPR committee consider the following topics for future discussion and review, including but not limited to:

Review and recommend changes to committee charter;
Board member education and onboarding policy (original audit committee recommendation);
Board composition and governance structure;
Creation of additional standing committees including an investment committee;
Future legislative requests on behalf of SIB;
Plan for SIB Governance Manual annual review; and
Any additional topics as directed by the committee.

COMMITTEE ACTION REQUESTED: Discuss topics for future committee meetings and direct staff accordingly.

Governance & Policy Review Committee Charter

PURPOSE

The Governance & Policy Review Committee (“Committee”) will assist the State Investment Board (SIB) to fulfill its responsibilities regarding matters that relate to governing the SIB, policies, and identifying and making recommendations to the SIB.

KEY RESPONSIBILITIES

The Committee shall perform all duties as requested or required by the SIB. The Governance & Policy Review Committee will specifically be responsible for the following duties and responsibilities:

1. Advise the SIB about operational strategies relevant to the SIB’s governance manual to strengthen the SIB and empower the Board members to meet its obligations related to sound governance principles and abide by the agency’s mission.
2. Advise the SIB about strategies that strive to increase the individual Board member effectiveness and their abilities to work collaboratively with their peers.
3. Review and make recommendations for policies for the governance manual that reflect best practices for overall good governance.
4. As directed by the board, review specific governance concerns and make recommendations for improvement.
5. Request Retirement and Investment Office staff for specific topics for training and education for Board members. Make recommendations regarding an orientation process for newly appointed SIB members.

GOVERNANCE & POLICY REVIEW COMMITTEE COMPOSITION AND TERM LIMITS

The Governance & Policy Review Committee shall be composed of at least three members. They will be nominated and approved by a majority vote of the SIB. This is a standing committee with no term limits. The Executive Director will be responsible for meeting preparation.

MEETINGS

The Governance & Policy Review Committee will meet quarterly and hold additional meetings as needed to fulfill its responsibilities as described in this Committee Charter and as called by the Governance Committee Chair.

AUTHORIZATION AND LIMITATIONS OF POWER

The Governance & Policy Review Committee is established by the SIB governance manual and has no power or authority to act on behalf of the full board. The Governance & Policy Review Committee will abide by the provisions in the governance manual that pertain to the meetings and actions of the Board.

Tentative SIB and Standing Committees Meeting Schedule 2022-23

July 2022

GPR Comm: 21st - 10:00 a.m.

SIB: 22nd - 8:30 a.m.

August 2022

Audit Comm: 9th - 2:30 p.m.

GPR Comm: 25th - 10:00 a.m.

SIB: 26th - 8:30 a.m.

September 2022

Securities Lit: 20th - 10:00 a.m.

GPR Comm: 22nd - 10:00 a.m.

SIB: 23rd - 8:30 a.m.

October 2022

GPR Comm: 27th - 10:00 a.m.

SIB: 28th - 8:30 a.m.

November 2022

Audit Comm: 15th - 2:30 p.m.

GPR Comm: 17th - 10:00 a.m.

SIB: 18th - 8:30 a.m.

December 2022

Securities Lit: 13th - 10:00 a.m.

SIB: 16th - 8:30 a.m. (Tentative)

January 2023

GPR Comm: 26th - 10:00 a.m.

SIB: 27th - 8:30 a.m.

February 2023

Audit Comm: 16th - 10:00 a.m.

SIB: 17th - 8:30 a.m.

March 2023

Securities Lit: 14th - 3:00 p.m.

GPR Comm: 23rd - 10:00 a.m.

SIB: 24th - 8:30 a.m.

April 2023

GPR Comm: 27th - 10:00 a.m.

SIB: 28th - 8:30 a.m.

May 2023

Audit Comm: 11th - 2:30 p.m.

Securities Lit: 16th - 3:00 p.m.

GPR Comm: 18th - 10:00 a.m.

SIB: 19th - 8:30 a.m.