



ND STATE INVESTMENT BOARD MEETING

Friday, April 28, 2017, 8:30 a.m.
Workforce Safety & Insurance
1600 E Central Avenue, Bismarck, ND

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

II. ACCEPTANCE OF MINUTES (March 24, 2017)

III. INVESTMENTS

- A. Annual Board Planning Cycle - Mr. Hunter (enclosed) (20 min) **Board Acceptance**
- B. Legacy and Budget Stabilization Advisory Board Update - Mr. Hunter (enclosed) (10 min) *Informational*
- C. Tobacco Prevention and Control Trust Fund Update – Ms. Flanagan (5 min) *Informational*

IV. BOARD EDUCATION / GOVERNANCE

- A. Open Records and Meetings Laws (Ms. Murtha) (to follow) (30 min) *Informational*
- B. Client Investment Policy Statements and Social Investing – Mr. Hunter (5 min) *Informational*
- C. Possible GM Litigation Update - Ms. Murtha (to follow) (10 min) *Informational*
Executive Session for Attorney Consultation Pursuant to 44-04-19.2 and 44-04-19.1(2) and (5)

V. ADMINISTRATION

- A. Executive Review Committee Update - Ms. Smith (enclosed) (10 min)
- B. Legislative Update - Mr. Hunter (enclosed) (10 min)
- C. RIO Agency Update (Office Space and Voluntary Separation Incentive Program) - Mr. Hunter (10 min)

VI. QUARTERLY MONITORING (enclosed) (10 min) **Board Acceptance**

- A. Budget and Financial Conditions - Ms. Flanagan
- B. Executive Limitations / Staff Relations - Mr. Hunter
- C. Investment Program - Mr. Schulz
- D. Retirement Program - Ms. Kopp
- E. Watch List - Mr. Schulz

VII. OTHER

Next Meetings:

SIB Audit Committee meeting - May 25, 2017, 3:00 pm - State Capitol, Peace Garden Room

SIB meeting - May 26, 2017, 8:30 a.m. - State Capitol, Peace Garden Room

ADJOURNMENT

**NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
MARCH 24, 2017, BOARD MEETING**

MEMBERS PRESENT: Brent Sanford, Lt. Governor, Chair
Mike Sandal, Vice Chair
Lance Gaebe, Commissioner of Trust Lands
Mike Gessner, TFFR Board
Jon Godfread, Insurance Commissioner
Rob Lech, TFFR Board
Mel Olson, TFFR Board (TLCF)
Kelly Schmidt, State Treasurer
Troy Seibel, PERS Board
Yvonne Smith, PERS Board
Cindy Ternes, WSI Designee

STAFF PRESENT: Eric Chin, Investment Officer
Connie Flanagan, Fiscal & Invt Ops Mgr
Bonnie Heit, Assist to the SIB
David Hunter, ED/CIO
Fay Kopp, Dep ED/CRO
Terra Miller Bowley, Supvr Audit Services
Cody Schmidt, Compliance Officer
Darren Schulz, Dep CIO
Susan Walcker, Invt Acct

OTHERS PRESENT: Jeff Engleson, Dept. of Trust Lands
Levi Erdmann, Dept. of Trust Lands
Jan Murtha, Attorney General's Office
Keith Read, Cerberus
Dan Wolf, Cerberus

CALL TO ORDER:

Lt. Governor Sanford, Chairman, called the State Investment Board (SIB) meeting to order at 8:30 a.m. on Friday, March 24, 2017, at Workforce Safety & Insurance, 1600 E Century Ave, Bismarck, ND.

AGENDA:

IT WAS MOVED BY MR. GESSNER AND SECONDED BY MS. TERNES AND CARRIED ON A VOICE VOTE TO ACCEPT THE REVISED AGENDA FOR THE MARCH 24, 2017, MEETING AS DISTRIBUTED.

AYES: COMMISSIONER GODFREAD, MS. TERNES, MR. GESSNER, MS. SMITH, MR. SEIBEL, MR. SANDAL, MR. LECH, MR. OLSON, TREASURER SCHMIDT, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GAEBE

MINUTES:

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. SMITH AND CARRIED ON A VOICE VOTE TO APPROVE THE MINUTES OF THE FEBRUARY 24, 2017, MEETING AS DISTRIBUTED.

AYES: MR. GESSNER, MS. SMITH, TREASURER SCHMIDT, MR. LECH, COMMISSIONER GODFREAD, MR. OLSON, MR. SEIBEL, MR. SANDAL, MS. TERNES, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GAEBE

INVESTMENTS :

Improving Risk Adjusted Returns - Mr. Hunter reviewed with the board the reasons RIO personnel will be recommending the international fixed income mandates with UBS and Brandywine be replaced with U.S. centric debt mandates.

Fixed Income Manager Interview (Cerberus) - Cerberus representatives, Mr. Wolf and Mr. Read, reviewed the following with the board - overview of the firm including business finance, middle-market direct lending, and fundamentals of the company's lending business.

Fixed Income Manager Recommendation -

IT WAS MOVED BY MR. GESSNER AND SECONDED BY MR. SANDAL AND CARRIED BY A ROLL CALL VOTE TO MOVE INTO EXECUTIVE SESSION PURSUANT TO NDCC §44-04-18.4(1), §44-04-19.1(9), & §44-04-19.2 TO DISCUSS CONFIDENTIAL COMMERCIAL AND FINANCIAL INFORMATION AND TO PROVIDE CONTRACT NEGOTIATING INSTRUCTIONS TO ITS ATTORNEY OR NEGOTIATOR.

AYES: MS. TERNES, MR. OLSON, COMMISSIONER GODFREAD, TREASURER SCHMIDT, COMMISSIONER GAEBE, MR. SEIBEL, MR. LECH, MR. SANDAL, MS. SMITH, MR. GESSNER, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

The Board moved into Executive Session at 9:31 a.m. The Board, RIO staff, and Ms. Murtha were present.

The Board exited Executive Session at 10:09 a.m.

Mr. Sandal thanked RIO personnel for their due diligence work and documentation outlining their recommendation.

IT WAS MOVED BY MR. GESSNER AND SECONDED BY MS. TERNES AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION AND ENGAGE CERBERUS CAPITAL MANAGEMENT TO IMPLEMENT AND MANAGE A CUSTOMIZED SENIOR MIDDLE MARKET DIRECT LENDING STRATEGY FOR THE PENSION TRUST AND THE LEGACY FUND; ALLOCATING AN INITIAL MINIMUM EQUITY COMMITMENT OF \$200 MILLION SUBJECT TO CONTINUED NEGOTIATIONS AND FINALIZATION OF THE CONTRACT.

AYES: MS. TERNES, COMMISSIONER GODFREAD, MR. OLSON, MR. SANDAL, TREASURER SCHMIDT, MR. GESSNER, MS. SMITH, COMMISSIONER GAEBE, MR. LECH, MR. SEIBEL, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

The Board recessed at 10:12 am and reconvened at 10:22 a.m.

Investment Work Plan Update - Mr. Hunter reviewed an investment work plan as of March 17, 2017. The review was for informational purposes only.

FargoDome Investment Policy Statement - Mr. Hunter presented a revised investment policy statement for the FargoDome. The City of Fargo approved the guidelines on February 28, 2017. There were no changes to the asset allocation. Language was added regarding "standards of investment performance" which has been adopted by most of the other SIB clients.

IT WAS MOVED BY MR. SANDAL AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE REVISED INVESTMENT POLICY STATEMENT FOR THE FARGODOME FUND.

AYES: MR. LECH, TREASURER SCHMIDT, MR. OLSON, COMMISSIONER GAEBE, MR. SEIBEL, MR. SANDAL, COMMISSIONER GODFREAD, MR. GESSNER, MS. SMITH, MS. TERNES, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ADMINISTRATION:

Executive Review Committee - Ms. Smith, Chair, along with Committee members Ms. Ternes and Mr. Sandal, met March 8 and March 20, 2017, to finalize the Executive Director/CIO survey used in prior evaluations. The survey will be distributed electronically to the SIB on or before April 3, 2017, with a due date no later than April 14, 2017. The Committee's next meeting is scheduled for April 18, 2017, where the compiled survey results will be reviewed. The results of the survey will be shared with the SIB at their April 28, 2017, meeting. The Committee will be giving their final report to the SIB at their May 26, 2017, meeting.

Legislative Update - Mr. Hunter reviewed legislation which may affect RIO or the SIB: HB1022 - RIO Budget, HB1175 - SIB Membership, HB1023 - PERS Budget, HB1088 - Data Breach Response/Remediation Costs, HB1155 - Transfer/Expenditures from the Budget Stabilization Fund.

Government Finance Officers Association (GFOA) Award - RIO was awarded a Certificate of Achievement for Excellence in Financial Reporting from GFOA for its Comprehensive Annual Financial Report for the year ended June 30, 2016. This is the 19th consecutive year that RIO has received the award. Mr. Hunter thanked Ms. Flanagan, Ms. Walcker, Mr. Schmidt as well as the entire team at RIO.

The Teachers' Fund for Retirement (TFFR) also received the Public Pension Standards Award for Administration for the period ending June 30, 2016. This is the ninth consecutive year that RIO has received the award for funding and/or administration of the plan.

BOARD EDUCATION:

Callan College - Callan Associates will be conducting a "Callan College" July 28, 2017, at the Bismarck State College Energy Center. This board education session will also be available to the SIB's client boards. The agenda will include education on asset allocation, capital markets theory, investment policy statements, and fiduciary responsibilities.

OTHER:

The next meeting of the SIB is scheduled for April 28, 2017, at 8:30 a.m. at Workforce Safety & Insurance, 1600 E Century Ave., Bismarck, ND.

The next meeting of the SIB Audit Committee is scheduled for May 25, 2017, at 3:00 p.m. at the State Capitol, Peace Garden Room, Bismarck, ND.

ADJOURNMENT:

With no further business to come before the SIB, Lt. Governor Sanford adjourned the meeting at 10:43 a.m.

Lt. Governor Sanford, Chair
State Investment Board

Bonnie Heit
Assistant to the Board

Board Acceptance Requested

Annual Board Planning Cycle Biennial Agenda and Strategic Investment Plan

April 24, 2017

Overview:

Each April, the SIB reviews the Biennial Agenda for the upcoming year to ensure it is aligned with RIO's Mission Statement and Strategic Investment Plan. Ends policies are also reviewed to confirm the SIB and RIO are meeting client expectations while adhering to approved budget guidelines. RIO's review of the Biennial Agenda for 2017-19 revealed no major changes although there was a desire to: 1) highlight the importance of continuing board education; and 2) raise awareness of recent initiatives to enhance existing risk management systems and their critical role in our internal control environment.

Dave Hunter, Executive Director / CIO
Darren Schulz, Deputy Chief Investment Officer
ND Retirement & Investment Office (RIO)
State Investment Board (SIB)

RIO's Mission Statement

RIO's "Mission" is defined in SIB Governance Policy [D-1](#) on "Ends".

The Retirement and Investment Office serves the SIB and exists in order that:

- 1) SIB clients receive investment returns, consistent with their written investment policies and market variables, in a cost effective investment manner and under the Prudent Investor Rule. [D-3](#)
- 2) Potential SIB clients have access to information regarding SIB's investment services. [D-4](#)
- 3) TFFR benefit recipients receive their retirement benefits in a cost effective and timely manner. [D-5](#)
- 4) TFFR members have access to information which will allow them to become knowledgeable about the issues and process of retirement. [D-6](#)
- 5) SIB clients and TFFR benefit recipients receive satisfactory services from the boards and staff. [D-7](#)

Mission Accomplishments:

- 1) Every SIB client generated positive excess returns for the 5-years ended 12/31/2016 while adhering to approved investment guidelines for risk and reducing investment management fees (as a % of assets under management) from 0.65% to 0.42% in the last three fiscal years.
- 2) RIO implemented a transparency enhancement initiative in 2015-16 which enhanced public access to our website by adding new hyperlinks for our governance manual, audit charter and meeting materials (including our quarterly investment performance reviews).
- 3) RIO's internal audit team routinely conducts reviews which provide reasonable assurance that TFFR benefit recipients receive their retirement benefits in a cost effective and timely manner.
- 4) TFFR member surveys support management's belief that members have access to information which will allow them to become knowledgeable about retirement issues and processes.
- 5) SIB and TFFR client surveys confirm that the boards and staff provide satisfactory services.

Pension Clients – December 31, 2016 Performance

	1 Yr Ended 12/31/2016	3 Yrs Ended 12/31/2016	5 Yrs Ended 12/31/2016	Risk 5 Yrs Ended 12/31/2016
PERS (Main Plan)				
Net Investment Return	7.13%	4.50%	8.57%	5.6%
Policy Benchmark Return	7.19%	4.09%	7.90%	5.3%
Excess Return	-0.06%	0.41%	0.67%	105%
TFFR				
Net Investment Return	6.99%	4.48%	8.61%	5.6%
Policy Benchmark Return	6.95%	4.04%	7.90%	5.3%
Excess Return	0.04%	0.44%	0.71%	105%
BISMARCK EMPLOYEES				
Net Investment Return	7.72%	4.80%	8.21%	4.9%
Policy Benchmark Return	6.95%	4.08%	7.15%	4.6%
Excess Return	0.76%	0.72%	1.06%	106%
BISMARCK POLICE				
Net Investment Return	7.16%	4.46%	8.31%	5.3%
Policy Benchmark Return	7.28%	4.04%	7.49%	5.0%
Excess Return	-0.12%	0.41%	0.82%	106%
JOB SERVICE				
Net Investment Return	6.80%	5.14%	8.26%	4.6%
Policy Benchmark Return	6.23%	4.06%	6.51%	4.1%
Excess Return	0.57%	1.08%	1.75%	112%
CITY OF GRAND FORKS				
Net Investment Return	7.96%	4.64%	8.94%	5.8%
Policy Benchmark Return	7.83%	4.22%	8.13%	5.6%
Excess Return	0.13%	0.42%	0.81%	104%
GRAND FORKS PARK DISTRICT				
Net Investment Return	6.59%	4.68%	9.10%	5.8%
Policy Benchmark Return	6.88%	4.35%	8.29%	5.6%
Excess Return	-0.29%	0.32%	0.81%	104%

Pension Trust:

- Every Pension client generated positive “Excess Return” for the 5-year periods ended 12/31/16.
- “Excess Return” is defined as actual investment return (after deducting investment fees) over the expected return of the underlying investment policy or benchmark (i.e. a passive index).
- SIB’s use of active management generated over **\$100 million of net incremental income** (after fees) in the last 5-years for our Pension clients. This is based on \$4 billion of managed assets and **Excess Return of over 0.50%** ($\$4 \text{ billion} \times 0.50\% = \$20 \text{ million per year} \times 5 \text{ years} = \100 million).
- These strong returns have been achieved while **adhering to approved risk levels, as measured by standard deviation, during the past 5-years.** Standard deviation measures the amount of variation or dispersion from the average. The boards for our Pension clients have approved a maximum guideline for risk equal to 115% of the policy benchmark.

Non-Pension Clients – December 31, 2016 Performance

	1 Year Ended 12/31/2016	3 Years Ended 12/31/2016	5 Years Ended 12/31/2016	Risk 5 Yrs Ended 12/31/2016
WORKFORCE SAFETY INS.				
Net Investment Return	7.00%	5.06%	6.88%	3.53%
Policy Benchmark Return	4.84%	4.01%	4.86%	3.13%
Excess Return	2.15%	1.06%	2.02%	OK
<i>Estimated Excess Return (\$)</i>	<u><i>\$35 million</i></u>	<u><i>\$50 million</i></u>	<u><i>\$150 million</i></u>	
LEGACY FUND				
Net Investment Return	8.15%	4.39%	3.59%	3.59%
Policy Benchmark Return	6.41%	3.47%	2.56%	3.24%
Excess Return	1.75%	0.92%	1.03%	111%
<i>Estimated Excess Return (\$)</i>	<u><i>\$60 million</i></u>	<u><i>\$80 million</i></u>	<u><i>\$100 million</i></u>	
BUDGET STABILIZATION FUND				
Net Investment Return	2.36%	1.72%	1.90%	0.69%
Policy Benchmark Return	1.20%	0.80%	0.62%	0.50%
Excess Return - %	1.16%	0.92%	1.28%	OK
<i>Estimated Excess Return (\$)</i>	<u><i>\$5 million</i></u>	<u><i>\$15 million</i></u>	<u><i>\$30 million</i></u>	

WSI 2016 Assets Under Management (AUM) \$1.8 billion x 2% Excess Return = \$36 million
WSI 2014-16 AUM \$1.7 billion x 1% Excess Return = \$17 million/yr. x 3 years = \$51 million
WSI 2012-16 AUM \$1.5 billion x 2% Excess Return = \$30 million/yr. x 5 years = \$150 million
Legacy 2016 AUM \$3.8 billion x 1.7% Excess Return = \$64 million
Legacy 2014-16 AUM \$3 billion x 0.9% Excess Return = \$27 million/yr. x 3 years = \$81 million
Legacy 2012-16 AUM \$2 billion x 1% Excess Return = \$20 million/yr. x 5 years = \$100 million
BSF 2016 Assets Under Management (AUM) \$500 million x 1.1% Excess Return = \$5 million
BSF 2014-16 AUM \$575 million x 0.9% Excess Return = \$5 million/yr. x 3 years = \$15 million
BSF 2012-16 AUM \$500 million x 1.2% Excess Return = \$6 million/yr. x 5 years = \$30 million

Non-Pension Clients:

- Every Non-Pension Client generated positive “**Excess Return**” for the 5-years ended December 31, 2016.
- WSI and the Legacy Fund earned over \$250 million of incremental income via the prudent use of active management for the 5-years ended 12/31/2016. Excess return exceeded \$100 million for our Non-Pension clients in 2016.
- Returns were achieved in a risk controlled framework as nearly every client (with a 5-year track record) generated positive “**Risk Adjusted Excess Return**” for the 5-years ended 12/31/2016.

Risk Adjusted Excess Return measures a portfolio’s excess return adjusted by its risk relative to a benchmark portfolio. This metric is positive if returns are due to smart investment decisions or negative if driven by excess risk.

Investment Fees and Expenses – Summary

During the last three-years, investment management fees and expenses as a % of average assets under management declined from **0.65% in fiscal 2013** to **0.51% in fiscal 2014** to **0.48% in fiscal 2015** and to **approximately 0.42% in fiscal 2016**.

<u>All State Investment Board Clients</u>	<u>Investment Fees and Expenses</u> a	<u>Average "Assets Under Management"</u> b	<u>% of "AUM"</u> a / b
Fiscal Year Ended June 30, 2013	\$45 million	\$6.9 billion	0.65%
Fiscal Year Ended June 30, 2014	\$44 million	\$8.6 billion	0.51%
Fiscal Year Ended June 30, 2015	\$48 million	\$10.1 billion	0.48%
Fiscal Year Ended June 30, 2016	\$46 million	\$10.9 billion	0.42%

Key Point: Based on \$10 billion of assets, this 20+ bps decline between fiscal 2013 and 2016 translates into over \$20 million of annual savings.

➤ RIO will diligently work to prudently manage all SIB client investment fees and expenses, but acknowledges it will be challenging to reduce fees and expenses below 45 bps (0.45%) per annum in future years. Current fiscal years results were materially impacted by low incentive performance fees.

A basis point (or "bp") is equal to one one-hundredth of one percent (or 0.01%) such that 100 basis points ("bps") is equivalent to 1%.

SIB Client Satisfaction Scores Remain Strong in 2016

TO: State Investment Board
FROM: Dave Hunter, Executive Director/CIO
DATE: October 20, 2016
SUBJECT: SIB Client Satisfaction Survey – Cover Memo

The Audit Services team conducted the 2016 Customer Satisfaction Survey over the past few months. Survey responses were received from all but one customer board. Several methods were used this year to collect the survey data including customer created paper forms, Survey Monkey, and PDF.

SIB clients assigned a 3.6 overall rating in 2016 which is the comparable to prior years (of 3.7). This numerical score was based on 4.0 rating scale as follows:

Excellent	4.0
Above Average	3.0
Average	2.0
Poor	1.0
Not Applicable	-

Terra Miller Bowley, Supervisor of Audit Services, has provided a summary which follows on the next two pages. Terra can address any questions on the overall survey or individual board responses. I am also able to answer any questions relating to the survey comments noting that the vast majority of board responses were positive and encouraging.

Similar to last year, we received two comments requesting “faster turnaround on monthly reports”. As noted last year, RIO has not historically closed our fiscal year-end financial reporting until the external audit is substantially complete which generally does not take place until mid-to-late September.

I am pleased to note that we obtained more responses this year than in prior years and “N/A” was only provided as a response to one question this year (versus 18 in 2015).

SIB Client Boards:

1. PERS
2. TFFR
3. City of Bismarck
4. City of Grand Forks Employees
5. City of Grand Forks Park District
6. WSI
7. Insurance Commissioner
8. State Risk Mgmt.
9. ND Association of Counties
10. Council on the Arts
11. State Board of Medical Examiners
12. Center for Tobacco Prevention & Control
13. City of Fargo
14. Legacy & Budget Stabilization Fund Advisory Board

Annual Board Planning Cycle – Biennial Agenda

Current Version

Annual Board Planning Cycle Biennial Agenda

Fiscal 2015-16	July 2015	August	September	October	November	December	January 2016	February	March	April	May	June
	Gov. Offsite	Annual	Annual	Annual	Investment	No Meeting		Investment	Review	Review	Investment	No Meeting
	- Election of Officers, - Appoint Audit Comm. - Plan Annual Agenda - Plan Board Education	Investment Performance Review - Establish Work Plan - Add Invest. Education	Review of Gov. Manual (Done) - New Board Member Orientation Complete	Evaluation of RIO vs. Ends policies - Annual Board Evaluation	Director Report on Investment Work Plan	Scheduled		Director Report on Investment Work Plan - Executive Limitations Review	Budget Guidelines for next Biennium	"Ends" Policies, Biennial Agenda, Strategic Plan and Budget Guidelines	Director Report on Investment Work Plan ED/CIO Review - Investment Guidelines	Scheduled

Fiscal 2016-17	July 2016	August	September	October	November	December	January 2017	February	March	April	May	June
<i>The SIB Meeting Agenda has not been established for Fiscal 2016-17</i>	Gov. Offsite	Annual	Annual	Annual	Investment	No Meeting		Investment	Confirm	Review	Investment	No Meeting
	- Election of Officers, - Appoint Audit Comm. - Plan Annual Agenda - Plan Board Education	Investment Performance Review - Establish Work Plan - Add Invest. Education	Review of Gov. Manual - New Board Member Orientation Complete	Evaluation of RIO vs. Ends policies - Annual Board Evaluation	Director Report on Investment Work Plan	Planned	- Legislative Update	Director Report on Investment Work Plan - Executive Limitations Review	Budget Guidelines - Legislative Update	Biennial Agenda, End Policies, Strategic Investment Plan and Budget Guidelines	Director Report on Investment Work Plan ED/CIO Review - Investment Guidelines	Planned



- 1.) SIB Governance Policy B-7 on Governance Process states that "the Board will follow a biennial agenda which (a) completes a re-exploration of Ends policies annually (April) (which is also referred to as "RIO's Mission Statement") and (b) continually improves its performance through attention to board education and to enriched input and deliberation."
- 2.) "In the first three months of the new cycle, the Board will develop its agenda for the ensuing year. Scheduled monitoring will be used to evaluate and adjust the annual agenda as needed."
- 3.) "The Board will identify areas of education and input needed to increase the level of wisdom forethought it can give to subsequent choices. A board education plan will be developed during July and August of each year."
- 4.) **Budget Guidelines:** RIO will prepare and submit a biennial budget pursuant to OMB guidelines as established by the Governor which will not reduce the level of service provided by RIO. Expenditures for budget items will not exceed the appropriation without approval of the State Investment Board.

Date: April 14, 2016

Annual Board Planning Cycle – Biennial Agenda

RIO Recommendation (Board Acceptance Requested)

Annual Board Planning Cycle Biennial Agenda

Fiscal 2017-18	July 2017	August	September	October	November	December	January 2016	February	March	April	May	June
	Board Education (BSC Offsite) - Election of Officers, - Appoint Audit Comm. - Plan Annual Agenda	Annual Investment Performance Review - Establish Investment Work Plan - Add Invest. Education	Annual Review of Gov. Manual - New Board Member Orientation Complete	Annual Evaluation of RIO vs. Ends policies - Annual Board Evaluation	Investment Director Report on Investment Work Plan Board Education Investments	No Meeting Scheduled	Board Education Risk Management	Investment Director Report on Investment Work Plan - Executive Limitations Review	Review Budget Guidelines for next Biennium	Review "Ends" Policies, Biennial Agenda, Strategic Plan and Budget Guidelines	Investment Director Report on Investment Work Plan ED/CIO Review - Investment Guidelines	No Meeting Scheduled
Fiscal 2018-19	July 2016	August	September	October	November	December	January 2017	February	March	April	May	June
 <i>The SIB Meeting Agenda has not been established for Fiscal 2018-19</i>	Plan Board Education Offsite - Election of Officers, - Appoint Audit Comm. - Plan Annual Agenda	Annual Investment Performance Review - Establish Investment Work Plan - Add Invest. Education	Annual Review of Gov. Manual - New Board Member Orientation Complete	Annual Evaluation of RIO vs. Ends policies - Annual Board Evaluation	Investment Director Report on Investment Work Plan Board Education Investments	Reserved for a potential SIB meeting in advance of Legislative Session (Preview RIO Budget)	Board Education Risk Management - Legislative Update	Investment Director Report on Investment Work Plan - Executive Limitations Review	Confirm Budget Guidelines - Legislative Update	Review Biennial Agenda, End Policies, Strategic Investment Plan and Budget Guidelines	Investment Director Report on Investment Work Plan ED/CIO Review - Investment Guidelines	No Meeting Planned

- 1.) SIB Governance Policy B-7 on Governance Process states that "the Board will follow a biennial agenda which (a) completes a re-exploration of Ends policies annually (April) (which is also referred to as "RIO's Mission Statement") and (b) continually improves its performance through attention to board education and to enriched input and deliberation."
- 2.) "In the first three months of the new cycle, the Board will develop its agenda for the ensuing year. Scheduled monitoring will be used to evaluate and adjust the annual agenda as needed."
- 3.) "The Board will identify areas of education and input needed to increase the level of wisdom forethought it can give to subsequent choices. A board education plan will be developed during July and August of each year."
- 4.) **Budget Guidelines:** RIO will prepare and submit a biennial budget pursuant to OMB guidelines as established by the Governor which will not reduce the level of service provided by RIO. Expenditures for budget items will not exceed the appropriation without approval of the State Investment Board.

Date: April 21, 2017

RIO 2015-17 Strategic Investment Plan - Current Version

Fundamental Investment Beliefs

Asset allocation decisions are the primary driver of investment returns, but the prudent use of active investment management is an important contributor towards ensuring our clients attain their stated investment objectives. SIB clients generated over **\$200 million** of incremental income via the prudent use of active investment management over the past five years including approximately **\$40 million** of excess return in **2015**.

Strategic Investment Plan

1. Reaffirm the organizational commitment to our **current governance structure including a persistent awareness** to the importance of continuing board education.
 2. Enhance transparency and understanding of our core goals and beliefs.
 - a. Remain steadfast in our commitment to the prudent use of active investment management.
 - b. Expand awareness to downside risk management which is essential to achieving our long term investment goals.
 - c. Given actual and projected growth of SIB client assets and the heightened public awareness of the Legacy Fund, align our investment platforms to promote greater clarity and efficiency in reporting and implementing client investment policies.
 3. Expand RIO's influence and ability to create positive and sustainable change by developing relationships with existing clients, organizations and legislative leaders.
 - a. Enhance community outreach to build upon public awareness and confidence.
 - b. Develop concise presentations which highlight our overall risk, return and cost control framework including our progress towards attaining our long-term goals.
 4. Heighten employee engagement by promoting an open and collaborative work environment while encouraging employee participation in staff meetings, offer more opportunities to impact RIO's change initiatives and improve overall compensation levels.
 - a. RIO's ability to continue to deliver strong results is dependent on the combined efforts of our highly valuable team members.
 5. **Enhance our existing risk management tools processes by developing a more robust risk management framework utilizing proven risk management solutions with a focus on portfolio construction and downside risk management (or "stress test" scenarios).**
 - a. **A robust risk management framework provides a foundation to understand downside risks and our ability to withstand market corrections in varying stress test scenarios.**
 6. Evaluate and expand the efficient use of technology in our investment program activities including risk management, compliance monitoring, client satisfaction surveys, website design and communications in order to increase overall efficiency and effectiveness.
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RIO 2017-19 Strategic Investment Plan – Recommended

Fundamental Investment Beliefs

Asset allocation decisions are the primary driver of investment returns, but the prudent use of active investment management is an important contributor towards ensuring our clients attain their stated investment objectives. SIB clients generated over **\$250 million** of incremental income via the prudent use of active investment management the last five years including **\$100 million** of incremental income (or excess return) in **2016**.

Strategic Investment Plan

1. Reaffirm our organizational commitment to the importance of **continuing board education and strong board governance**.
 2. Enhance understanding of our core goals and beliefs while enhancing overall transparency.
 - a. Remain steadfast in our commitment to the prudent use of active investment management.
 - b. Expand awareness to downside risk management which is essential to achieving our long term investment goals.
 - c. Given actual and projected growth of SIB client assets and the heightened public awareness of the Legacy Fund, align our investment platforms to promote greater clarity and efficiency in reporting and implementing client investment policies.
 3. Expand RIO's influence and ability to create positive and sustainable change by building deeper relationships with existing clients, organizations and legislative leaders.
 - a. Enhance community outreach to build upon public awareness and confidence.
 - b. Develop concise presentations which highlight our overall risk, return and cost control framework including our progress towards attaining our long-term goals.
 4. Heighten employee engagement by promoting an open and collaborative work environment while encouraging employee participation in staff meetings, offer team members more opportunities to impact RIO's change initiatives **and improve the office environment for staff and clients**.
 - a. RIO's ability to continue to deliver strong results is dependent on the combined efforts of our highly valuable team members.
 5. **Enhance our internal control environment by improving use of proven risk management solutions relating to fraud risk assessments, investment risk management and overall enterprise risk management.**
 - a. **A robust risk management framework serves as a foundation to support a sound internal control environment and lessen downside risks.**
 - b. **Broaden stakeholder awareness of the challenges faced in estimating Legacy Fund earnings for any given period. A deeper understanding may serve to change the basic methodology used for determining budget estimates in future biennia.**
 6. Evaluate and expand the efficient use of technology in our investment program activities including risk management, compliance monitoring, client satisfaction surveys, website design and communications in order to increase overall efficiency and effectiveness.
-

Fundamental Investment Beliefs

- ❑ **Asset allocation is the # 1 driver of investment returns.**

- ❑ **The prudent use of active investment management is an important contributor towards ensuring our clients attain their stated investment objectives.**
 - **SIB clients generated over \$250 million of incremental income via the prudent use of active investment management since 2012.**

 - **SIB clients generated approximately \$100 million of excess return via the prudent use of active investment management in 2016.**

SIB Governance Policy D-3 on the “Ends” for Investment Services are based on the following:

- 1. Comparison of client fund’s rate of return net of fees and expenses, to that of the client’s policy benchmark over a minimum evaluation period of 5 years.**
- 2. Comparison of the client fund’s risk, measured by standard deviation of net returns, to that of the client’s policy benchmark over a minimum period of 5 years.**
- 3. Comparison of the risk adjusted performance of the client fund, net of fees and expenses, to that of the client’s policy benchmark over a minimum period of 5 years.**

Affirm Commitment to Board Governance and Education

- ❑ **Reaffirm organizational commitment to our current governance structure.**
 - Annual board review of SIB governance manual including a second governance day offsite in mid-2016.

- ❑ **Maintain a persistent awareness to the importance of continuing board education.**
 - Emphasize continuing board education at SIB meetings and promote the attendance of educationally focused industry conferences.
 - Given current budget pressures, the SIB has engaged our consultant to offer “Callan College” in Bismarck in order improve accessibility for board members and clients while seeking to reduce costs.



Enhance Understanding of Core Goals and Beliefs

- **Enhance transparency and understanding of our core goals and beliefs.**
 - **Remain steadfast in our commitment to the prudent use of active investment management.**
 - **Expand awareness to downside risk management which is essential to achieving our long term investment goals.**
 - **Given actual and projected growth of SIB client assets and the heightened public awareness of the Legacy Fund, align our investment platforms to promote greater clarity and efficiency in reporting and implementing client investment policies.**



Expand Influence and Ability to Create Positive Change

- **Expand RIO's influence and ability to create positive and sustainable change by developing relationships with existing clients, organizations and legislative leaders.**
 - Enhance community outreach to build upon public awareness and confidence.
 - Develop concise presentations which highlight our overall risk, return and cost control framework including our progress towards attaining our long-term goals.
 - Build relationships with our legislative leaders to ensure the proper alignment of interests for our SIB clients and constituents.

Heighten Employee Engagement and Impact

- **Heighten employee engagement by promoting an open and collaborative work environment while encouraging employee participation in staff meetings, offer more opportunities to impact RIO's change initiatives and either improve total compensation or significantly enhance our physical work environment.**
 - RIO's ability to continue to deliver strong results is dependent on the combined efforts of our highly valuable team members.
 - Although SIB and TFFR client satisfaction remain strong (at 3.6 to 3.8 on a 4.0 scale), we always attempt to find ways enhance client services by improving customer access and exploring better office space alternatives. This proposal will only be pursued if it enhances client service and substantially improves the employee work environment while operating within RIO's approved budget level.

Enhance Existing Risk Management Framework

- ❑ **Enhance RIO's internal control environment by improving use of proven risk management solutions relating to fraud risk, investment risk and overall enterprise risk management.**
 - **A robust risk management framework provides a foundation to understand downside risks and our ability to withstand market corrections in varying stress test scenarios.**
 - **Investment risk management should focus on portfolio construction while seeking to enhance risk management reporting for board members and clients.**
 - **RIO seeks to broaden stakeholder awareness of the challenges faced in estimating Legacy Fund earnings for any given period. A deeper understanding may serve to change the basic methodology used for determining budget estimates in the future (new statement).**



Evaluate and Expand the Efficient Use of Technology

- Evaluate and expand the efficient use of technology in our investment program activities including risk management, compliance monitoring, client satisfaction surveys, website design and communications in order to increase overall efficiency and effectiveness.



Sixty-fifth Legislative Assembly of North Dakota In Regular Session Commencing Tuesday, January 3, 2017

HOUSE BILL NO. 1022
(Appropriations Committee)

**RIO's Budget for 2017-19
was approved by the House
and Senate on April 20, 2017.**

AN ACT to provide an appropriation for defraying the expenses of the retirement and investment office; and to provide for a transfer.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. APPROPRIATION. The funds provided in this section, or so much of the funds as may be necessary, are appropriated out of any moneys from special funds derived from income for the purpose of defraying the expenses of the retirement and investment office, for the biennium beginning July 1, 2017, and ending June 30, 2019, as follows:

	<u>Base Level</u>	<u>Adjustments or Enhancements</u>	<u>Appropriation</u>
Salaries and wages	\$4,340,551	\$85,019	\$4,425,570
Operating expenses	990,874	(128,390)	862,484
Contingencies	<u>82,000</u>	<u>(30,000)</u>	<u>52,000</u>
Total special funds	\$5,413,425	(\$73,371)	\$5,340,054
Full-time equivalent positions	19.00	0.00	19.00



SECTION 2. HEALTH INSURANCE INCREASE. The salaries and wages line item in section 1 of this Act includes the sum of \$50,436 from special funds for increases in employee health insurance premiums from \$1,130 to \$1,241 per month.

SECTION 3. APPROPRIATION LINE ITEM TRANSFERS. Upon approval of the state investment board, the retirement and investment office may transfer from their contingencies line item in section 1 of this Act to all other line items. The agency shall notify the office of management and budget of each transfer made pursuant to this section.

Legacy and Budget Stabilization Fund Advisory Board

April 20, 2017

Dave Hunter, Executive Director/CIO
Darren Schulz, Deputy Chief Investment Officer
ND Retirement & Investment Office (RIO)
State Investment Board (SIB)

Budget Stabilization Fund

RIO Update

Budget Stabilization Fund

Funding, Income and Disbursement History

	Principal		Income		Net Assets End of Period
	Transfers In	Net Increase	Distributions Out	Withdrawals	
FY2006 (Initial Funding - Sept. 2005)	99,472,631	3,611,730	(3,207,845)		99,876,516
FY2007	-	4,980,987	(4,981,500)		99,876,003
FY2008	100,527,369	122,430	(1,688,532)		198,837,270
FY2009	-	(8,736,058)	-		190,101,212
FY2010	124,936,548	21,464,258	(11,385,172)		325,116,846
FY2011	-	12,031,101	(11,474,863)		325,673,084
FY2012	61,414,562	7,867,160	-		394,954,806
FY2013	-	7,239,388	(1,036,797)		401,157,397
FY2014	181,060,584	10,966,393	(7,183,404)		586,000,970
FY2015	5,073,760	5,918,386	(23,332,755)		573,636,701
FY2016	-	10,684,659	(8,606,169)		575,715,191
FY2017*	-	2,738,247	-	(505,000,000)	73,453,438
	<u>572,485,454</u>	<u>78,888,681</u>	<u>(72,897,037)</u>	<u>(505,000,000)</u>	


Net Increase - Inception to Date	78,888,681
Income Distributions Taken	(72,897,037)
Income Retained in Fund	5,991,644
February 28, 2017 Investment Fair Value	<u>73,658,682</u>

The Budget Stabilization Fund declined from \$575 million at June 30, 2016 to \$73 million at Feb. 28, 2017 and under \$6 million at Mar. 31, 2017.

*FY2017 amounts are preliminary and unaudited.

Budget Stabilization Fund Investment Performance

As of February 28, 2017

The Budget Stabilization Fund was \$6 million at Mar. 31, 2017.	February-17	Current FYTD		Prior Year FY16		3 Years Ended 6/30/2016		5 Years Ended 6/30/2016	
		Returns		Returns					
	Market Value	Gross	Net	Gross	Net	Gross	Net	Gross	Net
BUDGET STABILIZATION FUND	73,658,682	0.73%	0.61%	1.97%	1.82%	1.99%	1.88%	2.00%	1.91%
<i>POLICY TARGET BENCHMARK</i>		<i>0.06%</i>	<i>0.06%</i>	<i>1.50%</i>	<i>1.50%</i>	<i>0.95%</i>	<i>0.95%</i>	<i>0.69%</i>	<i>0.69%</i>
Bank of ND Match Loan CDs 	-	0.69%	0.69%	2.61%	2.61%	2.70%	2.70%	3.23%	3.23%
BND and Northern Trust S/T Cash	4,560,797	0.20%	0.20%	0.12%	0.12%	0.05%	0.05%	0.13%	0.13%
90 Day T-Bill		0.27%	0.27%	0.19%	0.19%	0.09%	0.09%	0.09%	0.09%
SHORT TERM FIXED INCOME	69,097,886	0.47%	0.31%	1.88%	1.70%	1.88%	1.74%	1.61%	1.48%
Blmbrg 1-3 Year US Gov't Index		-0.31%	-0.31%	1.31%	1.31%	1.00%	1.00%	0.75%	0.75%



NOTE: Monthly returns and market values are preliminary and subject to change.

Asset Allocation Update: RIO has commenced the transfer of the BND Match Loan CD Program to the Legacy Fund in October of 2016 and completed the transition by January 31, 2017. The asset allocation of the Budget Stabilization is effectively 100% short-term fixed income and cash noting the investment balance is less than \$6 million as of March 31, 2017, due to recent transfers to the General Fund over the past six months.

Budget Stabilization Fund

Comparison of Actual vs Expected Results

Net Returns Exceed Policy Benchmark - December 31, 2016

		Current FYTD <u>12/31/2016</u>	1 Year Ended <u>12/31/2016</u>	3 Years Ended <u>12/31/2016</u>	5 Years Ended <u>12/31/2016</u>
BUDGET STABILIZATION FUND					
Total Fund Return - Net	a	0.48%	2.36%	1.72%	1.90%
Policy Benchmark Return	b	-0.18%	1.20%	0.80%	0.62%
Excess Return	a - b	0.66%	1.16%	0.92%	1.28%
			<u>\$5 million</u>	<u>\$15 million</u>	<u>\$30 million</u>
					
					

1. For the 1-Year Ended 12/31/2016, the Fund generated a **Net Return of 2.36%** exceeding the Policy Benchmark (of 1.20%) and creating **Excess Return of 1.16%**. Actual net returns exceed the Policy Benchmark Return by approximately **\$5 million for the 1 year ended 12/31/2016**.
2. For the 5-Years Ended 12/31/2016, the Fund earned a **Net Return of 1.90%** exceeding the Policy Benchmark (of 0.62%) and creating **Excess Return of 1.28%**. Actual net returns exceed the Policy Benchmark Return by approximately **\$30 million for the 5 years ended 12/31/2016**.

BUDGET STABILIZATION FUND INVESTMENT POLICY STATEMENT

1. FUND CHARACTERISTICS AND CONSTRAINTS.

The Budget Stabilization Fund (Fund) is a special fund created in 1987 under Chapter 54-27.2 of the North Dakota Century Code used to deposit general fund moneys in excess of appropriations. Notwithstanding the provisions of sections 54-27.2-01 and 54-27.2-02, \$124,936,548 was required to be transferred by the state treasurer to the budget stabilization fund from the general fund on July 1, 2009 along with \$61,414,562 on July 1, 2011 and \$181,060,584 on July 1, 2013. These transfers provide over \$580 million in the budget stabilization fund as of May 31, 2016. The statutory cap for the 2015-17 biennium is \$572,485,454. The state investment board shall supervise investment of the budget stabilization fund in accordance with chapter 21-10.

Any interest or other budget stabilization fund earnings must be deposited in the fund. Any amounts provided by law for deposit in the fund and any interest or earnings of the fund which would bring the balance in the fund to an amount greater than five percent of the current biennial state general fund budget, as finally approved by the most recently adjourned special or regular session of the legislative assembly, may not be deposited or retained in the fund but must be deposited instead in the state general fund.

If the director of the office of management and budget projects that general fund revenues for the biennium will be at least two and one-half percent less than estimated by the most recently adjourned special or regular session of the legislative assembly, and if the governor orders a transfer, the state treasurer shall transfer the appropriate funds from the budget stabilization fund to the state general fund to offset the decrease in general fund revenues. The amount transferred from the budget stabilization fund upon order of the governor may not exceed the difference between an amount two and one-half percent below the general fund revenue projections for the biennium and the general fund revenue projections for the biennium by the director of the office of management and budget.

2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB).

The Fund is charged by law under NDCC 21-10-02.1 with the responsibility of establishing policies on investment goals and asset allocation of the Fund. The SIB is charged with implementing these policies and asset allocation and investing the assets of the Fund in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and objectives of the funds participating in the pools.

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security

selection is supervisory, not advisory. In accordance with this Investment Policy Statement, the Fund's assets may be invested directly or through collective investment vehicles.

The SIB is responsible for establishing criteria and procedures and making decisions with respect to hiring, maintaining, and terminating money managers. This responsibility includes selecting performance measurement services, consultants, and report formats and determining the frequency of meetings with managers.

The SIB will implement changes to this policy as promptly as is prudent.

3. INVESTMENT OBJECTIVES.

The investment objectives of the Fund reflect the relatively unknown life-span and the moderate risk tolerance of the Fund. Operating and statutory considerations shape the Fund's policies and priorities as outlined below:

Objective: Sufficient liquidity is to be maintained to meet known or anticipated financial obligations and preserve the value of the surplus. Cash equivalent investments will be used to achieve this objective.

4. STANDARDS OF INVESTMENT PERFORMANCE.

The Fund's investment objectives are expressed in terms of reward and risk expectations relative to investable, passive benchmarks. The Fund's policy benchmark is comprised of policy mix weights of appropriate asset class benchmarks as set by the SIB:


- a. The Fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.
- b. The risk-adjusted performance of the Fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

5. POLICY AND GUIDELINES.

The asset allocation of the Budget Stabilization Fund is established by the SIB, with input from the Legacy and Budget Stabilization Advisory Board (“Advisory Board”). Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the fund:

Short-term Fixed Income & BND CDs	Minimum of 90%
Bank Loans w/floating yield	Maximum of 5%
Absolute Return Strategies	Maximum of 5%

 Bank of North Dakota Match Loan Certificates of Deposit Program (“BND CD”) limit of 35%. On June 15, 2016, the Advisory Board acknowledged RIO’s stated intent to transfer the BND CD investment to the Legacy Fund on or before July 1, 2017. The latter date was based on preliminary budget guidance provided by OMB, although the transfer may occur in late-2016.

Rebalancing of the Fund to this target will be done in accordance with the SIB’s rebalancing policy.

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund’s assets will be invested, it is understood that:

- a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation
- b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.
- c. All assets will be held in custody by the State Investment Board’s master custodian or such other custodians as are acceptable to the State Investment Board.
- d. No funds shall be borrowed excluding a SIB approved securities lending program.
- e. No unhedged short sales or speculative margin purchases shall be made.
- f. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

For the purpose of this document, Social Investing is defined as *“The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries.”*

- g. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule. For the purpose of this document economically targeted investment is defined as an investment designed to produce a competitive rate of return

commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the Exclusive Benefit Rule is met if the following four conditions are satisfied:

- (1) The cost does not exceed the fair market value at the time of investment.
- (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
- (4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the Fund's policy favors investments which will have a positive impact on the economy of North Dakota.

6. EVALUATION AND REVIEW.

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards. Evaluation will be conducted quarterly by the SIB through its review of funds participating in the Insurance Trust.

Money managers will be evaluated by the SIB quarterly. In-state meetings will be held with the money managers at least annually.

Approved by:

**LEGACY AND BUDGET STABILIZATION
FUND ADVISORY BOARD
STATE INVESTMENT BOARD**


**Representative Keith Kempenich
Chairman**

Date: 8-3-16

**NORTH DAKOTA
STATE INVESTMENT BOARD**


**David Hunter
Executive Director/CIO, RIO**

Date: 8-3-16

Approved by the NDSIB: 7/22/2016
Approved by the LBSFAB: 6/15/2016

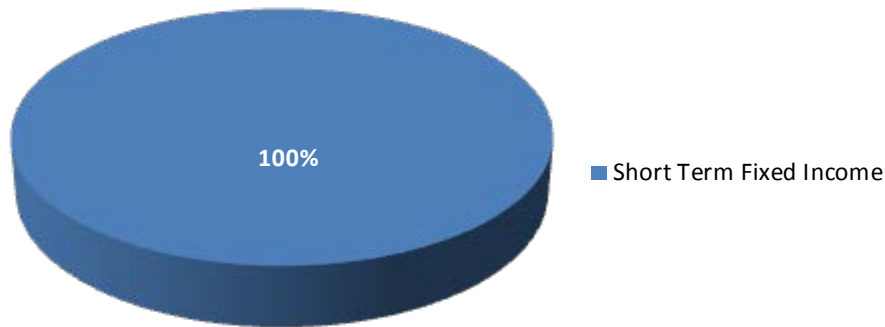


Legacy Fund

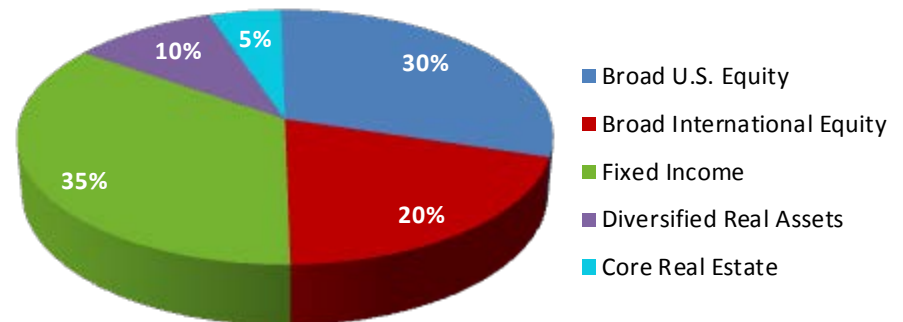
RIO Update

Legacy Fund Strategic Asset Allocation

Actual Allocation
8/1/2013



Policy Allocation
January 31, 2015 to Current



Note: Amounts are preliminary, unaudited and subject to change.

Legacy Fund

Summary of Deposits, Net Earnings and Balances – February 28, 2017

Key Point: Legacy Fund Net Earnings exceed **\$574 million** since inception including **\$308 million** in Fiscal 2017 (for the 8 months ended Feb. 28, 2017).

Column	A	B	C	D	E
					Earnings as defined in NDCC 21-10-12
	Deposits	Net Earnings	Net Increase/ (Decrease)	Ending Net Position	
FY2012	396,585,658	2,300,225	398,885,883	398,885,883	2,571,475
FY2013	791,126,479	4,216,026	795,342,505	1,194,228,388	15,949,089
FY2014	907,214,971	113,153,662	1,020,368,633	2,214,597,021	50,033,655
FY2015	1,011,343,040	99,895,650	1,111,238,690	3,325,835,711	95,143,905
FY2016	434,853,950	45,851,680	480,705,630	3,806,541,341	65,326,673
FY2017*	258,227,439	308,656,884	566,884,323	4,373,425,664	153,658,323
Totals	3,799,351,537 Total Deposits	574,074,127 Net Earnings		4,373,425,664 Ending Balance	382,683,120

Note: Amounts are preliminary, unaudited and subject to change.

* FY2017 amounts are preliminary and unaudited.

Column A - Deposits into the Legacy Fund total **\$3.799 billion** since inception including **\$258,227,439** in Fiscal 2017.

Column B - Net Earnings for the Legacy Fund total **\$574 million** since inception including **\$308,656,884** in Fiscal 2017.

Column C - Represents the sum of Deposits (Column A) and Net Earnings (Column B) totalling \$566,884,323 in Fiscal 2017.

Column D - Represents the "Ending Net Position" of the Legacy Fund and approximates **\$4.373 billion** at February 28, 2017.

Column E - Earnings (per NDCC 21-10-02) approximates **\$382 million** since inception including **\$153 million** in Fiscal 2017.

Legacy Fund – Interim Results February 28, 2017

Unaudited and Subject to Change

	February-17			Current FYTD		Prior Year FY16		3 Years Ended	
	Allocation			Returns		Returns		6/30/2016	
	Market Value	Actual	Policy	Gross ⁽¹⁾	Net	Gross ⁽¹⁾	Net	Gross ⁽¹⁾	Net
TOTAL LEGACY FUND	4,378,385,883	100.0%	100.0%	8.08%	7.88%	1.31%	1.08%	3.87%	3.86%
POLICY TARGET BENCHMARK				6.60%	6.60%	1.01%	1.01%	3.05%	3.05%
ATTRIBUTION ANALYSIS									
Asset Allocation				-0.02%	-0.02%	-0.03%	-0.03%	-0.20%	-0.20%
Manager Selection				1.68%	1.41%	0.32%	0.07%	1.01%	0.78%
TOTAL RELATIVE RETURN				1.57%	1.39%	0.30%	0.04%	0.81%	0.58%
LARGE CAP DOMESTIC EQUITY									
Los Angeles Capital Russell 1000 Growth	301,372,492	6.9%	6.6%	11.05%	10.88%	4.96%	4.73%	N/A	N/A
				13.74%	13.74%	3.02%	3.02%		
LSV Russell 1000 Value	310,610,843	7.1%	6.6%	21.50%	21.23%	-2.89%	-3.17%	N/A	N/A
				15.17%	15.17%	2.86%	2.86%		
Los Angeles Capital Russell 1000	197,568,601	4.5%	4.4%	13.08%	12.97%	5.83%	5.67%	N/A	N/A
				14.45%	14.45%	2.94%	2.94%		
Clifton Group S&P 500	197,552,163	4.5%	4.4%	14.08%	13.81%	4.77%	4.70%	N/A	N/A
				14.23%	14.23%	3.99%	3.99%		
TOTAL LARGE CAP DOMESTIC EQUITY	1,007,104,099	23.0%	22.0%	15.15%	14.95%	2.72%	2.52%	N/A	N/A
Russell 1000				14.45%	14.45%	2.94%	2.94%		
SMALL CAP DOMESTIC EQUITY									
PIMCO RAE (formerly Research Affiliates)	171,992,848	3.9%	4.0%	21.96%	21.74%	-3.71%	-3.98%	N/A	N/A
Clifton	202,882,678	4.6%	4.0%	21.75%	21.14%	-5.30%	-5.76%	N/A	N/A
TOTAL SMALL CAP DOMESTIC EQUITY	374,875,526	8.6%	8.0%	21.85%	21.42%	-4.58%	-4.99%	N/A	N/A
Russell 2000				21.45%	21.45%	-6.73%	-6.73%		
INTERNATIONAL EQUITY									
LSV MSCI EAFE	352,609,467	8.1%	8.0%	16.88%	16.55%	-10.97%	-11.30%	N/A	N/A
				10.29%	10.29%	-10.16%	-10.16%		
William Blair MSCI ACWI ex-US IMI (Net)	323,656,978	7.4%	8.0%	8.37%	8.12%	N/A	N/A	N/A	N/A
				11.05%	11.05%				
DFA Vanguard (1)	86,397,132	2.0%	2.0%	18.82%	18.82%	-9.28%	-9.28%	N/A	N/A
S&P/ICMgroup BMI EPAC < \$2BN	81,793,561	1.9%	2.0%	10.49%	10.49%	-7.27%	-7.27%	N/A	N/A
				11.15%	11.15%	-3.37%	-3.37%		
TOTAL INTERNATIONAL EQUITY	844,467,139	19.3%	20.0%	13.03%	12.79%	-10.46%	-10.73%	N/A	N/A
MSCI World Ex US (2)				10.92%	10.92%	-10.16%	-10.16%		

The Legacy Fund has earned 7.89% for the 8 months ended Feb. 28, 2017, surpassing its policy target of 6.5% by 1.39%.

Strong returns in US Equities (up 15%-to-21%), Int'l. Equities (up 12%) and Real Estate (up 4%) were offset by weak Fixed Income results (up 1%) and a decline in Diversified Real Assets (down 1%).

Legacy Fund – Interim Results February 28, 2017

Unaudited and Subject to Change

The BND Match Loan CD Program was transferred to the Legacy Fund during the past six months.

	February-17		Current FYTD		Prior Year FY16		3 Years Ended 6/30/2016			
	Market Value	Allocation	Actual	Policy	Gross ⁽¹⁾	Net	Gross ⁽¹⁾	Net	Gross ⁽¹⁾	Net
FIXED INCOME										
Western Asset	447,376,400	10.2%	10.8%		0.47%	0.37%	6.70%	6.56%	N/A	N/A
Prudential	166,232,373	3.8%	2.8%		0.71%	0.51%	7.53%	7.24%	N/A	N/A
PIMCO (DISCO II) (1)	44,474,024	1.0%	1.0%		10.28%	10.28%	4.39%	4.39%	N/A	N/A
PIMCO (BRAVO III) (1)	24,953,675	0.6%	0.6%		8.36%	8.36%	7.02%	7.02%	N/A	N/A
Bloomberg Aggregate					-1.68%	-1.68%	6.00%	6.00%		
Declaration (Total Return) (1) 3m LIBOR	105,942,204	2.4%	2.4%		2.85%	2.85%	2.59%	2.59%	N/A	N/A
State Street Bloomberg Gov/Credit	189,339,291	4.3%	4.9%		-2.00%	-2.03%	6.71%	6.68%	N/A	N/A
Wells Capital Bloomberg Credit Baa	435,283,918	9.9%	10.8%		2.20%	2.06%	7.16%	6.97%	N/A	N/A
Bank of ND Match Loan CDs	76,728,888	1.8%	1.8%		N/A	N/A	N/A	N/A	N/A	N/A
TOTAL FIXED INCOME	1,490,330,773	34.1%	35.0%		1.27%	1.17%	6.54%	6.40%	N/A	N/A
Bloomberg Aggregate					-1.68%	-1.68%	6.00%	6.00%		
Bloomberg Global Inflation Linked Index										
Western	289,446,844	6.6%	7.6%		-1.77%	-1.87%	2.72%	2.58%	N/A	N/A
BC Global Inflation Linked Index					-1.20%	-1.20%	2.55%	2.55%		
Grosvenor CIS II	15,674,578	0.4%	0.4%		-0.76%	-0.76%	6.10%	6.10%	N/A	N/A
JP Morgan (Infrastructure) CPI	87,519,754	2.0%	2.0%		0.09%	-0.20%	5.17%	3.97%	N/A	N/A
					0.93%	0.93%	0.64%	0.64%		
TOTAL DIVERSIFIED REAL ASSETS	392,641,176	9.0%	10.0%		-1.27%	-1.41%	3.51%	3.14%	N/A	N/A
Benchmark					-0.69%	-0.69%	2.00%	2.00%		
REAL ESTATE										
JP Morgan	133,627,782	3.1%	2.5%		5.62%	5.16%	10.16%	9.03%	N/A	N/A
Invesco	121,815,020	2.8%	2.5%		3.89%	3.71%	10.95%	10.59%	N/A	N/A
TOTAL REAL ESTATE	255,442,802	5.8%	5.0%		4.79%	4.46%	10.51%	9.79%	N/A	N/A
NCREIF Total Index					4.72%	4.72%	10.64%	10.64%		
CASH EQUIVALENTS										
Northern Trust (1)	5,108,273				0.14%	0.14%	0.13%	0.13%	N/A	N/A
Bank of ND	6,426,077				N/A	N/A	N/A	N/A	N/A	N/A
TOTAL CASH EQUIVALENTS	11,534,350	0.3%	0.0%		0.21%	0.21%	0.13%	0.13%	0.05%	0.05%
90 Day T-Bill					0.27%	0.27%	0.19%	0.19%	0.09%	0.09%

Legacy Fund – Actual Performance vs Policy Benchmark

Net Returns Exceed Policy Benchmark – Periods Ended 12/31/2016

The SIB Governance Manual states “SIB clients should receive investment returns consistent with their written investment policies and market variables. This “End” is evaluated based on comparison of each client’s (a) actual net investment return, (b) standard deviation and (c) risk adjusted excess return, to the client’s policy benchmark over 5 years.”

LEGACY FUND	Current	1 Yr Ended	3 Yrs Ended	5 Yrs Ended	Risk 5 Yrs Ended 12/31/2016	Risk Adj Excess Return 5 Yrs Ended 12/31/2016
	FYTD 12/31/2016	12/31/2016	12/31/2016	12/31/2016		
Net Investment Return	4.8%	8.15%	4.4%	3.6%	3.6%	0.70%
Policy Benchmark Return	3.5%	6.41%	3.6%	2.6%	3.2%	OK
Excess Return	1.3%	1.75%	0.8%	1.0%	111%	
Estimated Incremental Income:		Last 1-Year = \$60 million		Last 5-Years = \$100 million		

1. For the 1-Year Ended 12/31/16, the Legacy Fund generated a **Net Return of 8.1%** exceeding the Policy Benchmark (of 6.4%) and creating **Excess Return of 1.7%**. Actual net returns exceed the Policy Benchmark by over **\$60 million** for the 1 year ended 12/31/16 (e.g. \$4 billion x 1.5%).
2. For the 5-Years Ended 12/31/16, the Fund earned a **Net Return of 3.6%** exceeding the Policy Benchmark (of 2.6%) and creating **Excess Return of 1.0%**. Actual returns exceed the Policy Benchmark Return by **\$100 million** for the 5 years ended 12/31/16 (e.g. \$2 billion x 1% x 5 years).
3. Returns achieved while adhering to stated investment guidelines for Risk (of no more than 115%) and generating **0.70%** of Risk Adjusted Excess Return over the last 5-years.

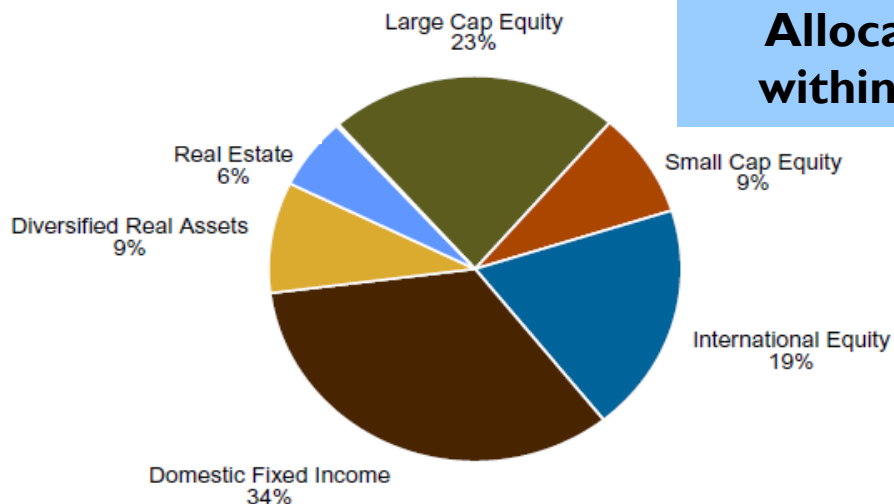
Note: Current Fiscal Year To Date and all returns as of December 31, 2016 are unaudited and subject to change.

Legacy Fund - Asset Allocation

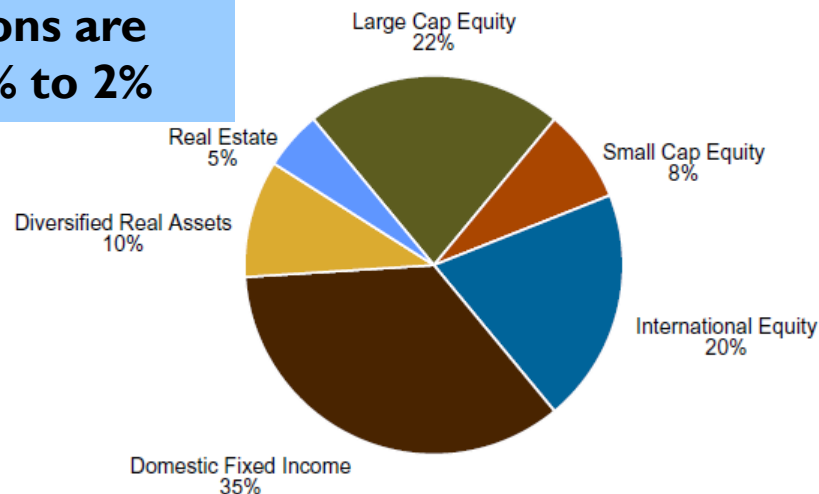
Market Valuations as of December 31, 2016

Actual and Target Allocations are within 1% to 2%

Actual Asset Allocation



Target Asset Allocation



Asset Class	\$000s Actual	Weight Actual	Target	Percent Difference	\$000s Difference
Large Cap Equity	956,157	22.8%	22.0%	0.8%	34,503
Small Cap Equity	369,572	8.8%	8.0%	0.8%	34,425
International Equity	805,323	19.2%	20.0%	(0.8%)	(32,544)
Domestic Fixed Income	1,410,552	33.7%	35.0%	(1.3%)	(55,715)
Diversified Real Assets	390,428	9.3%	10.0%	(0.7%)	(28,506)
Real Estate	251,367	6.0%	5.0%	1.0%	41,901
Cash & Equivalents	5,936	0.1%	0.0%	0.1%	5,936
Total	4,189,336	100.0%	100.0%		

* Current Quarter Target = 35.0% BB Barclays Aggregate Idx, 22.0% Russell 1000 Index, 20.0% MSCI EAFE, 10.0% NDSIB Legacy DRA Weighted Benchmark, 8.0% Russell 2000 Index and 5.0% NCREIF Total Index.

NORTH DAKOTA LEGACY FUND
INVESTMENT POLICY STATEMENT

1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS

The North Dakota legacy fund was created in 2010 when the voters of North Dakota approved a constitutional amendment--now Article X, Section 26, of the Constitution of North Dakota--to provide that 30 percent of oil and gas gross production and oil extraction taxes on oil and gas produced after June 30, 2011, be transferred to the legacy fund. The principal and earnings of the legacy fund may not be spent until after June 30, 2017, and any expenditure of principal after that date requires a vote of at least two-thirds of the members elected to each house of the Legislative Assembly. Not more than 15 percent of the principal of the legacy fund may be spent during a biennium. The Legislative Assembly may transfer funds from any source to the legacy fund, and such transfers become part of the principal of the fund. The State Investment Board (SIB) is responsible for investment of the principal of the legacy fund. Interest earnings accruing after June 30, 2017, are transferred to the general fund at the end of each biennium. North Dakota Century Code Section 21-10-11 provides that the goal of investment for the legacy fund is principal preservation while maximizing total return.

2. FUND MISSION

The legacy fund was created, in part, due to the recognition that state revenue from the oil and gas industry will be derived over a finite timeframe. The legacy fund defers the recognition of 30 percent of this revenue for the benefit of future generations. The primary mission of the legacy fund is to preserve the real inflation-adjusted purchasing power of the money deposited into the fund while maximizing total return.

3. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD

The Legacy and Budget Stabilization Fund Advisory Board (the "Advisory Board") is charged by law under Section 21-10-11 with the responsibility of recommending policies on investment goals and asset allocation of the legacy fund. The SIB is charged with implementing policies and asset allocation and investing the assets of the legacy fund in the manner provided in Section 21-10-07--the prudent institutional investor rule. The fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

Management responsibility for the investment program not assigned to the SIB in Chapter 21-10 is hereby delegated to the SIB, which must establish written policies for the operation of the investment program consistent with this investment policy.

The SIB may delegate investment responsibility to professional money managers, which are also required to employ investment strategies consistent with the investment policy. Where a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory not advisory.

At the discretion of the SIB, the fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and the objectives of the funds participating in the pool.

The SIB is responsible for establishing criteria, procedures, and making decisions with respect to hiring, retaining, and terminating money managers. The SIB investment responsibility also includes selecting performance measurement services, consultants, report formats, and frequency of meetings with managers.

The SIB shall notify the Advisory Board within 30 days of any substantial or notable changes in money managers; performance measurement services; and consultants, including hiring or terminating a money manager, performance measurement service, or a consultant.

The SIB, after consultation with the board, will implement necessary changes to this policy in an efficient and prudent manner.

4. RISK TOLERANCE

The Advisory Board's risk tolerance with respect to the primary aspect of the legacy fund's mission is low. The Advisory Board is unwilling to undertake investment strategies that might jeopardize the ability of the legacy fund to maintain principal value over time. The Advisory Board recognizes that the plan will evolve as the legacy fund matures and economic conditions and opportunities change.

5. INVESTMENT OBJECTIVES


The Advisory Board's investment objectives are expressed in terms of reward and risk expectations relative to investable, passive benchmarks. The legacy fund's policy benchmark is comprised of policy mix weights of appropriate asset class benchmarks as set by the SIB:

- a. The legacy fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.
- b. The legacy fund's risk, measured by the standard deviation of net returns, should not exceed 115 percent of the policy benchmark over a minimum evaluation period of five years.
- c. The risk-adjusted performance of the legacy fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

6. POLICY ASSET MIX

After consideration of all the inputs and a discussion of its own collective risk tolerance, the Advisory Board approved the following policy asset mix for the legacy fund as of April 2, 2013:

Asset Class	Policy Target Percentage
Broad US Equity	30%
Broad International Equity	20%
Fixed Income	35%
Core Real Estate	5%
Diversified Real Assets	10%



Rebalancing of the fund to this target will be done in accordance with the SIB's rebalancing policy, but not less than annually. The SIB approved an 18-month implementation strategy which completed in January of 2015. On June 15, 2016, the Advisory Board acknowledged RIO's stated intent to transfer the Bank of North Dakota Match Loan Certificates of Deposit Program ("BND CD") to the Legacy Fund on or before July 1, 2017. The BND CD investment will be limited to the lesser of \$200 million or 5% of the Legacy Fund (and represent a sector allocation within fixed income). The Advisory Board approved this future change in the Legacy Fund's asset allocation without exception. BND will be requested to guarantee a minimum 1.75% investment return. The minimum return requirement will be periodically reviewed in connection with the Legacy Fund's overall asset allocation framework. BND CD's were rated AA by S&P as of June 15, 2016.

7. RESTRICTIONS

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the legacy fund's assets will be invested, it is understood that:

- a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
- b. Derivatives use will be monitored to ensure that undue risks are not taken by the money managers.
- c. No transaction may be made that would threaten the tax-exempt status of the legacy fund.
- d. All assets will be held in custody by the SIB's master custodian or such other custodians as are acceptable to the SIB.
- e. No unhedged short sales or speculative margin purchases may be made.
- f. Social investing is prohibited unless it meets the exclusive benefit rule, and it can be substantiated that the investment provides an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk. For the purpose of this document, social investing is defined as the consideration of socially responsible criteria in the investment or commitment of public fund money for the purpose of obtaining an effect other than a maximized return to the Fund.
- g. Economically targeted investing is prohibited unless the investment meets the exclusive benefit rule.

For the purpose of this document, economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the exclusive benefit rule is met if the following four conditions are satisfied:

- The cost does not exceed the fair market value at the time of investment.
- The investment provides the legacy fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- Sufficient liquidity is maintained in the legacy fund to permit distributions in accordance with the terms of the plan.

- The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity, are equivalent, the Advisory Board's policy favors investments which will have a positive impact on the economy of North Dakota.

8. INTERNAL CONTROLS

A system of internal controls must be in place by the SIB to prevent losses of public funds arising from fraud or employee error. Such controls deemed most important are the separation of responsibilities for investment purchases from the recording of investment activity, custodial safekeeping, written confirmation of investment transactions, and established criteria for investment manager selection and monitoring. The annual financial audit must include a comprehensive review of the portfolio, accounting procedures for security transactions, and compliance with the investment policy.

9. EVALUATION AND REVIEW

Investment management of the legacy fund will be evaluated against the fund's investment objectives and investment performance standards. Emphasis will be placed on 5-year and 10-year results. Evaluation should include an assessment of the continued feasibility of achieving the investment objectives and the appropriateness of the investment policy statement for achieving those objectives.

Performance reports will be provided to the Advisory Board periodically, but not less than quarterly. Such reports will include asset returns and allocation data. Additionally, not less than annually, reports will include information regarding all significant and/or material matters and changes pertaining to the investment of the legacy fund, including:

- Changes in asset class portfolio structures, tactical approaches, and market values.
- Loss of principal, if any.
- Management costs associated with various types of investments.
- All material legal or legislative proceedings affecting the SIB.
- Compliance with this investment policy statement.
- An evaluation of the national economic climate.
- A forecast of the expected economic opportunities and dangers.
- Management of risk by the SIB.

In addition to the quarterly and annual evaluation and review process, the SIB shall notify the Advisory Board within 30 days of any substantial or notable deviation from the normal management of the legacy fund, including any anomalies, notable losses, gains, or liquidation of assets affecting the fund.



Approved by:

**LEGACY AND BUDGET STABILIZATION
FUND ADVISORY BOARD**

Rep. Keith Kempenich

**Representative Keith Kempenich
Chairman**

Date: 8-3-16

STATE INVESTMENT BOARD

David Hunter

**David Hunter
Executive Director / CIO**

Date: 8-3-16

Approved by the NDSIB: 7/22/2016
Approved by the LBSFAB: 6/15/2016

Legacy Fund – Investment Fees and Expenses

Fiscal 2016 vs Fiscal 2015

	FY 2016				FY 2015			
	Average Market Value	Fees in \$	Fees in %	Contribution to Total Fees	Average Market Value	Fees in \$	Fees in %	Contribution to Total Fees
Investment managers' fees:								
Domestic large cap equity managers	778,006,246	2,095,229	0.27%	0.06%	657,310,185	1,280,864	0.19%	0.04%
Domestic small cap equity managers	279,004,042	1,204,775	0.43%	0.03%	240,214,984	1,043,694	0.43%	0.03%
International equity managers	686,819,896	2,752,321	0.40%	0.08%	587,722,699	2,397,207	0.41%	0.07%
Domestic fixed income managers	1,261,572,841	3,376,076	0.27%	0.09%	985,960,253	2,910,709	0.30%	0.08%
Diversified real assets managers	355,643,550	1,485,125	0.42%	0.04%	249,618,003	599,955	0.24%	0.02%
Real estate managers	208,482,344	1,347,554	0.65%	0.04%	151,340,748	1,125,359	0.74%	0.03%
Short-term fixed income managers	-	-	0.00%	0.00%	152,806,876	202,772	0.13%	0.01%
Cash & equivalents managers	14,048,537	20,951	0.15%	0.00%	15,892,632	21,374	0.13%	0.00%
Total investment managers' fees	3 3,583,577,456	12,282,031	0.34%	6	3,040,866,380	9,581,934	0.32%	
Custodian fees		355,571	0.01%	0.01%		313,311	0.01%	0.01%
Investment consultant fees		198,884	0.01%	0.01%		152,627	0.01%	0.01%
Total investment expenses	2	12,836,486	0.36%	1	10,047,873	0.33%		
Total Performance Fees Paid		1,988,561	0.06%		1,754,110	0.06%		
Actual Investment Performance (Net of Fees)			1.06%				3.31%	
Policy Benchmark			1.01%				2.37%	
		Outperformance	5	0.05%		Outperformance	7	0.94%
		<i>Average Market Value (3) x Outperformance (5)</i>		\$1.8 million		<i>Average Market Value (6) x Outperformance (7)</i>		\$28 million

➤ Investment management fees & expenses increased to 0.36% from 0.33% in the last year as the approved asset allocation strategy was implemented. Performance fees remained flat at approximately 0.06%.

➤ The use of active management paid minimal returns for the Legacy Fund in Fiscal 2016 as we paid \$12.8 million in fees to earn 1.06% (or \$38 million) and only outperformed our benchmark by 0.05% (or \$1.8 million).

Investment Fees and Expenses – Summary

During the last three-years, investment management fees and expenses as a % of average assets under management declined from **0.65% in fiscal 2013** to **0.51% in fiscal 2014** to **0.48% in fiscal 2015** and to **approximately 0.42% in fiscal 2016**.

<u>All State Investment Board Clients</u>	<u>Investment Fees and Expenses</u> a	<u>Average "Assets Under Management"</u> b	<u>% of "AUM"</u> a / b
Fiscal Year Ended June 30, 2013	\$45 million	\$6.9 billion	0.65%
Fiscal Year Ended June 30, 2014	\$44 million	\$8.6 billion	0.51%
Fiscal Year Ended June 30, 2015	\$48 million	\$10.1 billion	0.48%
Fiscal Year Ended June 30, 2016	\$46 million	\$10.9 billion	0.42%

Key Point: Based on \$10 billion of assets, this 20+ bps decline between fiscal 2013 and 2016 translates into over \$20 million of annual savings.

➤ RIO will diligently work to prudently manage all SIB client investment fees and expenses, but acknowledges it will be challenging to reduce fees and expenses below 45 bps (0.45%) per annum in future years. Current fiscal years results were materially impacted by low incentive performance fees.

A basis point (or "bp") is equal to one one-hundredth of one percent (or 0.01%) such that 100 basis points ("bps") is equivalent to 1%.

SIB Client Assets Under Management

<u>Fund Name</u>	<u>Market Values as of 12/31/16 ⁽¹⁾</u>	<u>Market Values as of 6/30/16 ⁽²⁾</u>	<u>Market Values as of 12/30/15 ⁽¹⁾</u>
Pension Trust Fund			
Public Employees Retirement System (PERS)	2,563,018,948	2,459,388,086	2,371,419,312
Teachers' Fund for Retirement (TFFR)	2,147,574,445	2,082,183,640	2,036,260,471
Job Service of North Dakota Pension			93,985,042
City of Bismarck Employees Pension	85,523,410	82,441,003	79,987,495
City of Grand Forks Employees Pension	58,008,561	57,975,758	55,321,141
City of Bismarck Police Pension	35,374,745	33,983,598	33,013,643
Grand Forks Park District	5,871,117	5,720,245	5,770,147
City of Fargo Employees Pension			1,512
Subtotal Pension Trust Fund	4,895,371,226	4,721,692,330	4,675,758,763
Insurance Trust Fund			
Workforce Safety & Insurance (WSI)	1,825,110,509	1,832,104,203	1,746,807,452
Budget Stabilization Fund	103,537,937	575,918,381	573,743,813
PERS Group Insurance Account	36,834,347	37,715,356	38,411,033
City of Fargo FargoDome Permanent Fund	33,312,203	38,782,721	38,489,674
State Fire and Tornado Fund	22,545,969	24,091,203	23,169,406
Petroleum Tank Release Compensation Fund	6,842,054	7,149,512	6,931,840
State Risk Management Fund	6,246,768	6,534,801	6,213,232
State Risk Management Workers Comp Fund	5,748,688	5,516,177	5,723,481
ND Association of Counties (NDACo) Fund	4,164,771	4,048,863	3,895,582
State Bonding Fund	3,292,172	3,296,372	3,187,067
ND Board of Medicine	2,258,841	2,208,667	2,156,260
Insurance Regulatory Trust Fund	1,477,615	1,085,836	1,057,824
Bismarck Deferred Sick Leave Account	661,093	642,265	615,610
Cultural Endowment Fund	406,389	386,452	372,713
Subtotal Insurance Trust Fund	2,052,439,356	2,539,480,809	2,450,774,987
Legacy Trust Fund			
Legacy Fund	4,189,334,992	3,809,485,177	3,522,475,430
PERS Retiree Insurance Credit Fund	106,879,605	101,623,224	96,046,927
Job Service of North Dakota Pension	95,685,427	96,588,333	
ND Tobacco Prevention and Control Trust Fund	50,509,542	54,366,538	46,438,466
Total Assets Under SIB Management	11,390,220,148	11,323,236,410	10,791,494,573

- ▶ SIB client assets grew by nearly \$600 million (or 5.5%) in the last year largely due to Legacy Fund tax deposits of \$365 million plus Legacy Fund net investment earnings of \$300+ million.
- ▶ The Pension Trust posted a net return of 7.06% in the last year. During the last 5-years, the Pension Trust generated a net annualized return of 8.48%, exceeding the performance benchmark of 7.86%.
- ▶ The Insurance Trust generated a net return of 6.05% in the last year. During the last 5-years, the Insurance Trust posted a net annualized return of 5.18%, exceeding the performance benchmark of 3.64%.
- ▶ The Legacy Fund generated a net investment gain of 8.15% for the year ended December 31, 2016, exceeding its performance benchmark. Since inception, the Legacy Fund has generated a net annualized return of 3.43% (over the last 5 ¼ years) exceeding the performance benchmark of 2.52%.
- ▶ SIB client assets totaled approximately \$11.4 billion as of December 31, 2016, based on unaudited valuations.

⁽¹⁾ 12/31/16 and 12/31/15 market values are unaudited and subject to change.

⁽²⁾ 6/30/16 market values as stated in the Comprehensive Annual Financial Report.

AGENDA ITEM IV.A.

INFORMATIONAL

TO: State Investment Board
FROM: Dave Hunter
DATE: April 24, 2017
SUBJECT: **Board Education – Open Record and Meeting Laws**

Jan Murtha, legal counsel from the Office of the Attorney General, will provide board education relating to North Dakota's open record and meeting laws including the impact of recent changes enacted during the most recent legislative session.



Open Meetings & Records Update 2017

Board Education.
4/27/17 & 4/28/17

H.B. 1345 (2017) Background

- After 2015 biennium NDAG establishes OR/OM task force.
- Recognized need for updates or improvements to the OR/OM law.
- 16 member task force included: media, legislators, state, county and city representation.
- Resulted in task force bill submitted by sponsors.

H.B.1345 Discussion

- Comprised of 15 Sections
- Addresses law enforcement related records, other entity records, access to records, open meetings, and process of review.
- Focus discussion on Sections: 3, 4, 5, 10, 11, 12, 13, and 15.

H.B. 1345 Section 3

- Change?
 - Excludes from the definition of meeting training seminars where no other public business is considered or discussed.
- Impact?
 - No need to notice training or take minutes. Also alleviates quorum concerns for out of state seminars.

H.B. 1345 Section 4

- Change?
 - May require written clarification of request.
 - Clarifies that entity need not provide direct access to computer terminal or mobile device.
 - If the information requested is available online, entity may direct requestor to website.
- Impact?
 - Reduce response time to requestor and improve efficient time management and allocation of entity resources.

H.B. 1345 Section 5

- Change?
 - Requestor may use personal device to duplicate records under reasonable circumstances.
 - If repeated requests disrupt essential functions, entity may deny further inspection or copies of records. Remedy.
- Impact?
 - Reduce cost for both parties.
 - Discourage use of OR law as a means to harass. High Bar for entity.

H.B. 1345 Section 10

- Change?
 - Expands the definition of attorney consultation.
 - Protects draft agreements under some circumstances.
- Impact?
 - Permits entities to receive advice on risk management without impairing possible future litigation.
 - Protects an entities negotiating position.

H.B. 1345 Section 11

- Change?
 - Creates an exemption for settlement agreements under certain circumstances.
- Impact?
 - Protects an entities negotiating position.

H.B. 1345 Section 12

- Change?
 - Clarifies that filing a yearly schedule of upcoming meetings does not relieve the entity from following other notice requirements.
 - Clarifies the timing requirements for posting notice of a meeting.
- Impact?
 - Provides clarity and consistency in notice requirements for entities.

H.B. 1345 Section 13

- Change?
 - Authorizes the AG to issue summary opinions and require entities to participate in training.
- Impact?
 - Reduces time to respond to some opinion requests and addresses some enforcement concerns.

H.B. 1345 Section 15

- This section declared H.B. 1345 to be an emergency measure.
- This bill was signed by the Governor on April 11 and filed with the Secretary of State on April 12.
- The provisions we have discussed are now governing law.

H.B. 1345 Other Sections

- Sections 1, 2, 9 and 14 relate to the protection of information about victims, witnesses, and emergency services.
- Sections 6 and 8 expands the definition of personal information.
- Section 7 creates a section regarding internal investigation records.

Violations – In General

- Attorney general's opinions under N.D.C.C. § 44-04-21.1:
 - 30 days of alleged violation except meetings without notice – 90 days.
 - If AG opinion concludes that violation occurred and action needed to correct violation not taken within 7 days & requester prevails in civil action, requester will get attorney's fees.
 - Consequence for failure to comply with AG opinion – potential personal liability & pay for legal counsel.

Violations - Continued

- Violations may be subject of civil action under N.D.C.C. § 44-04-21.2.
- Action must be commenced within 60 days of the date the person knew or should have known of the violation or 30 days from issuance of AG opinion.
- Court may award \$1,000 or actual damages for intentional or knowing violations.

Violations - Continued

- AG can refer a public servant to the state's attorney for multiple violations.
- A public servant who knowingly violates the law is guilty of a class A misdemeanor.
- It is a Class C felony to knowingly release confidential information.

N.D.C.C. § 44-04-21.3

N.D.C.C. § 12.1-11-06

N.D.C.C. §12.1-13-01

More information

- ❖ www.attorneygeneral.nd.gov
 - ❖ Manuals
 - ❖ Opinions
 - ❖ Fact Sheets

INFORMATIONAL

TO: State Investment Board
FROM: Dave Hunter
DATE: April 24, 2017
SUBJECT: Client Investment Policy Statements and Social Investing

The Investment Policy Statements for nearly all of our State Investment Board clients contain the following language relating to social investing:

Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

For the purpose of this document, social investing is defined as "The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."

Although there is a great debate about the costs and benefits of social investing please see excerpts from two articles published in "*Pensions and Investments*" which reference statements made by CalPERS (the California Public Employees Retirement System) and Norway's Government Pension Fund as examples on the cost of social investing.

CalPERS mulls ending tobacco investment ban

By [RANDY DIAMOND](#) | April 4, 2016

CalPERS has missed out on as much as \$3 billion in investment gains since the nation's largest defined benefit plan shed its tobacco holdings, as that industry powered ahead, a recent report from its consultant states.

Norway wealth fund misses out on returns due to divestment, Norges says

By [PAULINA PIELICHATA](#) | March 22, 2017 4:08 pm | Updated 4:12 pm

Norway's Government Pension Fund Global's equity portfolio missed out on 1.1 percentage points of additional gain due to the exclusion of stocks on ethical grounds over the past 11 years, according to Norges Bank Investment Management, which manages the sovereign wealth fund's assets.

<http://www.pionline.com/article/20170322/ONLINE/170329935/norway-wealth-fund-misses-out-on-returns-due-to-divestment-norges-says>

INFORMATIONAL

TO: State Investment Board
FROM: Dave Hunter (on behalf of SIB Executive Review Committee)
DATE: April 21, 2017
SUBJECT: **Executive Review Committee Update**

In accordance with SIB Governance Manual section C-4 on **Monitoring Executive Performance**, the SIB Chairman will appoint a three-member executive review committee for the annual performance review of the Executive Director. The action was completed in February with the appointments of Yvonne Smith, Cindy Ternes and Mike Sandal. Ms. Smith agreed to be Chair of the Committee.

In March and April, the Committee conducted a formal evaluation of the Executive Director, which included a 30-question survey completed by each SIB member.

The Executive Review Committee intends to provide the SIB with an update of the annual review process at our April 28th board meeting. The annual evaluation of the Executive Director will be completed in May and finalized at our next SIB meeting on May 26, 2017.

SIB Legislative Update April 23, 2017

BILL NO.	DESCRIPTION	INTRODUCED BY:
<u>HB 1022</u>	RIO Budget	Appropriations Committee

HB 1022 contains the 2017-19 budget authority and continuing appropriations for RIO’s administrative costs for operating the retirement program for the TFFR board and the investment program for the SIB.

The House amended RIO’s budget and reduced it from \$5.41 million to \$5.27 million. Operating Expenses were cut by 20% or \$200,000 and Contingencies were cut by 37% or \$30,000. Salaries and Wages increased by 2% or \$89,000 due to higher health care (\$54,000) and cost to continue salary increases in the 2015-17 biennium. The House approved the amended bill by vote of 81-10.

The Senate Appropriations Committee conducted a hearing on Engrossed HB 1022 on 3/7 which was attended by Connie, Fay and Dave. RIO requested that the Senate add back \$87,750 for temporary salaries and critical staff and board travel and professional development. This proposal represented a 1% decrease to RIO’s current 2015-17 budget and 1.7% increase to the House approved budget.

Although RIO had several discussions with House and Senate Appropriation Committee members regarding our request for the Senate to reinstate \$87,750 to fund critical travel and professional development expenses, the Senate Appropriations Committee only made amendments for a \$3,940 reduction in health insurance premiums, and passed RIO’s budget out of Committee with a 14-0 “do pass” vote. On 3/27, the Senate approved the amendment and passed the bill by a vote of 45-0.

On 4/7, the House voted to “not concur” with amended HB 1022. Representatives Delzer, Kempenich, Brandenburg and Boehning were instrumental in supporting RIO’s request to make “needed corrections” to our budget. Senators Holmberg and Krebsbach were also strong advocates.

On 4/10, HB 1022 moved into Conference Committee (consisting of Reps. Boehning, Brabandt and Vigesaa and Senators Krebsbach, Bowman and Dever). On 4/13, the Committee gave a “do pass” recommendation to reinstate \$72,457. **On 4/18, re-engrossed HB 1022 passed the House (by a vote of 83-9) and Senate (by a vote of 42-0). About ½ of the \$145,828 cut from our current 2015-17 budget was reinstated to fund critical travel and professional development expenses. HB 1022 was sent to the Governor on 4/20.**

	<u>Base Level</u>	<u>Adjustments or Enhancements</u>	<u>Appropriation</u>	<u>% Decrease</u>
Salaries and Wages	\$ 4,340,551	\$ 85,019	\$ 4,425,570	2.0%
Operating Expenses	990,874	(128,390)	862,484	-13%
Contingencies	82,000	(30,000)	52,000	-37%
Total Special Funds	<u>\$ 5,413,425</u>	<u>\$ (73,371)</u>	<u>\$ 5,340,054</u>	<u>-1.4%</u>
Full-time equivalent positions	19.00	0.00	19.00	-

BILL NO.	DESCRIPTION	INTRODUCED BY:
<u>HB 1175</u>	SIB Membership	Rep. Kreidt, Delzer, Devlin, Kempenich and Sen. Klein

HB 1175 adds two members to the SIB, one selected by the House Majority Leader and one selected by the Senate Majority Leader, thereby increasing the number of SIB members to 13. The House approved the bill by a vote of 71-22.

In a Senate Political Subdivisions Committee hearing on 3/3, Rep. Devlin introduced the bill and indicated the main reason for the bill was to involve legislators on the investment board due to the amount of state funds invested by the SIB, particularly the Legacy Fund. No others testified in favor of the bill. Testifying in opposition to the bill was RaeAnn Kelsch (on behalf of ND Council of Educational Leaders). Dave Hunter (SIB) testified in a neutral position and provided information about the SIB members, responsibilities, and process. Testimony is attached. Besides Dave and Fay, others in attendance included Insurance Commissioner Godfread, and representatives from NDCEL, ND United, and NDRTA.

On 3/10, the Senate Political Subdivisions Committee gave the bill a “do not pass” recommendation by a vote of 6-0. On 3/13, **HB 1175 failed in the Senate** by a vote of 14-31.

OTHER BILLS OF INTEREST:

BILL NO.	DESCRIPTION	INTRODUCED BY:
<u>HB 1023</u>	PERS Budget	Appropriations Committee

HB 1023 is the PERS appropriations bill. In addition to PERS budget items, the House approved amendments to the bill which would change the governance of PERS. These amendments make the PERS Board advisory and change its membership; create a state agency called the PERS Office; provide that the Governor appoint an Executive Director of the PERS Office; modify the membership on the SIB to include two members of the PERS advisory board and the PERS Office executive director or designee; and add three nonvoting members of the PERS advisory board to the interim Legislative Employee Benefits Programs Committee. The actuarial and technical analysis determined that there would be no actuarial impact on the PERS plan, however the amendments would have an impact on the governance of PERS, as well as affect the governance of the SIB and RIO. The House approved the amended bill by a vote of 76-15.

The Senate GVA Committee held a hearing on Engrossed HB 1023 on 3/2. House Majority Leader Al Carlson presented the amendments and indicated the possibility of additional amendments to separate the insurance and retirement aspects of the bill due to fiduciary concerns. Rep. Kasper also testified in favor of the bill. Testifying in opposition (or no position) on various sections of the bill were NDPERS Executive Director Sparb Collins, ND United President Nick Archuleta, Senator Dever, and a retired public employee. Concerns brought up by those testifying in opposition to the bill was the process by which the amendments were added, lack of time to study the implications of the amendments, lack of member and employer input (including political subdivisions), and the need to study such significant changes relating to governance and fiduciary oversight of the PERS program from a multi-trustee to a sole trustee structure.

On 3/20 the Senate GVA Committee amended HB 1023 by requesting a legislative study of the power and duties of the PERS board including its fiduciary duties and administrative structure. The amendment also included a review of the power and duties of the Employee Benefits Program Committee, the feasibility and desirability of a self-funded insurance plan, and the contract bidding process. On 3/21, the Senate adopted the proposed amendment referred Engrossed HB 1023, including PERS budget, the Senate Appropriations Committee. Additional amendments were made, and on 3/30, Senate Appropriations offered a “do pass” recommendation by a 14-0 vote. On 3/31, the Senate re-referred engrossed HB 1023, as amended, back to the Appropriations Committee.

HB 1023 remains in Conference Committee (consisting of Reps. Vigesaa, Boehning and Keiser and Senators Krebsbach, Oehlke and Robinson) as of 4/23.

BILL NO.	DESCRIPTION	INTRODUCED BY:
HB 1088	Risk Management - Data Breach Response Costs	OMB

HB 1088 would allow the State’s Risk Management fund to cover state agencies for certain 1st party costs associated with a data breach including notification of affected parties, credit counseling, etc. A related OMB bill also includes special fund appropriation authority for self-insurance remediation costs, i.e. fixing the issues related to hardware and software. Please be reminded that RIO had originally included funds in an optional budget package for cyber insurance.

The House approved the bill by a vote of 91 – 1. The Senate has also approved the bill by a vote of 46-0. The Governor signed the bill on 3/2.

HB 1155 – Transfers and Expenditures from Budget Stabilization Fund
Introduced by: Representatives Delzer, Bellew, Carlson, Monson and Streyle

<http://www.legis.nd.gov/assembly/65-2017/documents/17-0101-05000.pdf>
<http://www.legis.nd.gov/assembly/65-2017/bill-actions/ba1155.html>

HB 1155 changes the rules which govern transfers and expenditures from the budget stabilization fund to the general fund and increases the Budget Stabilization Fund to 15% of the current biennial state general fund budget (versus 9.5% currently). (HB 1154 was incorporated into HB 1155 such that HB 1154 failed to pass with a vote of 5-84 on 2/10.)

The House Appropriations Committee scheduled a Committee hearing for HB 1155 on 1/18. On 2/7 the Committee gave a “do pass” recommendation to HB 1155 by a vote of 19-0. On 2/10, Engrossed HB 1155 passed the House with a vote of 89-2 (and the emergency clause was declared carried).

On 2/20, HB 1155 was read by the Senate and referred to its Appropriations Committee. Senate Appropriations scheduled a hearing for HB 1155 on 3/22 at 8:30am. On 3/31, Senate Appropriations offered a “do pass” recommendation to amended HB 1155 by a vote of 14-0. On 4/3, the Senate passed engrossed and amended HB 1155 by a vote of 47-0 and the emergency clause carried.

On 4/10, the House refused to concur on HB 1155. HB 1155 was then moved into Conference Committee consisting of Representatives Delzer, Vigesaa and Holman and Senators Holmberg, Wanzek and Grabinger. On 4/13-14, the House and Senate passed amended HB 1155 by a vote of 88-1 and 45-0, respectively, with an emergency clause. The President of the Senate and Speaker of the House signed HB 1155 on 4/17. The bill was signed by the Governor and filed with the Secretary of State on 4/18.

HB 1345 – Open Records and Meetings Laws

**Introduced by: Representatives Devlin, Delmore and Koppelman; and
Senators Armstrong, Casper and Nelson**

<http://www.legis.nd.gov/assembly/65-2017/documents/17-8156-04000.pdf>

On 4/12, HB 1345 was filed with the Secretary and, with its emergency clause, is now law. This is the open records and meetings task force bill worked on last biennium. There are many relevant sections for SIB (and TFFR) members. As such, we will kindly request the Office of the Attorney General to present these sections to the SIB at our April 28th meeting.

Probably the most relevant change is found in section 10 of the bill. This expands what is considered an “attorney consultation” and “attorney work product” that can be utilized to withhold records and go into an executive session. The new language allows you to close off meetings/records when you give “advice and guidance on the legal risks, strengths, and weaknesses of an action of a public entity” if doing so in public would have an adverse fiscal effect. The Task Force recognized that our public entities need to make fully informed decisions and are sometimes not able to because providing this information in an open meeting would have adverse effects. The language was a compromise, and looked to close that gap.

You will also notice in this section that draft contracts or agreements are exempt if revealing them to the public would have an adverse fiscal effect. See also Section 11 that makes settlement agreements involving multiple parties exempt until all settlements have been reached (this one does not require a showing of adverse fiscal impact). Other sections/areas in the bill:

Section 3 – boards/commissions can now attend “training seminars” without needing to post notice or take minutes (as long as no other public business is conducted during that time).

Section 4 – open record requests – although the initial request cannot be required to be in writing (so boards cannot mandate a form be filled out before it would respond to a request), if an entity needs to have the request be made in writing thereafter for clarification purposes, they can make such a mandate, but still cannot require the requestor to give up their name or motive for wanting the records.

Also in this section, if you keep public records online, you can now point a requestor to the website where they can access the information, instead of being required to print it out or email it to them – unless the requestor does not have access to a computer/internet. I think this will really help out with some of the GIS/Tax Roll requests we have been getting.

Section 5 – if you have a requestor who is harassing the public entity, and interrupting essential office functions, you are now allowed to deny further record requests. I would use this very sparingly any denial under this is subject to review by the attorney general’s office and will be a high bar to meet.

Section 7 – records of an internal investigations of employee misconduct are exempt until the investigation is complete or 75 days has passed

Section 12 – the yearly schedule of upcoming meetings that set the regular meeting dates can now be filed anytime in the year, not just in January. For special meetings, as soon as the public entity knows it will be meeting, the public should know – so notice must be posted at the required locations – even if an agenda has not yet been prepared.

HB 1425 – Protection from Foreign Laws

**Introduced by: Representatives Koppelman, Brabandt, Carlson, Jones, Karls, Maragos, Olson
Senators Burckhard, Clemems and Luick**

<http://www.legis.nd.gov/assembly/65-2017/documents/17-0697-04000.pdf>

HB 1425 intends to protect the U.S. citizens from the application of foreign laws in the event the foreign laws violate fundamental rights guaranteed by the Constitutions of the U.S. or North Dakota. The proposed language may be problematic and impair the ability of the SIB to enter into contracts relating to the prudent management of international investments. The Office of the Attorney General is reviewing the potential implications of this bill on behalf of the SIB, RIO and its clients along with several other governmental agencies in North Dakota.

HB 1425 passed by a vote of 62-30 in the House on 2/21. On 2/25, the bill was referred to the Senate Judiciary Committee. No action was taken on HB 1425 in a committee hearing on 3/22.

On 3/30, the Senate Judiciary Committee offered a “do pass” recommendation to proposed amendments to HB 1425 by a vote of 4-2. On 3/31, the Senate adopted amendments on HB 1425 as recommended by the Senate Judiciary Committee. **On 3/31, HB 1425, as amended, failed by a vote of 15-29 in the Senate.**

BUDGETING / FINANCIAL CONDITION

AS OF MARCH 31, 2017

	2015-2017 BUDGET	ADJUSTED APPROPRIATION	BIENNIUM TO DATE ACTUAL	EXPENDITURES		
				BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	\$ 4,340,551.00	\$ 4,342,556.31	\$ 3,685,548.84	\$ 657,007.47	15.13%	12.50%
OPERATING EXPENDITURES	990,874.00	990,874.00	607,152.46	383,721.54	38.73%	12.50%
CONTINGENCY	82,000.00	82,000.00	0.00	82,000.00	100.00%	12.50%
TOTAL	<u>\$ 5,413,425.00</u>	<u>\$ 5,415,430.31</u>	<u>\$ 4,292,701.30</u>	<u>1,122,729.01</u>	<u>20.73%</u>	<u>12.50%</u>

EXPENDITURE REPORT
QUARTER ENDED MARCH 31, 2017

	INVESTMENT	RETIREMENT	QUARTERLY TOTALS	FISCAL YEAR TO - DATE	BIENNIUM TO - DATE
CONTINUING APPROPRIATIONS					
INVESTMENT EXPENDITURES (SEE ATTACHED DETAIL)	\$ 7,222,799.17	\$ 0.00	\$ 7,222,799.17	\$ 22,182,282.42	\$ 54,444,042.04
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0.00	47,388,836.35	47,388,836.35	142,515,859.80	322,219,636.00
2. REFUND PAYMENTS	0.00	1,386,106.48	1,386,106.48	4,454,095.28	10,706,664.78
TOTAL MEMBER CLAIMS	0.00	48,774,942.83	48,774,942.83	146,969,955.08	332,926,300.78
OTHER CONTINUING APPROPRIATIONS	85,076.61	99,742.88	184,819.49	410,280.76	887,645.15
TOTAL CONTINUING APPROPRIATIONS	7,307,875.78	48,874,685.71	56,182,561.49	169,562,518.26	388,257,987.97
BUDGETED EXPENDITURES					
1. SALARIES & BENEFITS					
SALARIES	199,345.75	201,968.75	401,314.50	1,205,078.33	2,727,609.66
OVERTIME/TEMPORARY	0.00	0.00	0.00	4,185.00	8,021.25
TERMINATION SALARY & BENEFITS	0.00	0.00	0.00	0.00	0.00
FRINGE BENEFITS	62,413.70	78,111.12	140,524.82	416,542.68	949,917.93
TOTAL SALARY & BENEFITS	261,759.45	280,079.87	541,839.32	1,625,806.01	3,685,548.84
2. OPERATING EXPENDITURES					
DATA PROCESSING	2,797.40	14,511.87	17,309.27	49,682.27	128,085.02
TELECOMMUNICATIONS - ISD	821.43	1,364.35	2,185.78	5,944.73	15,219.91
TRAVEL	1,647.61	1,993.98	3,641.59	22,332.77	62,609.33
IT - SOFTWARE/SUPPLIES	763.36	1,943.06	2,706.42	2,835.27	3,210.32
POSTAGE SERVICES	818.07	18,031.62	18,849.69	38,726.47	82,864.58
IT - CONTRACTUAL SERVICES	244.86	486.88	731.74	37,245.74	42,861.94
BUILDING/LAND RENT & LEASES	10,348.32	16,747.08	27,095.40	69,088.50	150,974.70
DUES & PROF. DEVELOPMENT	235.75	3,764.25	4,000.00	14,889.00	37,168.50
OPERATING FEES & SERVICES	952.74	683.13	1,635.87	3,527.33	26,901.94
REPAIR SERVICE	285.90	520.95	806.85	909.85	922.35
PROFESSIONAL SERVICES	1,000.71	2,730.29	3,731.00	9,611.00	20,392.00
INSURANCE	0.00	0.00	0.00	638.79	1,269.56
OFFICE SUPPLIES	138.72	410.41	549.13	1,566.65	3,591.55
PRINTING	461.13	1,211.03	1,672.16	8,514.60	24,023.21
PROFESSIONAL SUPPLIES & MATERIALS	95.29	0.00	95.29	858.13	1,505.47
MISCELLANEOUS SUPPLIES	103.30	306.49	409.79	558.51	1,338.70
IT EQUIPMENT UNDER \$5000	0.00	0.00	0.00	0.00	2,182.38
OTHER EQUIPMENT UNDER \$5000	0.00	0.00	0.00	0.00	472.00
OFFICE EQUIPMENT & FURNITURE UNDER \$5000	(53.08)	(5.90)	(58.98)	1.00	1,559.00
TOTAL OPERATING EXPENDITURES	20,661.51	64,699.49	85,361.00	266,930.61	607,152.46
3. CONTINGENCY	0.00	0.00	0.00	0.00	0.00
TOTAL BUDGETED EXPENDITURES	282,420.96	344,779.36	627,200.32	1,892,736.62	4,292,701.30
TOTAL EXPENDITURES	\$ 7,505,220.13	\$ 49,119,722.19	\$ 56,809,761.81	\$ 171,455,254.88	\$ 392,550,689.27

INVESTMENT EXPENDITURE DETAIL			
FEES PAID DURING THE QUARTER ENDED MARCH 31, 2017			
FOR QUARTER ENDED 9/30/16			
<u>INSURANCE FIXED INCOME POOL</u>			
Wells			139,283.96
<u>INSURANCE SHORT TERM FIXED</u>			
JP Morgan			78,255.91
<u>LEGACY FIXED INCOME</u>			
Wells			195,522.29
TOTAL FOR QUARTER ENDED 9/30/16			413,062.16
FOR QUARTER ENDED 12/31/16			
<u>PENSION DEVELOPED INTERNATIONAL EQUITY POOL</u>			
Northern Trust		22,852.31	
Wellington		172,441.45	
William Blair		121,889.78	
TOTAL PENSION INTERNATIONAL EQUITY			317,183.54
<u>PENSION GLOBAL EQUITY POOL</u>			
Epoch		551,836.43	
LSV		120,924.00	
TOTAL PENSION GLOBAL EQUITY			672,760.43
<u>PENSION BELOW INVESTMENT GRADE FIXED</u>			
Loomis Sayles			237,413.48
<u>PENSION INVESTMENT GRADE FIXED INCOME POOL</u>			
JP Morgan		63,756.70	
PIMCO		147,844.59	
State Street		6,887.58	
TOTAL PENSION INVESTMENT GRADE FIXED INCOME			218,488.87
<u>PENSION INFRASTRUCTURE POOL</u>			
JP Morgan			241,586.38
<u>PENSION LARGE CAP EQUITY POOL</u>			
LA Capital			216,024.77
<u>PENSION SMALL CAP EQUITY POOL</u>			
Atlanta Capital			223,491.00
<u>PENSION REAL ESTATE</u>			
JP Morgan (Special & Strategic)		434,333.80	
Invesco		215,696.45	
TOTAL PENSION REAL ESTATE			650,030.25
<u>PENSION INTERNATIONAL FIXED INCOME</u>			
Brandywine		134,945.60	
UBS		88,891.80	
TOTAL PENSION INTERNATIONAL FIXED INCOME			223,837.40
<u>INSURANCE FIXED INCOME POOL</u>			
Prudential		72,365.38	
State Street		11,726.13	
Wells		134,418.34	
Western Asset		101,397.24	
TOTAL INSURANCE FIXED INCOME			319,907.09

INVESTMENT EXPENDITURE DETAIL			
FEES PAID DURING THE QUARTER ENDED MARCH 31, 2017			
<u>INSURANCE LARGE CAP EQUITY POOL</u>			
LA Capital		52,912.42	
LSV		59,202.00	
TOTAL INSURANCE LARGE CAP			112,114.42
<u>INSURANCE SMALL CAP EQUITY POOL</u>			
PIMCO RAE			24,359.09
<u>INSURANCE INT'L EQUITY</u>			
LSV		73,173.00	
William Blair		63,368.47	
TOTAL INSURANCE INT'L EQUITY			136,541.47
<u>INSURANCE DIVERSIFIED REAL ASSETS</u>			
JP Morgan		129,592.78	
Western Asset		37,359.79	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS			166,952.57
<u>INSURANCE REAL ESTATE</u>			
Invesco		54,846.87	
JP Morgan		135,690.56	
TOTAL INSURANCE REAL ESTATE			190,537.43
<u>INSURANCE SHORT TERM FIXED</u>			
Babson		41,447.74	
JP Morgan		44,913.66	
TOTAL INSURANCE SHORT TERM FIXED			86,361.40
<u>LEGACY FIXED INCOME</u>			
Prudential		103,136.38	
State Street		16,145.41	
Wells		191,777.90	
Western Asset		144,453.83	
TOTAL INSURANCE FIXED INCOME			455,513.52
<u>LEGACY LARGE CAP EQUITY</u>			
LA Capital		201,990.51	
LSV		219,977.00	
TOTAL INSURANCE LARGE CAP			421,967.51
<u>LEGACY SMALL CAP EQUITY</u>			
PIMCO RAE			103,531.91
<u>LEGACY INT'L EQUITY</u>			
LSV		332,551.00	
William Blair		320,765.85	
TOTAL INSURANCE INT'L EQUITY			653,316.85
<u>LEGACY DIVERSIFIED REAL ASSETS</u>			
JP Morgan		141,506.74	
Western Asset		96,888.62	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS			238,395.36
<u>LEGACY REAL ESTATE</u>			
Invesco		104,853.43	
JP Morgan		248,859.87	
TOTAL INSURANCE REAL ESTATE			353,713.30
<u>PERS RETIREE HEALTH INSURANCE CREDIT FUND</u>			
SEI			75,851.91
<u>JOB SERVICE FUND</u>			
SEI			64,980.18
<u>TOBACCO PREVENTION & CONTROL TRUST FUND</u>			
STATE STREET			4,185.91

INVESTMENT EXPENDITURE DETAIL						
FEES PAID DURING THE QUARTER ENDED MARCH 31, 2017						
<u>CUSTODIAN</u>						
Northern Trust						237,147.85
<u>CONSULTANT</u>						
Adams Street				16,421.00		
Callan				99,753.55		
Novarca				20,196.00		
TOTAL CONSULTANT						136,370.55
TOTAL FOR QUARTER ENDED 12/31/16						6,782,564.44
FOR QUARTER ENDED 3/31/17						
<u>INSURANCE SHORT TERM FIXED</u>						
Babson						17,458.95
<u>PENSION CASH</u>						
Northern Trust						9,713.62
TOTAL FOR QUARTER ENDED 3/31/17						27,172.57
TOTAL FEES PAID DURING QUARTER ENDED 3/31/2017						7,222,799.17

NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE

QUARTERLY MONITORING REPORT

Quarter Ended March 31, 2017

EXECUTIVE LIMITATIONS / STAFF RELATIONS

The Executive Limitation “Staff Relations” deals with the treatment of staff at RIO. The executive director “shall not cause or allow any condition or any communication which is unfair, undignified, or disrespectful.” This Executive Limitation lists six specific limitations that range from personnel policies to exit interviews. All the limitations are intended to protect staff from unfair, undignified, or disrespectful treatment by management.

During the past quarter, there were no exceptions to this Executive Limitation.

The Executive Limitations Audit for the year ended December 31, 2016, was completed by Terra Miller-Bowley, Supervisor of Audit Services, during the past quarter. The audit examined the Executive Director/CIO’s level of compliance with the SIB Governance Manual Executive Limitation policies A-1 through A-11. The RIO Audit Division and SIB Audit Committee is of the opinion that the Executive Director/CIO is in compliance with these policies. The SIB accepted the Executive Limitations Audit Report on February 24, 2017.

The Executive Director/CIO held four full office meetings and five manager meetings during the first calendar quarter of 2017 in order to promote an open and collaborative work environment while enhancing team member communication, awareness and engagement.

RIO recently adopted an Infant at Work pilot program in response to a request from a team member. As of the date of this report, the pilot program has been generally well received by our team members and clients.

RIO is fully staffed as of March 31, 2017.

Quarterly Report on Ends Q3:FY17

Investment Program

Ongoing due diligence conducted on the following organizations:

Adam Street (private equity)	Loomis Sayles (domestic fixed income)
Axiom (emerging market equity)	LSV (global equity)
Barings (domestic fixed income)	Manulife (domestic fixed income)
BlackRock (private equity)	PIMCO (domestic fixed income)
DFA (international equity)	Prudential (domestic fixed income)
Grosvenor (infrastructure)	SEI (multi-manager)
JP Morgan (infrastructure)	Western (core fixed income, global TIPs)
LA Capital (large cap US equity)	

Preliminary due diligence conducted on the following organizations:

Ares (direct lending, opportunistic credit)	Highbridge (opportunistic credit)
Bain (opportunistic credit)	King Street (event driven credit)
BlackRock (core fixed income)	KKR (opportunistic credit)
Canyon (distressed credit)	Oaktree (opportunistic credit)
Cerberus (direct lending)	TCW (domestic fixed income)
Golub (direct lending)	TPG (alternative credit)
GSO (direct lending)	WisdomTree (public equity, fixed income)

At the January SIB meeting, the Board approved the selection of Ares Management to manage a \$200 million middle market direct lending fund-of one on behalf of the Pension Trust and Legacy Fund. Legal contract review is currently underway.

At the March SIB meeting, the Board approved the selection of Cerberus Capital to manage a \$200 million middle market direct lending fund-of one on behalf of the Pension Trust and Legacy Fund. Legal contract review is currently underway.

Staff is continuing its restructuring of the current fixed income manager structure within the pension trust and further changes will be submitted to the Board at future meetings. Staff is currently conducting due diligence on a number of core fixed income and opportunistic credit managers and will be advancing finalists to present to the Board.

Staff completed the beta phase of the implementation of the BlackRock Solutions Aladdin system and started the live phase this Spring.

Staff attended meetings with the following entities: TFFR Board, NDPERS Investment Subcommittee, and Workforce Safety & Insurance.

Staff continues to conduct preliminary due diligence on possible managers/products for future consideration.

Staff continues to monitor each client's asset allocation monthly and makes rebalancing decisions based on rebalancing policy and cash flow requirements.

Quarterly Monitoring Report on TFFR Ends Quarter Ended March 31, 2017

Retirement Program

This report highlights exceptions to normal operating conditions.

- The TFFR plan received a favorable IRS determination letter.
- As a result of an RFP process, the TFFR board selected Segal to continue as the plan's actuary to provide the TFFR retirement program with actuarial and consulting services effective July 1, 2017.
- There were no legislative proposals approved during the 2017 session that directly impacted TFFR plan benefits, contribution rates, or other plan provisions. To address the RIO budget reductions for 2017-19, staff is discussing TFFR cost saving initiatives where feasible.

NDSIB Watch List

Data as of 03/31/2017

PIMCO MBS (Pen.)		\$181,843,474	
	Returns	Index ¹	Excess
1 Year	0.69	0.17	0.52
3 Year	2.76	2.69	0.07
Inception*	2.12	2.04	0.08

*Funded 3/31/2012

PIMCO Unconstrained (Pen.)		\$66,110,009	
	Returns	Index ²	Excess
1 Year	9.67	0.84	8.83
3 Year	3.17	0.49	2.67
Inception*	3.16	0.42	2.74

*Funded 3/12/2012

JP Morgan MBS (Pen.)		\$129,628,371	
	Returns	Index ¹	Excess
1 Year	1.08	0.17	0.91
Inception*	2.51	2.18	0.33

*Funded 09/30/2014

UBS International Fixed (Pen.)		\$102,055,766	
	Returns	Index ³	Excess
1 Year	(4.46)	(3.93)	(0.53)
3 Year	(2.99)	(2.69)	(0.30)
Inception*	5.82	5.56	0.26

*Funded 07/01/1989

- ¹ Bloomberg Mortgage Index
- ² Libor 3-Month
- ³ Bloomberg Global Aggregate ex-US

Note: Return data is gross of fee due to data availability

TO: State Investment Board (“SIB”) Clients
FROM: Dave Hunter, Darren Schulz, and Eric Chin
DATE: April 24, 2017
SUBJECT: **Watch List Action – Adams Street Partners**

Adam Street Partners (“Adams Street” or “ASP”)

RIO recommends that Adams Street be removed from the Watch List noting that ASP has substantially reinstated detailed investment reporting for two consecutive quarters. Due to increasing concerns over the transparency provided by Adams Street, the SIB placed ASP on Watch on October 28, 2016. RIO continues to recommend the SIB pause future investments until Staff has sufficient time to conduct additional due diligence at Adams Street offices in upcoming months.

Background: Over the past year, Staff spent considerable time and resources working to optimize SIB’s projected private equity portfolio. As a consequence of these efforts, Staff became aware that Adams Street provides different levels of transparency to different types of clients. Clients “subject to FOIA or similar laws” were previously provided a redacted reporting package. ASP withheld key metrics on the underlying GPs including internal rate of return, % drawn, % distributed, money multiples, and ASP internal manager ratings.

Adams Street’s rationale was twofold:

1. ASP has signed confidentiality agreements with their underlying general partners such that Adams Street is mandated to limit information to investors “subject to FOIA or similar laws”.
2. ASP is concerned that North Dakota’s confidentiality provisions may be inadequate, and unable to protect confidential information if contested by a third party (despite numerous conversations between North Dakota and Adams Street’s counsel).

Update: While the reduced transparency did not directly affect Adams Street’s investment capabilities, it did place the SIB in a disadvantageous position compared to other non-FOIA/open records investors invested in the same commingled products. **In recent months, however, ASP restated its willingness to provide us with full investment transparency in their offices and substantially reinstated detailed reporting in their quarterly reports. Consequently, Staff is now comfortable with recommending the SIB remove Adams Street from our Watch List.**

Adams Street Transparency Update – \$45 million partnership value at 12/31/2016

- Adams Street contacted all funds from years 2006-2016, representing 98% of the remaining value
- Remaining value of funds which will not allow performance disclosure: \$8 million, or about 19%
- As expected, most of the top-tier early stage venture capital managers will not allow performance disclosure.
- North Dakota has transparency on 81% of the remaining partnership net asset value.
- Adams Street projects transparency to remain in the 80-85% range going forward.
- Adams Street has transparency on 100% of the portfolio and shares in-depth analysis with NDSIB staff regularly.
- Adams Street remains committed to providing excellent investment performance and reporting to NDSIB.



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NUMBER 150, MAR.-APR. 2017

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Organizations as Open Systems That Need Purpose and Integrated Thinking

by Victoria Hurth

The world is changing more rapidly than ever. Here, Victoria Hurth, Associate Professor in Marketing and Business Sustainability at Plymouth University UK, discusses the extent to which the role of the organization has to change within it.

IT IS BECOMING impossible for organizations to sustain an isolationist view and many are arguing that we need to completely revise how we see organizations in order to maximize their performance.¹ In this article, I will be arguing that organizations must see themselves as part of dynamic environments that they affect and that affect them through rapid feedback as well as emergent, longer-term, and unexpected consequences. Increasing complexity, changes relating to the various capitals businesses rely on, and increasing global consciousness require organizations to view themselves as part of a wider system rather than as isolated units that decide when and how to engage with others. Operating as members of a system requires organizations to be reflexive and clear about what they are trying to achieve in the system. In particular, they need to understand their dependence on others within the

system to achieve their goals. Using integrated thinking and being purpose driven are two systemic approaches that organizations can use to address the challenges they face and turn them into massive opportunity. Adopting these approaches, however, requires profound change, and realizing their potential rests heavily on boards as the groups of people who are ultimately responsible for the governance of organizations.

Why Organizations Must Relate to Their Environment

The VUCA Environment

Organizations have never operated in a vacuum. However, we (particularly in Western thought) went through a period of time where we attempted to pretend that we could contain and control organizational interactions with the outside world. This view of isolated organizations can be seen as strongly linked to the liberal "scientific" approach of understanding the world by breaking things into smaller parts, which in effect serves to distance these parts from the interconnected whole;

(continued on page 2)

EVENTS

JUNE 22-24, 2017

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Plenary sessions, workshops, discussions, presentations, and networking for nonprofit board members, chief executives, staff, and nonprofit professionals to learn how to guide their organizations toward greater impact and mission

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ALSO IN THIS ISSUE

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TOWARD A REQUISITE BOARD
COMPETENCIES MATRIX..... 5

Open Systems

(continued from front page)

something documented by a range of authors from Capra² to Checkland³ and, in an organizational context, from Senge⁴ to Hutchins.⁵ This was arguably heightened in the neoliberal era of economics (1970s–1990s) when the normative way in which we allocated scarce resources to maximize societal welfare (well-being) was largely reduced to a set of mathematical equations.⁶

There have been many challenges to reductionism, and the assumptions we made in order to cope with those aspects that didn't fit the "model." These challenges have come from a range of disciplines, for example, psychology,⁷ international development,⁸ and via postmodernist thinking.⁹ However, it is the inescapable reality of an increasingly complex and interconnected world that is perhaps at the heart of an observable rejection of the reductionist approach.

The notion that our world is becoming faster, more complex, and more interconnected is a long-discussed phenomenon. Some pinpoint the shift toward seeing life as complex as starting in the 1920s after the First World War and Bolshevik revolution.¹⁰ Others connect it to the discovery of the "uncertainty principle" in quantum mechanics, which undermined the idea that science could predict the world with certainty.¹¹ This has now taken shape in organizational language (a sign of concept maturity) in terms of what is known as a "VUCA environment" (volatile, uncertain, complex, and ambiguous). The reasons behind an increasing VUCA environment have been analyzed over the years, with the key interrelated themes including rapid advancement of technology speeding up the creation and transfer of information and reaction to it, globalization (the increased connection between organizations and their dependencies), and fragmentation (of identities, systems, preferences).

It is the "chaos" that ensues that provides one of the foundational imperatives for organizations to primarily understand themselves within the con-

text of their external environment and relationships with it. Despite attempts to run faster and study more individual facets more furiously, there are signs that those overseeing and studying organizations are moving instead toward a different way of conceiving of organizations—toward a systems view. It is this sometimes subtle shift toward systems thinking over the decades that could be judged as shifting organizational focus onto the relations between a system and its environmental context, rather than on the internal operations of the system.¹²

From a systems view, organizations are seen in the context of a complex bounded planetary system. The organization is made up of many interdependent parts and many bounded subsystems that interact and have varying dependencies. This means that understanding the interactions and *relationships* between the whole and its parts, and between different interdependent systems within the environment in which the whole operates, is essential to understanding how any organization works, how it can be influenced, and how it can cope with chaos. This does not mean that reductionist thinking is replaced by considerations of the whole but that dialogue between the two needs to occur.¹³

Limits to the Way We Regard and Use Capital

As well as chaos providing a core motivation for whole-scale perspective change, since the 1970s the planetary system has also been informing us, with greater and greater clarity, that we are reaching limits to the natural systems that provide the basis of all organizational functioning. This provides an additional core requirement for organizations to see themselves as part of a broader system, and the realities of living at the edge of these limits that are, in themselves, a driver of the VUCA environment and the far longer term perspective needed in order to understand system processes.

Recent estimates by the United Nations (UN) suggest that as a result of desertification and drought:

- Twelve million hectares of arable land are lost per annum (twenty-three hectares per minute), an area where twenty million tons of grain could have been grown.
- Of six hundred marine stock monitored by the UN, only 3 percent of global fish stock are underexploited.

In addition, the World Wildlife Fund (WWF) estimates that:

- We have lost 50 percent of wild animals in the past forty years.
- Although South Africa, Brazil, the United States, and China have all grown their gross domestic product (GDP) in 1990–2008, they have significantly depleted their natural capital reserves over the same period by 33 percent, 25 percent, 20 percent, and 17 percent, respectively.

One of the key drivers of this is that organizations, which are the key decision makers in resource use, pay only a small percentage of the real cost of natural resources if they were to be preserved in a system state that could perpetuate itself. If this full cost were accounted for, KPMG estimates that it would amount, on average, to 41 percent of organizational earnings.¹⁴

Of course, it is not just natural capital that has been unfairly and unsustainably exploited, with human and social/relational capital (depending on who you are and where you live) also paying a price for the *modus operandi* of many organizations. This may be because of the unethical practices hidden within a supply chain or, more intractably,

FOOD FOR THOUGHT

"In preparing for battle I have always found that plans are useless, but planning is indispensable." □

Dwight D. Eisenhower, 34th president of the United States, 1953–1961 (1890–1969)

because of the system impacts on natural resources—for example, the use of palm oil or similar products, which has disastrous knock-on system effects. It is not just for-profits that are at fault here. Nonprofits are also often just as guilty of “robbing Peter to pay Paul” or worse. As a demonstration of how difficult the move to systems thinking is, the obvious interconnection between the natural and human systems has only in recent years started to be discussed by nongovernmental organizations operating in either field. The point is that we are only just starting to connect the dots between different systems and see their interdependencies. As a result, there are very few organizations that are accountable for all their value creation and value destruction.

The Evolution of Consciousness

A third key development that is causing organizations to broaden and deepen their self-perspective is the evolution of global consciousness. Academics pinpoint the dawning of instant communications as the basis for global consciousness and, since the middle of the last century (the Information/Knowledge Age), such technologies have continued to explode in capacity and accessibility.¹⁵ We have been on a journey of ever widening space/time consciousness, and this allows us to see global humanity and our shared dependencies within a planetary system—an increasing system-wide global consciousness. This exposes mutually dependent relationships between organizations and their broad stakeholders. Indeed, stakeholders’ system awareness has resulted in claims on the organization from an increasing range of groups,¹⁶ as they become more and more aware of the impact on their own lives (and those of their offspring) of organizational decisions regarding using resources and adding or destroying value. These groups include employees and customers who are increasingly seeking meaning from what they do and buy. The deeper understandings and relationships that are emerging between organizations

and their stakeholders underpin a stronger ethical imperative for an organization to understand its impacts, minimize negatives, and maximize the positives. Instantaneous global knowledge sharing has also impacted the shift to ethical approaches to stakeholders because of the impossibility of gatekeeping knowledge. Public relations departments can no longer decide how an organization appears. An unethical culture therefore poses huge unmanageable risks and many organizations are seeing genuine transparency as the only practicable way forward. The potential for this authentic ethical imperative to be not just a hygiene factor but the backbone of a highly motivated workforce and engaged stakeholder base is just starting to be really interrogated and is addressed below.

How Organizations Must Relate to Their Environment

Although a shift can be discerned over the past few decades, we are only on the cusp of understanding what this systems perspective means for the way we govern organizations and how these changes can be implemented. However, systemic approaches commensurate with the challenge and opportunity posed are beginning to emerge in mainstream organizational language and behavior.

Integrated Thinking

One way organizations have started to better relate to their environment is through the adoption of “integrated reporting,” (IR) a term that is becoming widely used and could be seen as another term for systems thinking. This is strongly associated with the Integrated Reporting Council and their global framework for reporting, which they launched in 2014 as a replacement for standard financial reporting, and is already obligatory in some countries, such as South Africa. IR requires organizations to report on their short-, medium-, and long-term value creation strategy; the capitals required to deliver it; the material risks to those capitals; as well as assessment of how they will

enhance rather than deplete them and the governance structures that will oversee the delivery. The report therefore requires an organization to understand itself and its relation to the “system” in much more depth and to prove to itself, investors, and other stakeholders that it is truly a value creation entity. Drawing from the Daly Triangle, an organization must, as a result, begin to think about the ultimate ends it is trying to create and the ultimate means on which it depends to do this¹⁷ and all the interactions in between, rather than focusing only on narrower instrumental ends and means. It is ultimately for boards to decide to adopt this approach, and by doing so they will likely be initiating a deep journey of self-reflection and systemic change, as those who have undertaken this journey testify.

Organizational Purpose

Integrated reporting gets organizations to ask the right questions of a business but doesn’t specifically address an approach to dealing with the multiple crises of VUCA, sustainability, and the search for activities we can be meaningfully proud of. Perhaps the most significant advance in this area is the notion of organizational “purpose” that is being advanced across a range of organizational forms, including publicly listed for-profits. Although there is still concept ambiguity, purpose is about an organization being clear about its long-term fundamental societal reason for existence—its core service group, the long-term positive outcomes it wants to see for them, its particular organizational role in achieving this, and the way in which it will serve the long-term interests of its stakeholders within the system who underpin the delivery of those outcomes. Because the overarching frame is about high-level, long-term societal good, this requires an organization to think systemically and again to connect these ultimate ends to ultimate means. To deliver the outcomes most successfully and sustainably requires recognizing the intricacies of the system that influence these outcomes and working with this system creatively and

flexibly to achieve the best results in a financially and resource-sustainable way.

As a systems concept, purpose offers a way of dealing with chaos. Traditionally, it was believed that chaos should be evaded through control; however, as Dolan et al. note, “there’s such a tight relation between chaos and order, so much that one leads to another in a dynamic process. You don’t try to avoid chaos; instead you use it to self-organize your system through an ‘attractor.’”¹⁸ Purpose could be seen as providing a clear transcendent societal attractor, which provides the common force that unites the energy and objectives of the organization and its stakeholders. The existence of a meaningful reason for productive efforts by employees also means that energy is enhanced because the motivation to achieve organizational ends is increased. For example, being clear about the ultimate reason for people’s work is shown to increase performance.¹⁹ This is further enhanced because the existence of a clear context for decision making allows for a reduction in management rules, instructions, and objectives and instead unleashes the creativity, passion, and agility of employees.

Therefore, purpose appears to offer the potential to make organizations more agile and entrepreneurial and more empowering, challenging, and meaningful for employees—the most significant resource in most organizations. Additionally, through an absolute focus on the “who” they serve and a clarity of organizational identity that is meaningful at a human level, the organization is much more likely to harness the energy of stakeholders and create highly satisfied and loyal customers. More profoundly still, it offers opportunities for organizations to create real net value for society through innovation and business model design that serves society.

Purpose is not just about having a higher goal; it is about how this is expressed and lived out daily and in relation to the system as a whole—it is DNA level. Shifting to a purpose-driven organization is a huge undertaking, with many on this journey saying that

you either need to be committed for the long hard road or wait until you are. Therefore, it could arguably be seen as an equal challenge (and opportunity) to social enterprises, B Corps, and third-sector organizations, whose constitutional declaration of social purpose and supportive owners may aid this but do not determine it.

Setting, communicating, and delivering an organization’s purpose is at the heart of governance. This poses a fundamental challenge to governance if the long-term interest of the organization (both as a system member and due to its interconnection with the rest of the system) is best delivered through service to a higher societal purpose, and yet the owners of the organization do not recognize this (or do not have the long-term interests of the business at heart but rather short-term monetary gain at the expense of this). The governing body therefore has a vital role, not just to distill the purpose and support the executive to create a purpose-driven organization, but it also has a significant responsibility to influence owners to make sure that the overarching purpose is shared. If not, then this represents perhaps the ultimate conflict of interest.

Supporting this shift, it is important to recognize that owners are also subject to the same forces outlined earlier in this article. The economy is, at its core, about allocating scarce resources to maximize social welfare/well-being. Organizations are given the social license to operate because they are entrusted with our shared planetary and national capital to transform it in a way that serves us best. This is the reality that overarches any ownership structure—something that has been brought to the fore in recent years, with trust in organizations at an all-time low as the social contract has been broken time after time.

In conclusion, organizations are facing a range of pressures that fundamentally alter how they need to perceive themselves within their environment in order to provide the conditions for organizational success. A systems view is required and, within this, a new way of viewing their role

within that system. Integrated thinking and organizational purpose offer two aligned approaches that organizations can adopt to transform themselves. Both require seeking real long-term value creation for society as the core goal—above any short-term demands of owners or other stakeholders. □

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(continued on page 8)

Toward a Requisite Board Competencies Matrix

by Axel Kravatzky

Having a competent board is vital to every organization, but what does that mean? Here, Axel Kravatzky—in the first of a two-part article—examines the necessary collective and individual competencies and advances in the design and use of Board Competency matrices.

Introduction

IN AN INCREASINGLY connected and complex world in which the digital transformation will continue to produce an unprecedented rate and depth of transformation, boards play very important roles in creating and assuring organizational success through the way they are directing, assuring, and accounting for the organization's behavior. Kiel et al. argue that there has been a "dual increase in both task breadth (or number of tasks) and depth (or degree of competence in carrying out tasks)," which has led to a multiple increase (e.g., quadrupling) in what is expected of modern directors.¹

Boards of directors are always composed of several persons who must act together.² There are no decisions of the governing body that are taken by any of its individual members alone. That means that the members of the body must be able to come to decisions together, bringing together their perspectives for the benefit of only one consideration: the best interest of the organization they are governing.

This requirement creates a challenge: we must create and assure that governing bodies have collective capabilities to address all the business of the organization coming before it, but our instruments of assessment and experience are largely concerned with the assessment or the classification of the capabilities of the individuals of governing bodies.

This challenge has at least two components: (1) how do we articulate the collective requirements against which we assess the collective capabilities of

the governing body? and (2) how do we combine the assessment of the capabilities of individual governing body members to determine the collective capability of the governing body?

Most corporate governance codes of good practice, listing, and regulatory requirements articulate and emphasize the need to have adequate diversity of skills and perspectives on boards. They speak of collective capabilities based on the capabilities and attributes of individuals, but there is little guidance for determining the collective requirement or assuring its adequacy. At the individual governing body member level, we often find lists that mix categories of capabilities and individual capabilities: leadership, ability to listen and work together, industry knowledge, financial literacy, ethics, and so on. Some of the individual skills and competencies are also mandatory for some board members—for example, most codes and regulations require the Board Audit Committee to have at least some financially literate persons.

In addition to the mix of requirements and desirable features, there is also little guidance on how to standardize the assessment of individuals or the collective, other than using a collective scale. But what do the different scale ratings really mean, and how should they be assessed?

The Board Skill or Competency Matrix is the tool almost universally recommended to be used in the composition and refreshment of boards of directors. These matrices almost invariably consist of rows of skills/competencies/values that are

WHEN WE SAY ...

BOARD LEADERSHIP'S mission is "to discover, explain, and discuss innovative approaches to board governance with the goal of helping organizations achieve effective, meaningful, and successful leadership to fulfill their missions."

Board Leadership aims to fulfill this mission by engaging its readers in a lively and illuminating inquiry into how board governance can be made more effective. This inquiry is based on three key assumptions:

- Boards exist to lead organizations; not merely monitor them.
- Effective board governance is not about either systems, structures, processes, theories, practices, culture, or behaviors—it is about all of them.
- Significant improvements are likely to come only through challenging the status quo and trying out new ideas in theory and in practice.

Uniquely among regular publications on board governance, *Board Leadership* primarily focuses on the job of board leadership as a whole, rather than on individual elements of practice within the overall job.

Over time, *Board Leadership* will provide a repository of different approaches to governance created through its regular "One Way to Govern" feature.

Here's what a few of the key terms we use mean to us:

- **Innovative:** Creating significant positive change.
- **Approaches to:** principles, theories, ideas, methodologies, and practices.
- **Board governance:** The job of governing whole organizations. □

sometimes grouped into different categories, and then the directors are individually listed in the column heads and are rated on every skill/competency/value on a common scale. If a scale is suggested (often between 1 and 5), then there is usually no guidance for establishing common definitions for what scales mean or how the levels are measured. Some of the matrices put forward also allow for importance weights to be used with the different criteria, but, again, little guidance is offered for establishing or using the weighting process.

One of the most recent developments in relation to board matrices came in October 2016 when the Romanian government adopted and published methodological norms for the application of Law 111 of 2016 for the corporate governance of state-owned enterprises.³ Those methodological norms included a detailed process outline spanning the entire selection process of boards of directors, from planning, searching, and long list review to the short list phase. The process descriptions are very detailed because the Romanian context to which it applies is very complex and also because the process needs to be merit based, structured, and transparent according to the Organisation for Economic Cooperation and Development (OECD) Corporate Governance Guidelines.⁴

This article focuses on two specific aspects of the state-owned enterprise board matrix and the process by which it is created to overcome some of the core challenges identified above:

- How to identify and articulate the collective capabilities a board or governing body.
- How to assess the individual competencies of directors and combine these to determine collective competencies.

Identifying and Articulating Collective Capabilities

The process of identifying and articulating the requisite capabilities

of the board as a whole proceeds in two steps, according to the regulation. The first step is to establish a board profile that contains the contextual requirements and the results of an analysis of the main capabilities that the board must possess in the forthcoming period of organizational development. The second step is to translate these requirements and capabilities into groups of criteria in the format of a matrix. The criteria include competencies that have individual and—this is primarily novelty—collective measurement dimensions.

Board Profile

The relationship between the board profile and the matrix is illustrated in Figure 1. In smaller private, unregulated companies the contextual requirements may be mostly focused on the relevant stipulations in the bylaws, the life-cycle stage, and the strategic positioning of the company. If the company is larger, is regulated, and has multiple shareholder blocks, and the state has a significant owner-

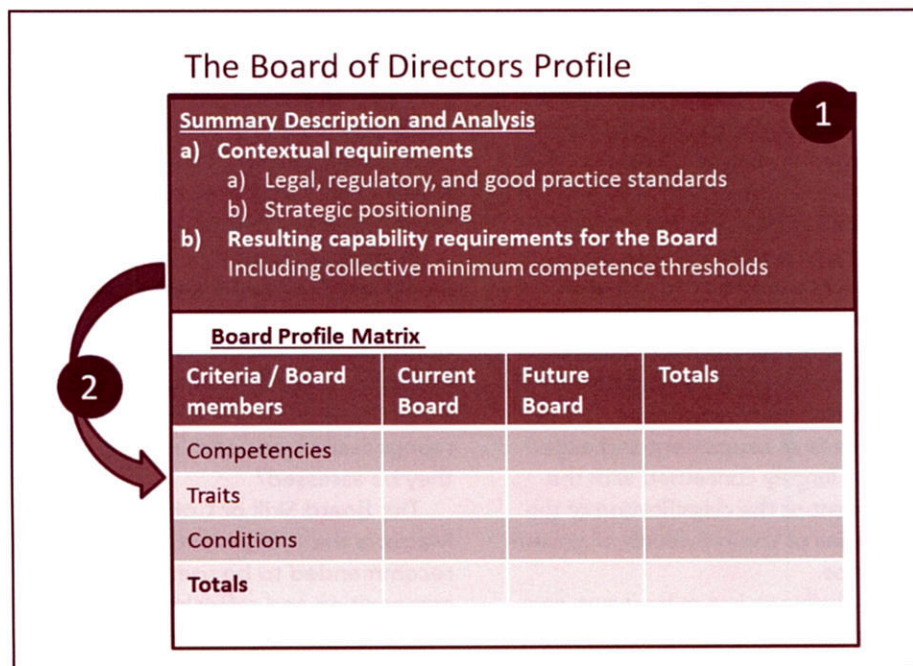
ship function to fulfill, then there are many legal, regulatory, and good practice standards to consider.

The board profile provides an analysis of what the right number of board members is as well as the conclusions of an analysis of what kind of questions and work will be coming before the board and therefore what capabilities the board needs to have. The strategy of the organization and the associated risk within its industry and business model, as well as the stage of the organization, largely determine the questions that will come before the board.

The term *board profile* is often used to describe the characteristics of an existing board, but sometimes it is used to refer to matrices that list criteria in one dimension and individual board members in the other dimension.⁶ What is usually missing is an explanation of “why” these criteria were chosen, what standard is meant to be achieved, and why that standard is reasonable and appropriate.

In most jurisdictions, regulators and good governance standard setters are specific about two aspects: (1) they

Figure 1: Relationship between Board Profile, Board Profile Matrix, and Competencies



Source: Kravatzky⁵

require companies to have balanced boards with diverse and relevant knowledge, skills, and experience and then (2) disclose details about the actual board members so that stakeholders can ascertain for themselves if the board is appropriate and the good governance principles have been applied.

The corporate governance guidelines of the Australian Stock Exchange (ASX) go a bit further than most by making the disclosure of the matrix itself mandatory as part of its “apply or explain” requirement. ASX Recommendation 2.2 states that:

A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.⁷

From a governance perspective, the most important point is that the Board Profile guides and enables us to judge the board composition in a world where everyone agrees that one size does not fit all.

The Matrix

When we compare the conventional board matrix (see for example Trautman⁸) with the Board Competences Matrix introduced through the government of Romania⁹ and illustrated in

Table 1, there are four features that stand out:

1. Grouping of criteria that includes competencies
2. Mandatory and optional criteria
3. Relative importance weights
4. Collective threshold levels

The groupings set out in the Romanian legislated regulation are as follows: (1) competencies, (2) attributes, and (3) other conditions that can be eliminatory. We will describe the competencies in the next section of this article.¹¹

The mandatory or optional dimension does not apply to all criteria, and for those that it can apply to, boards need be careful in how they use this feature: a mandatory competency criterion means that all board members must be competent in this dimension, which means that they need to be at level 3 (explained in the next section). Directors who are assessed to be at level 2 may still be appointed, but they would have to develop their competency to reach level 3.

The weights are scaling factors, usually between 0 and 1, where 1 indicates high importance, and numbers below that indicate that the criterion in question is relatively less important compared to the other. The most important aspect here is to note that the weight is not an indication of the absolute importance of a criterion

for governance, but of the extent to which we want the actual differences in scores between directors or candidates to influence our overall assessment of the directors, candidates, and the collective.

The most novel part of the design of the matrix is provided by the threshold dimensions (the introduction of concept is attributable to Chris Pierce¹²). The minimum collective threshold is expressed as a percentage of the total possible score that is considered acceptable for a criterion. For example, gender diversity policies conventionally indicate a threshold, such as 40 percent of board members need to be female. In this matrix, the thresholds are explicit and can be applied to competencies as well. A threshold of 80 percent would mean that the average score on a competency would have to be level 4 (out of 5). In such a case, no director can be below level 3, and for every person that is assessed to be at level 3, there must be one that is at level 5. That would be a very high threshold to achieve. The current collective threshold level column lists the actual percentage of the total possible score and is also used to compare various candidate configurations with one another.

In the second part of this article, which will appear in the next issue of *Board Leadership*, we will look at working with individual and collective competencies, the definitions of competence versus competency, and determining levels of competence and competency. □

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Table 1: Board Competences Matrix

Criteria	Mandatory (Mand.) or Optional (Opt.)	Weight (0-1)	Current			Candidates			Totals		Thresholds	
			Director 1	Director 2	Director 3	Nominee 1	Nominee 2	Nominee 3	Total	Weighted Total	Minimum Collective Threshold	Current Collective Level
A. Competencies												
a) Industry specific competencies												
Water Sector Demand Management	Mand.	1	2	3	3	3	4	2	17	17	70%	57%
b) Professional Competencies of Strategic Importance												
Finance & Accounting	Mand.	0.7	3	3	2	3	4	4	16	11.2	60%	53%
c) Corporate Governance												
Governance of SOEs	Mand.	1	4	3	3	5	2	2	19	19	70%	63%
d) Social & Personal												
Conflict Management	Opt.	0.9	3	4	3	4	4	4	22	19.8	50%	73%
<i>Sub-Total</i>			12	13	11	15	14	12	74			
<i>Weighted Sub-Total</i>			10.8	11.7	10	13.7	12.4	10.4		67		

Source: Simplified partial extract from Government of Romania.¹⁰

Open Systems

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Matrix

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